

February 21, 2005      Nearly 40 years ago, Federal Reserve chair Alan Greenspan wrote persuasively in favor of a gold monetary standard in an essay entitled Gold and Economic Freedom. In that essay he neatly summarized the fundamental problem with fiat currency in a few short sentences: “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... In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. There is no safe store of value... Deficit spending is simply a scheme for the ‘hidden’ confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights. If one grasps this, one has no difficulty in understanding the statists’ antagonism toward the gold standard.” Today, however, Mr. Greenspan has become one of those central planners he once denounced, and his views on fiat currency have changed accordingly. As the ultimate insider, he cannot or will not challenge the status quo, no matter what the consequences to the American economy. To renounce the fiat system now would mean renouncing the Fed itself, and his entire public career with it. The only question is whether history will properly reflect the destructive nature of Mr. Greenspan’s tenure. I had an opportunity to ask him about his change of heart when he appeared before the House Financial Services committee last week. Although Mr. Greenspan is a master of evasion, he was surprisingly forthright in his responses to me. In short, he claimed he was wrong about his predictions of calamity for the fiat U.S. dollar, that the Federal Reserve does a good job of essentially mimicking a gold standard, and that inflation is well under control. He even made the preposterous assertion that the Fed does not facilitate government expansion and deficit spending. In other words, he utterly repudiated the arguments he made 40 years ago. Yet this begs the question: If he was so wrong in the past, why should we listen to him now? First, the Federal Reserve does not mimic a gold standard by any measure. The clearest example of this lies in our current account deficit, which our fiat currency encourages. Under a gold standard we would not have exchange rate distortions between the Chinese renminbi and the U.S. dollar, for example. True currency stability is impossible when fiat dollars can be produced at will and foreign lenders bankroll our deficits. Second, inflation is a much greater problem than the federal government admits. Health care, housing, and energy are three areas where costs have risen dramatically. The producer price index is rising at the fastest rate in seven years. Bond prices are rising. To suggest that rapid expansion of the money supply and artificially low interest rates do not ultimately cause price inflation is absurd. Third, Fed policies do indeed have adverse political ramifications. Fiat currency and big government go hand-in-hand. Without a gold standard, Congress is free to spend recklessly and fall back on monetary expansion to pay the bills. Politically, it’s easier to print new dollars than raise taxes or borrow overseas. The Fed in essence creates paper reserves that enable Congress to undertake spending measures that far exceed tax revenues. The ill effects of this process are not felt by the politicians, who can always find popular support for new spending. Average Americans suffer, however, when their dollars are “confiscated through inflation,” as Mr. Greenspan termed it. It’s not enough to question the wisdom of Mr. Greenspan. Americans should question why we have a central bank at all, and whose interests it serves. The laws of supply and demand work better than any central banker to determine both the correct supply of money in the economy and the interest rate at which capital is available- without the political favoritism and secrecy that characterize central banks. Americans should not tolerate the manipulation of our economy and the inflation of our currency by an unaccountable institution.