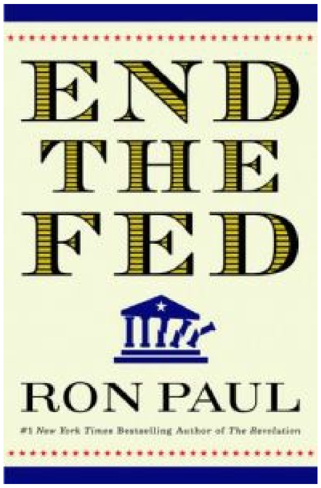

Book End the Fed

Ron Paul
Grand Central, 2009

Recommendation

Everybody cares about money, but do you really understand it? How much do you know about the Federal Reserve, the American institution that plays a profound but secretive role in steering the U.S. economy? Congressman and erstwhile presidential candidate Ron Paul believes that the Federal Reserve, not money, is the root of all evil. In his somewhat repetitious – and sometimes fearful – book, Paul holds the Fed responsible for wars, recessions, depressions, bubbles, busts, scheming politicians, overextended consumers and creeping socialism, and that's just in the first chapter. Libertarian Paul wants to rid the U.S. of the arrogant cabal behind the central bank and return the American economy to a truly free market-based and gold-based system. Although his conclusions may strike some readers as far-fetched, his reasoning is based on years of self-taught economics and legislative experience. While the opinions expressed are those of the author alone, *BooksInShort* would suggest this book to his supporters and to non-Libertarians who would like to understand an alternative point of view.

Take-Aways

- The U.S. Federal Reserve can create unlimited sums of money, which amounts to legalized counterfeiting.
- The Fed manipulates interest rates, bails out failing banks and gives the government carte blanche to spend on wars, stimulus packages and entitlements.
- Many of the Founding Fathers believed letting the government issue paper money would lead to tyranny.
- The U.S. enters into wars and foreign affairs without having to tax or save.
- Banks engage in risky business because they face no "moral hazard" as a result of their activities.
- Politicians promise entitlements because they don't worry about how to pay for them.
- Creating and spending money that is not derived from productivity and trade is an immoral policy.
- The more government acts as a safety net, the less freedom Americans enjoy.
- Currency that is not backed by gold or silver is unconstitutional.
- The U.S. money and credit markets practice socialism.

Summary

Why the Fed?

The Federal Reserve, America's central bank, exists to maintain a stable economy, to regulate banking organizations and to manage inflation. But its true purpose, one that no other institution in the U.S. can claim, is that it "enables the creation of money out of thin air." When bad economic times hit, everyone expects the government to throw money at the problem. That's surely the case during crises like the 2008 emergency when the government spends billions of dollars to prop up the economy. But are such actions the right solutions in the long term? And how will those actions affect you? To comprehend money, you must know what a central bank does, how it works and why abolishing the Fed ensures America's financial future.

> "Everyone should have an intense interest in what money is and how it's manipulated by the few at the expense of the many."

Most Americans assume that the Fed is a necessary organ of government, and that its absence would destabilize the economy. Yet at the time of the founding of the United States, Thomas Jefferson fought the establishment of a central bank. Thomas Paine, a seminal essayist of the American Revolution, wrote that the uncontrolled issuance of paper money invariably leads to tyranny.

> "Ending the Fed would be the single greatest step we could take to restoring American prosperity and freedom and guaranteeing that they both have a

future."

Closing down the Fed would:

- Prevent the government from financing needless wars and halt the dollar's decline.
- "Curb the government's attacks on the civil liberties of Americans."
- End the nation's growing debt and stop uncontrolled government growth.
- Slow the development "of the welfare state that has turned [the U.S.] into a nation of dependents."
- Reinstate "constitutional government."
- Put an end to successions of booms and busts and finish off inflation once and for all.
- Ensure Americans' wealth and make their deposits more secure.
- Cease the "corrupt collaboration between government and banks" and revive banks' financial health.
- Remove "monetary manipulation" from political elections.
- "Restore sanity to economic and political life in this country."

> "With no backing for the dollar at all, Americans became completely reliant on the Federal Reserve to manage our money and to do so with any outside discipline."

