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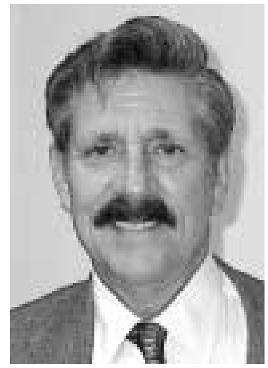

Ninety Years of Monetary Central Planning in the United States

Ninety years ago this month, on December 23, 1913, the Congress passed the Federal Reserve Act, establishing a national central-banking system in the United States. The governing board of the Federal Reserve was organized on August 12, 1914, and the Federal Reserve banks opened for operation on November 16, 1914.

On the surface, the preamble to the Act, which summarized the purpose of the new government-created institution, seemed fairly innocuous:

> An Act to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.

But what this meant was the start of the monopolization of monetary matters in the hands of a single politically appointed authority within the boundaries of the United States. Twice in the first half of the nineteenth century Congress had chartered a Bank of the United States, an institution meant to facilitate government borrowing and that also served as a corrupt political trough at which the friends and supporters of politicians were able to get cheap loans.

During the Civil War the Lincoln administration had set up a National Banking System, which also served as a vehicle for funding government deficit spending and creating the worst monetary inflation in nineteenth-century America. The color of the currency issued during this time became the basis of the colloquial phrase "Greenbacks."

In the last decades of the nineteenth and the first decade of the twentieth centuries, there was a major push by a number of leading bankers, financiers, and economists for the United States to establish a "modern" banking system on the model of the great European countries. "Modern" in this instance, meant a government-created and -controlled central banking system.

Those innocuously sounding functions listed in the Act's preamble, however, have given this monetary authority the power to: (a) control the quantity of money and credit supplied in the United States; (b) influence the value or purchasing power of the monetary unit that is used by the citizenry of the country in all their transactions; and (c) indirectly manipulate the rates of interest at which borrowers and lenders transfer savings for investment and other purposes, including the funding of government budget deficits.

The 90-year record of the Federal Reserve has been a roller coaster of inflations and recessions, including the disaster of the Great Depression, and the recent "excessive exuberance" of the late 1990s and dramatic market decline of the early 2000s.

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The crucial and fundamental problem with the power and authority of the Federal Reserve is that it represents *monetary central planning*. In a world that has, for the most part, turned its back on the theoretical error and practical disaster of believing that governments have the wisdom and ability to centrally plan the economic affairs of a society, central banking remains one of the major remaining forms of socialism practiced around the globe.

Government control and planning of the monetary system has enabled extensive political influence over virtually every aspect of economic life. In 1942 Gustav Stolper, a German free-market economist then in exile from war-torn Europe and living in the United States, published a book titled *This Age of Fables*. He pointed out:

> Hardly ever do the advocates of free capitalism realize how utterly their ideal was frustrated at the moment the state assumed control of the monetary system. . . . A "free" capitalism with government responsibility for money and credit has lost its innocence. From that point on it is no longer a matter of principle but one of expediency how far one wishes or permits government interference to go. Money control is the supreme and most comprehensive of all governmental controls short of expropriation.

The Power to Manipulate

Through monetary central planning governments have the capacity to manipulate and destroy the real value of the accumulated savings and wealth of tens of millions of hard-working people. Governments can redistribute income among individuals and groups in the society to serve various political purposes. And they can distort and twist the patterns of investment, capital, and resource allocation throughout the society, resulting in the booms and busts that have punctuated the economic history of the last 100 years.

The rationale behind such control has been the notion that governments and their appointed central-banking authorities have the knowledge and capability of maintaining economy-wide stability and growth. But what has never been explained is how a handful of central bankers can know, better than the free competitive market, what should be used as money, what the quantity and value of that money should be, and what interest rates can assure a proper and continuous balance between savings and investment.

In other words, central banking represents one of those instances of the hubris of the social engineer, who claims to know more about how to better manage some aspect of society rather than to leave these decisions and their outcomes to the market participants themselves.

In 1942 Stolper also pointed out that "There is today only one prominent [classical] liberal theorist consistent enough to advocate free, uncontrolled competition among banks in the creation of money, [Ludwig von] Mises." In the 1920s Mises proposed denationalizing the monetary and banking system, allowing the market to decide what was used as money, and permitting private, competitive banking to determine the quantity and value of that money in the marketplace.

Today, however, a growing number of economists and policy analysts has taken up the task of demonstrating why monetary central planning has so frequently led to the financial and economic disasters that have been experienced during the last century. And, in addition, they have shown the principles and logic through which such a private competitive monetary and banking system can, in fact, generate a greater degree of economy-wide stability and coordination than any government planning authority can ever hope to achieve.

If, in the 21st century, socialism is to be fully discarded into the "dustbin of history" (to use Karl Marx's phrase), a primary task will be the abolishment of central banking in the United States and around the world. □