MAGAZINE ARTICLE

A Christian Perspective on the Federal Reserve

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Biblical Law Economics Government Statism

Although oil, medical care, and a few other goods and services have become significantly more expensive in recent years, it has been quite some time since severe inflation has afflicted Americans. Since the inflationary episodes of the 1970s and early 1980s, the central bank of the United States, the Federal Reserve, seems to have been rather well behaved. Recessions since the early 1980s have been short, mild, and separated by relatively long periods of apparent prosperity. However, even fairly modest monetary manipulations by the Fed present a moral problem. And the Fed still has the potential to create serious economic problems, even if recent years have tended to improve the Fed's reputation.

The Origins of the Fed

From its inception, the Federal Reserve has been about the increase in the wealth of certain banking institutions at the expense of the general public. In the late 1800s, the United States was functionally on a gold standard. The difficulty with a gold standard, from the bankers' point of view, was that depositors could come into the bank at any time and exchange their paper bank notes for gold. This meant that the bank had to restrain itself when it came to issuing new money to borrowers. The more bank notes in circulation per ounce of gold, the greater the risk to the bank. So banks began looking for a kind of government "super-bank" that would back them up with a standing offer to bail them out if they over-extended themselves, lent too much, and had large numbers of worried depositors show up at their doors.

So from 1897 onward, banks carried out a lobbying and public-relations campaign to get a central bank. The Panic of 1907, a brief but severe recession, led to louder calls for banking reform. This was ironic, because the recession was caused by the Treasury Department functioning as a kind of central bank, manipulating the money supply. But within three years, the powerful political forces pushing for bank centralization generated a legislative proposal that would fundamentally change the American monetary system.

On November 22, 1910, Senator Nelson Aldrich and a handful of representatives of the large Morgan and Rockefeller banks left New Jersey for a "duck hunting" trip to Jekyll Island, Georgia. For the next week, at an exclusive club partly owned by J.P. Morgan, the six men wrote a bill that was later to become the Federal Reserve Act. The Aldrich Bill was presented to Congress the following January, but the Democratic victories in the elections of 1910 had turned Aldrich's Republicanism into a liability. Aldrich's name was dropped, and Senator Carter Glass, a Democrat from Virginia, took over sponsorship of the bill. As the Glass-Steagall Bill, the law creating a central bank was finally passed on December 22, 1913, to take effect the following year.

To head off concerns that the Federal Reserve System would entrench large Eastern banks in the positions of financial power, the bill provided for twelve district banks to be spread over the country. The Federal Reserve board members were given long (14-year) terms to insulate them from political pressure. But the Fed's actions have not been devoid of government influence.

Banks benefited, at least temporarily, from the existence of the Fed. The Fed's role as lender of last resort meant larger amounts of lending, which banks hoped would lead to larger profits. All the lending also meant a larger money supply.

Within 15 years of the Fed's founding, unrestrained money creation had led to a stock market bubble and set the economy up for a disastrous contraction. Artificially low interest rates maintained during the "Roaring 20s" encouraged "mal-investment" — investment that was not supportable by the actual amount of savings people were putting aside. A dangerous situation emerged, as companies (and their stock prices) were propped up by the appearance of ample investment funding.

When it became apparent to everyone that the investment funding was drying up, the stock market crashed. Massive government intervention under the Hoover and Roosevelt administrations then turned the correction into a depression of unprecedented length and depth. Ironically, the institution that triggered the disaster was granted more power. In 1933, shortly after Franklin Roosevelt's inauguration, a banking act gave the Fed more extensive authority, including control over interest rates on bank accounts.

The Fed became the enemy of free-market banking, and, in spite of claims to the contrary, the enemy of economic stability. In 1966, a prominent modern banking authority recognized these problems, and the advantages of a gold standard. He explained the problem well:

> A fully free banking system and fully consistent gold standard have not as yet been achieved. But prior to World War I, the banking system in the United States (and in most of the world) was based on gold and even though governments intervened occasionally, banking was more free than controlled.... It was limited gold reserves that stopped the unbalanced expansions of business activity, before they could develop into the post-World War I type of disaster. The readjustment periods were short and the economies quickly reestablished a sound basis to resume expansion.

> But the process of cure was misdiagnosed as the disease: if shortage of bank reserves was causing a business decline — argued economic interventionists — why not find a way of supplying increased reserves to the banks so they never need be short! If banks can continue to loan money indefinitely — it was claimed — there need never be any slumps in business. And so the Federal Reserve System was organized in 1913. It consisted of twelve regional Federal Reserve banks nominally owned by

> private bankers, but in fact government sponsored, controlled, and supported. Credit extended by these banks is in practice (though not legally) backed by the taxing power of the federal government.

The author went on to show how the Fed's excessive money creation in the late 1920s led to the economic collapse of the Great Depression. Then, he explained, "statists argued that the gold standard was largely to blame for the credit debacle which led to the Great Depression." The motivation, he noted, was the understanding that "the gold standard is incompatible with chronic deficit spending (the hallmark of the welfare state)." Gold stood in the way of this deficit spending, but "the abandonment of the gold standard made it possible for the welfare statists to use the banking system as a means to an unlimited expansion of credit."