Questioning the Fed takes on more importance now, because the amount of money created in response to the 2007-2008 downturn and the secrecy under which the Fed operates raise concerns of hyperinflation along the lines of Germany's between the world wars. From April 2008 to April 2009, one set of statistics showed a doubling of the money supply. These funds, held as reserves in U.S. banks, are ready to underwrite loans when the economy improves, but such loans will lead to soaring price escalations and to more indebtedness.

Banks and the Fed

Banks exercise two major functions: safeguarding deposits and lending deposited money. Melding these two functions creates "fractional reserves"; that is, the bank lends the deposited money to someone else, and as long as every saver doesn't demand his or her money back at once, everything proceeds swimmingly. But in a crisis, depositors want their money immediately, and that creates a run on the bank. Yet in a truly free market, banks should not commingle those two functions and you shouldn't expect that your money – for which you're paid interest – will be available to you at any time.

> "From its founding in 1913, secrecy and inside deals have been part of the way the Fed works."

If banks can't borrow from one another (which they might in a systemic panic), they need a central bank that will provide them with liquidity and restore public confidence. The Fed plays along with this charade, promising to repay every deposit (up to $250,000 per account) in the form of guarantees through the Federal Deposit Insurance Corporation (FDIC). In this way, banks can become "too big to fail." This leads to a "moral hazard" that removes the risk of loss and bankruptcy from companies in the banking business and interposes the government in personal financial transactions. It engenders "a system that is half-socialized."

History and the Fed

A central bank's raison d'être is to create money – not based on gold or silver – for government spending and for providing liquidity to banks. In their mandated testimony before Congress, Fed chairmen often behave as though the Fed were indispensable to the U.S. economy. Yet the Fed did not begin functioning in its present-day form until 1913. A series of financial setbacks, culminating in the Panic of 1907, led banks and businesses to clamor for a "national lender of last resort." To build their credit businesses, banks needed an ever-increasing supply of money. They didn't want to go bankrupt when their loans weren't repaid – they wanted "privatized profits and socialized losses." So banks, businesses and government pushed for creation of the Federal Reserve.

> "The Fed is in the business of generating inflation."

Prior attempts in American history to impose a central banking authority had failed. Following the hyperinflation brought about by the "continental," a currency issued by the Continental Congress in 1775, skepticism about paper money persisted. The First Bank of the United States, chartered in 1791, lasted only until 1811. The Second Bank of the United States was established to deal with the inflation brought on by the War of 1812. President Andrew Jackson wound it down in 1836. The Civil War's aftermath and subsequent panics led prominent bankers in the early 20th century to rally around a central bank that would protect depositors and bring order to economic chaos. Financier J.P. Morgan and other luminaries of the day attended clandestine meetings to decide on the proposed structure of the Federal Reserve System. They heralded the Fed as the beginning of the end of bank failures and financial crises.

> "The government cannot and should not be trusted with a monopoly on money."

But due to inflation, the dollar's value has dropped 95% since the creation of the Fed, and economic contractions still occur. True, the Fed's rescues have averted many bank failures. But why shouldn't banks fail? No other industry enjoys a guarantee against bankruptcy. Removing the risk of going out of business leads to wastefulness, ineptitude and excessive risk-taking. Consumers should be responsible for vetting their banks carefully; they should not rely on the government to save their deposits.

Wars and the Fed

Before the establishment of central banks, nations were reluctant to go to war. If they did, they would have to scrimp on resources to pay for the conflict and would work to resolve wars quickly. But with an "elastic" supply of money, governments can "pick fights" because they have an unlimited amount of funding. World War I began only a year after the U.S. established the Fed. The U.S. flexed its military and financial muscle by entering the war in 1917 and starting the "most centralized experiment in national economic planning to date." Taxes paid only 21% of the U.S.'s war expenses; government borrowing and "outright money creation" contributed the rest.

"Bad economic policy can destroy a civilization."

With this financial freedom, the world has since experienced a continual arms race, military expansion and almost constant war: The government responded to each emergency, including the September 11, 2001, terrorist attacks, by issuing more money.

