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**July 13, 2009**

## The Perils of Central Banking

**Don Boudreaux**

I just discovered [this April 2008 essay by George Selgin](#). It's filled with important facts that give us reasons to be skeptical of giving the Federal Reserve new powers -- and facts that cast further doubt on the common understanding that the Great Depression was caused by unfettered capitalism. Here are some key paragraphs:

How well did the Federal Reserve use its original powers? During World War I it abandoned penalty rates for "easy" money, and then began buying Liberty Bonds to support the government's war effort. Those actions helped hoist the inflation rate from close to zero in 1915 to almost 20 percent in 1920 — a level not seen since the Civil War. When the war ended the Fed reversed course, triggering the severe (though mercifully brief) plunge of 1920-1921.

Instead of learning a lesson, in the later 1920s the Fed turned to easy money again. But bankers had learned a lesson, and so refused to borrow from it even at low rates. Consequently the Fed, taking advantage of some fine print in the Federal Reserve Act, started buying large quantities of U.S. securities on the open market. The result was an unprecedented stock bubble, which the Fed only managed to prick, in late 1929, by choking-off normal business credit. During the ensuing panic the Fed, pleading impotence, stood by while the U.S. money stock lost a third of its pre-crash value. The "great contraction" — the worst credit-crunch in U.S. history — culminated in the national bank holiday of March 6th through March 12th, 1933, during which the domestic gold standard, which the Fed was supposed to preserve, was permanently disabled.

By the way, George's new, wonderful book, *Good Money*, is [reviewed here by the noted economic historian Robert Whaples](#).

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