The prominent modern banking authority who authored this defense of the gold standard? None other than Alan Greenspan, the chairman of the Federal Reserve Board.

The Fed and the Limits of the State

The moral problems with the Fed run deep. The civil magistrate is required to protect property rights, partly by ensuring that parties to a contract hold to the weights and measures agreed upon (Lev. 19:35-36). No one can ensure that people value an ounce of gold tomorrow as much as they do today, and so we would expect even a dollar based on gold to fluctuate in value.

When that dollar changes in value, some people will gain and some will lose. That, by itself, is not a moral problem. For example, when more gold is mined, manufacturers that use gold win, and gold investors lose. However, we would not consider the gold miners, manufacturers, or gold investors to have committed any sin. Gold investors do not have a right to a certain price for their investment, so they cannot accuse miners of any wrongdoing.

Dollar holders ("investors"), even if they have no right to a particular "purchasing power" for their dollars, *do* have a right to expect the civil government to stay within Biblical limits. Fundamentally, the civil magistrate is charged with punishing those who commit certain kinds of sins — those called "crimes." This includes using the sword to protect citizens against aggressors both domestic and foreign, and rewarding those who do well in that service (Rom. 13). Creating or destroying dollars, as the Federal Reserve System does each day, does not fit into that mandate.

Suppose we had a more expansive view of the role of the civil state, and wished to allow for state-run gold mines. We have already noted that increasing gold production would not be immoral, so if the state could run gold mines, could that be extended into allowing the state to control the amount of dollars, via the Fed? In short, no. While gold mining produces something good for the economy, printing more dollars does not, and actually causes harm.

Creating more bank notes does not create any new good for society, because the notes themselves are valued only for their use as a medium of exchange. For that purpose, the amount is irrelevant, as long as it accurately corresponds to the thing of value it represents (gold). In contrast to commodities such as gold, oil, computer chips, soybeans, or steel, creating more dollars merely transfers wealth. By creating money, the civil government is no longer acting as an impartial judge. It is instead favoring one party to a contract over another.

For example, suppose I agree with my friend Chris today to give him 50 gallons of gasoline in a month, at which time Chris will give me his collection of John Wayne movies. Now, if gasoline suddenly rises in price over that month, due perhaps to a disruption in the supply chain, I may regret my contract with Chris. But neither of us has cheated the other. However, if I successfully lobby the government to unload its Strategic Ready Reserve of gasoline onto the market, so as to lower the price of gasoline at the time I must pay Chris, I have enticed the government to tip the scales in my favor. The government, by working for me and against Chris, has overstepped its bounds and has become a player in the market, instead of a referee.

So What Do We Do About It?

It’s one thing to point out the immorality of the Fed and complain about the damage the Fed does to the economy. It’s another thing to work on a solution. Unhappily, there are no painless ways out. Returning to a gold-based dollar might take decades, while the Fed continues to plague the economy with its monetary fluctuations. A national awakening to the immorality of the current system, and/or some massive and obvious monetary failure might speed that effort along. However, moral awakening cannot be engineered, and as we have seen from Alan Greenspan’s own statements, monetary failure has been used as an excuse for further intervention that makes the problems even worse.

Some have suggested that in the meantime, individuals essentially boycott the dollar, as far as is possible, by returning to the use of gold and/or silver in transactions. A few schemes have appeared, some of them internet-based (e-gold and e-bullion being prominent examples). I recall a member of the church in which I grew up who quietly placed gold coins in the offering plate instead of a check or Federal Reserve notes.

Such efforts do have problems. As the Austrian-school economist Murray Rothbard pointed out, people are unlikely to give up using the dollar in exchange, even though it has been devalued by inflation. Therefore, substitutes for the dollar, like one internet scheme’s “gold grams,” are highly unlikely to become generally accepted. And general acceptance, after all, is what makes something money.

As for those who have moral compunctions about tithing in dollars, it might be well to remember that dollars *do* have value, even though they exist only as paper or binary digits in a bank computer. Ideas of "intrinsic value" have serious problems, as I have pointed out in an earlier article for Chalcedon.1 Perhaps the greatest good that is being produced by these "alternative money" efforts is the publicity — the eyebrows they raise and the questions they generate. It is constructive to think about what money is, why the gold standard was important, and whether we really need the civil government to control money at all.

Instead of a quick fix through a replacement money, we may need to work patiently for moral renewal — a renewal that brings the Christian faith to bear outside the church walls and into all areas of life. ("Faith for all of life," one might say!) It is not easy to convince even Christians of the immorality of our banking system. The relatively low inflation of recent years may make it more difficult to convince people that the Federal Reserve is really all that bad. Now, more than ever, it becomes critical to develop the moral case against the Fed.

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1 See http://www.chalcedon.edu/articles/0207/020709terrell.php.

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