Politics and the Fed

Political maneuverings inevitably follows the power to print money. Sadly, many members of Congress do not understand the workings of the Fed and its impact on fiscal policy. The ability to advocate for social programs without worrying about where the money will come from makes elected officials "behave like college students on spring break...using their parents' credit cards." The Fed's ability to manipulate interest rates is particularly useful during election periods. Chairman Arthur Burns cut interest rates to ensure his reappointment when Jimmy Carter became president. It "is an open secret in Washington" that the Fed will cut interest rates before elections and will not respond as quickly to economic slumps between elections.

"When government grows, liberty suffers."

Monetary expansion in 2000 allayed people's fears about Y2K and softened the blow from the tech bubble collapse. After 9/11, the Fed increased the money supply to show the world that the U.S. economy had not suffered. The Fed kept rates too low for too long, leading to the housing bubble. The Exchange Stabilization Fund, set up by President Franklin Roosevelt with profits from a gold revaluation, is a secret "slush fund" that officials use for bailouts and for intervening in the gold markets. The economic crisis beginning in 2007 demonstrates that despite what everyone thought, "the market was not free at all. It was manipulated and distorted." According to economist Michael Boskin, soaring deficits and growing government borrowing will mean future incremental taxes of $163,000 for each American household.

Why End the Fed?

Four arguments for ending the Fed are:

1. **"The Philosophical Case**" – The monopoly power of the Fed to create money, control interest rates and operate in secrecy is immoral. Low interest rates induce consumption, not saving. Americans live beyond their means because they have been encouraged to do so by a government that condones paying tomorrow for what you want today. Increasing the money in circulation is counterfeiting, and it reallocates wealth from the poor and the middle class to the rich. A coalition of government and big business, which benefits from the largesse of stimulus spending, bailouts and tax incentives, constitutes "the economic takeover of America."
2. **"The Constitutional Case"** – The Founding Fathers were clear in their opposition to paper money. The U.S. Constitution forbids states from issuing their own paper currencies and requires that "legal tender" be only gold and silver. Though silent on the issue of a central bank, the Constitution's article 10 says that the government cannot invoke any power not listed in the Constitution. Several Supreme Court rulings, however, have interpreted the Constitution's "implied powers" to permit legal tender not backed by gold or silver.
3. **"The Economic Case"** – America's credit and money markets are socialist because the Fed controls the money supply and interest rates. Free markets can never exist when a central authority dictates the levels of interest rates and the supply of cash. Market ups and downs are a direct result of the Fed's policies of low rates and loose money, but politicians are deeply reluctant to change a system that benefits them.
4. **"The Libertarian Case**" – The more the government intervenes in Americans' lives, the less freedom Americans enjoy. And the poor and middle class suffer from the inflation that results from each social program enacted and each war waged. Politicians exploited post-9/11 fears to encourage citizens to seek government protection, thereby centralizing even more power. Easy money allows the U.S. to finance conflicts without congressional approval. Free spending on social subsidies ends up harming the very people such programs are meant to help.

Byzantium and the Fed

For a lesson on the dangers of monetary devaluation, consider the fate of the Byzantine Empire. The major economy of its time, Byzantium flourished as a central trading and business hub. For 600 years, the gold *byzant* was considered safe and reliable and was accepted as currency throughout the known world. But in 1071, the Byzantine emperor shrunk the gold content of the byzant to pay for his war against the Turks. The Turks won, people lost faith in the byzant and the empire collapsed.

"The Federal Reserve should be abolished because it is immoral, unconstitutional, impractical, promotes bad economics and undermines liberty."

To return to a truly free market, the U.S. needs to "unplug the machinery of the Fed." Without the Fed, banking services will continue as before, credit will come from people's savings and interest rates will reflect the productive capacity of the economy. The dollar will no longer depreciate, banks will curtail their risk taking and economic power will no longer be concentrated in the hands of the few.

About the Author

Congressman **Ron Paul** has represented his district in Texas for 11 terms in the U.S. House of Representatives. An outspoken Libertarian, he trained as a physician and ran twice for president.