Matt Yglesias

Today at 11:28 am

The Fed Plays a Major Role in Everything

Here's an absurd argument from Daniel Mitchell at Cato:

> To put it mildly, the Federal Reserve has a dismal track record. It bears significant responsibility for almost every major economic upheaval of the past 100 years, including the Great Depression, the 1970s stagflation, and the recent financial crisis. **Perhaps the most damning statistic is that the dollar has lost 95 percent of its value since the central bank was created**.

It's difficult to know how to make sense of the claim that the combination of mild inflation and compound interest means currencies decline a lot in value over giant time scales. If you assume governments should put a very strong priority on the interests of people who want to save large sums of money in shoeboxes, I guess this is a damning statistic. But it seems to me that the relevant issue is that real income in the United States has increased enormously over the past 100 years and that we've done better in this regard than most countries.

As for the Fed's failures, Mitchell's going to easy on them. A central bank, by definition, bears significant responsibility for *all* macroeconomic crises. The job of a central bank is to avoid macroeconomic crisis. When one happens, they're screwing up. But by the same token, every time there's *not* a major macroeconomic crisis they're doing something right. Remember when the 1987 stock market crash wasn't followed by a giant recession? Remember when the economy recovered super-rapidly from the 1982 recession? Remember when wages and incomes grew steadily for 30 years between 1945 and 1975? Monetary policy is everywhere, through the good times and the bad. In part for that reason I don't think "ending" the Fed would achieve anything (though if the best political path to reforming it would be to give it a different name, I'm happy to believe that's an "end the Fed" agenda) since a country with a currency needs to have a monetary policy of some kind. But where I agree with Mitchell is that normally after a huge macroeconomic disaster we have a serious push for monetary reform. This time around, though, we've seen a counterproductive polarization between a minority faction of goldbug cranks and an establishment that merely wants to circle the wagons and pretend not to see the problem here.

5 Like

Showing 14 comments

Sort by Oldest first

ApeMan1976 48 minutes ago

"since a country with a currency needs to have a monetary policy of some kind."

This can be more explicity stated - the government must set at least one interest rate.

1 person liked this. Like Reply

adamnvillani 41 minutes ago

"If you assume governments should put a very strong priority on the interests of people who want to save large sums of money in shoeboxes, I guess this is a damning statistic."

Nice. But most likely Bob Roddis will come along to stand up for shoebox-Americans. Also GOOOOOOOLLLDDD!

3 people liked this. Like Reply

CastorpI 21 minutes ago in reply to adamnvillani

Let me ditto that "nice." Nice.

Like Reply

coton 40 minutes ago

As usual, critics of central banking conveniently ignore what things looked like prior to the existence of the Fed. In fact, there were periodic very sharp recessions, often accompanied and exacerbated by bank runs.

3 people liked this. Like Reply

SP123 35 minutes ago

Maybe they should split the fed into one organization mandated with full employment and another mandated with price stability. Then one can spend all day printing money and dropping it from helicopters while the other runs around trying to hide the money before anyone does something useful with it (metaphorically through market actions, that is.)

1 person liked this. Like Reply

John McDonnell 32 minutes ago

> Perhaps the most damning statistic is that the dollar has lost 95 percent of its value since the central bank was created.

This is the most pernicious misconception in folk-economics. Money should *not* be a store of value. That would be a bad thing. Money should be a useful intermediary to exchange your paycheck for real assets (like food, or index funds, or home equity). Its value should be "stable" in the sense of appreciating at a fixed rate, so that people signing contracts in dollars can have a reasonable expectation of what it payments they will be making or receiving in the future will be worth. It is not and should not be a store of value, because, as Adam Smith said, money locked in a box may as well be burned up or at the bottom of the sea. We don't want people sitting on it, we want people exchanging it.

5 people liked this. Like Reply

Dan Kervick 8 minutes ago in reply to John McDonnell

This seems like a major strain in libertarian thought - the notion that if someone chooses to check out of the economy and go into Rip Van Winkle mode in their sovereign bunker compound, the rest of society owes it to them that they should wake up just as rich as when they went to sleep.

Like Reply

Stephen Eldridge 7 minutes ago in reply to John McDonnell

It is not and should not be a store of value, because, as Adam Smith said, money locked in a box may as well be burned up or at the bottom of the sea.

Which raises the related point that if money is a store of value, then destroying money *would destroy value*. As it is, destroying money merely shifts value from the person whose money has been destroyed to the people who still have money (i.e., destroying money is disinflationary).

But imagine a true gold standard of the kind the goldbugs seem like they'd love--a system in which every dollar is actually tied to a specific amount of gold, and the government only prints enough dollars to match its gold assets. Because once you release a dollar into the world we have no way of knowing where it is or if it still exists, any money that was destroyed (without being replaced via a bank on a one-for-one basis) would orphan an amount of gold. The government couldn't print a new bill for that gold in case someone turned up with the old one, and so the gold would sit in perpetuity, unused and unclaimed. You'd end up with an ever-growing dead letter office of value.

Of course, goldbugs would probably love that, as the end result would be the amount of usable gold declining so that the price of gold would skyrocket at the expense of everything else in the economy, but I don't think that's a really sensible way to run an economy.

Like Reply

CastorpI 4 minutes ago in reply to Stephen Eldridge

Or we could go back to minting gold coins. It might take more shoeboxes to store your savings, but it would be worth it.

Like Reply

squidbreath 21 minutes ago

"But it seems to me that the relevant issue is that real income in the United States has increased enormously over the past 100 years and that we've done better in this regard than most countries."

You seem to be implying that fed actions caused this. That's a stretch.

Like Reply

jromance 15 minutes ago

This post by Matt was kinda of useless since the initial comment by the Cato guy was so bad -- so Matt takes him on and wastes some firepower. Okay, Matt can have some fun toying with his intellectual inferiors-- but he does raise a great issue in the last two sentences. I am not an economic historian -- but have we ever had such a great economic dislocation with so little call for reform?

Like Reply

halfkidding 14 minutes ago

The degree to which central bank policies determine everything, and that has been increasingly true since Breton-Woods collapsed, is the extent to which we are screwed. Unless of course you subscribe to the proposition that the course of history is best determined by a small group of bankers. Well a small group of anyone.

Adding to the delightful nonsense of Central Bank macro economic management is that the best possible outcome for markets derives from Central Banks micro managing the market price of money, ie. interest rates. That markets work best by negating markets.

It's really all down the rabbit hole sort of stuff.

The number one thing derived from low interest rates is excess speculation. So when that comes a cropper they double down and when that fails they double down again and so on and so forth. Until we have arrived at the dead end of 'structural unemployment' and the economic existential necessity of historically huge government deficits. Where little done by most citizens has any value, in any sense of the word, except consume.

Adding to the list of worlds shortest books like '400 years of German humor' or 'Fun with UNIX' I'd like to add 'The Wisdom of Modern Central Bankers'

Like Reply

ApeMan1976 9 minutes ago

"The number one thing derived from low interest rates is excess speculation."

People say this all the time. I always ask the same thing. Is there any evidence this is true?

Like Reply

Nylund 6 minutes ago

In order to gage the effectiveness of the Fed, you have to know what would have happened without the central bank during that time frame. We don't have that. Its a missing counterfactual. What we do have is the economic history of the US prior to the Fed. It was pretty terrible. You had a panic, crisis, or depression about once every three years. Many of them lasting for a long long time (eg. the long depression, 1873-1896).

1 person liked this. Like Reply

Real-time updating is **enabled**. (Pause)

Add New Comment

Required: Please login below to comment.

Type your comment here.

Post as ...