The Federal Reserve: An Economic and Ethical Disaster

Dr. Shawn Ritenour

Increasingly whenever tragedy strikes, be it a natural disaster such as Hurricane Katrina or criminal wickedness such as mass murder, the American masses turn to the state to soothe their anxiety and solve their problems. They often do the same in response to economic disasters, such as the Great Depression and the current economic mess. From the time it became clear that our economy was in a lot of trouble, eyes turned toward Ben Bernanke, Chairman of our nation's central bank, the Federal Reserve, for bold and decisive action that would right our economic woes. This is sadly ironic because, far from being the solution to our economic meltdown, the Federal Reserve is the ultimate cause. We are where we are in large part because of the Fed's violation of sound economic and ethical principles. We cannot solve our problems by still further violating sound economics and ethics.

Notwithstanding the plethora of propaganda to the contrary, the chief function of the Federal Reserve is to increase the quantity of money in existence. The official government charge to the Fed by Congress is to promote price stability and full employment. The Fed seeks to fulfill its mandate by increasing the money stock at a greater or lesser rate. Before the Fed was created in 1913, it was sold to the public as a way to provide an "elastic currency," meaning that when the economic going got tough, it could increase the money stock, thereby greasing the wheels of exchange. Since its inception, the Fed has been increasing the quantity of money virtually continually. In fact, the money stock is approximately 103 times greater now than it was in 1914, the first full year of the Federal Reserve's operations.

Well sure, some might say, the Fed had to increase the money supply in order to maintain price stability, because during this time the demand to hold money increased as well. It is true that the demand to hold money tends to increase with economic prosperity and population, so yes, one would expect that the demand for money increased since 1914 as well. If, however, the money stock increased at a rate just high enough to satisfy money demand, one would expect that the level of overall prices would remain relatively stable. But this is far from the reality, and due to inflation of the money stock by the Fed, prices for consumer goods increased by over 2100% since 1914. What one could buy for a $1.00 in 1914 takes approximately $22.22 today.

Monetary inflation is unsound for both economic and ethical reasons. Increasing the money supply can never provide a general benefit to the whole of society. As indicated by the data above, inflation merely results in higher prices. Increasing the money supply does not spontaneously increase the stock of land, labor, or capital goods. Therefore, increasing the money supply does not allow us to produce more consumer goods we can use to satisfy our ends. Rather, inflation merely increases the amount of money being spent on the same quantity of goods. Because more money is spent, the demand for producer and consumer goods increases, so overall prices increase and the purchasing power of the dollar falls. There is, consequently, no general social benefit from inflation.

We cannot solve our problems by still further violating sound economics and ethics.

The Institute for Principle Studies
•
P.O. Box 278
Modesto, CA 95353
•
(209) 575 2005
•
www.principlestudies.org

Increasing the money supply does, however, benefit some people at the expense of others by redistributing wealth. When the Federal Reserve increases the money supply, not all cash balances increase at the same time. Certain people get the new money first, usually from commercial banks. These early recipients benefit from inflation. Suppose a borrower buys a house with some of the newly created money. This increases the demand for houses. The seller of the house receives the new money second and spends some of it on a new pair of shoes. This increases the demand for shoes. The shoe maker then spends the new money he receives on groceries, thereby increasing the demand for groceries. The early recipients are able to spend the new money on goods before the prices of those goods increase. As the new money percolates through the economy, though, prices of goods begin to rise, so that at some point the increase in cash balances for some people is just enough to offset the general increase in prices. People on fixed incomes, however, do not get any of the new money but still have to pay the higher prices. Wealth is, in essence, taken from them and transferred to those who received the new money first. While monetary inflation does not provide an overall social gain, it does benefit those who receive the money sooner at the expense of those who receive it later or not at all.

Additionally, inflation via credit expansion creates the business cycle by spawning capital malinvestment. Artificial credit expansion makes many unwise investments—say, in residential and commercial real estate—look profitable because of the accessibility of cheap credit, so business activity expands, manifesting itself in an inflationary boom. Bad investments, however, are not made economically sound merely because there is more money in existence. These bad investments eventually must be liquidated. The boom resolves itself in a bust whose twin children are capital consumption and unemployment. The current economic situation in our nation is testimony to the consequences of inflation via the artificial expansion of bank credit. The moral of the story is that monetary expansion by the Federal Reserve is economically destructive.

A complete evaluation of Federal Reserve policy from a Christian perspective, however, must take into account both economics and ethics. Not only do the Federal Reserve and its inflationary policies have grave economic consequences, state monopolization of the money production process and government inflation also violates the Christian ethic of private property. It violates the ethical principles of voluntary exchange, and is inherently fraudulent. The actions of the Federal Reserve are both economically dangerous and ethically unjust.

The ethics of inflation begin with the relationship between monetary inflation and property rights. When the state monopolizes the money production process (as it does in the U. S. with the Federal Reserve) and engages in monetary inflation (as it does in the U. S. with the Federal Reserve), it violates the Christian ethic of private property, and hence, inflation cannot be accepted as moral economic policy.

Considering the debasement of a metallic currency furthers our understanding of the ethical problems of inflation. When ancient rulers debased metallic money either by clipping coins or by diluting coins with base metals, they represented a good (the debased coin) as something it was not (a pure metallic coin of defined weight). Metallic money developed through voluntary exchange and the different monetary units were different amounts of precious metals. For example, the money mentioned in the Bible—the shekel and the talent—were different units of weight. Debasement is an effort to use unjust scales by issuing money that says it is a certain weight of gold or silver, when in fact it contains less. Holy Scripture tells us that using false weights and measures is an act of fraud akin to theft. God requires just balances, and He finds false scales an abomination (Lev. 19:35–36; Prov. 11:1). Furthermore, when prophesying against the unfaithfulness of Jerusalem, Isaiah specifically cites monetary debasement as one of their sins when he says, “You silver has become dross” (Isa. 1:22a).

The Institute for Principle Studies
•
P.O. Box 278
Modesto, CA 95353
•
(209) 575 2005
•
www.principlestudies.org

Fractional reserve banking backed up by the Federal Reserve is a similar example of fraud in that the money created by commercial banks with the full support of the central bank are advertised as being payable on demand. However, because banks only hold a fraction of the money reserves necessary to cover all of their outstanding money warehouse receipts, there is no way for them to make good on all of their promises.

Additionally, as explained earlier, inflation results in a redistribution of wealth. It increases the wealth of those who receive new money sooner and takes it away from those who receive the new money later or not at all. Such redistribution of wealth is not the result of voluntary exchange of private property, but solely due to the state coercively monopolizing money production and using that monopoly to increase the money supply. Inflation generated by the Federal Reserve, our government-created money monopolist, ends up taking wealth from some and forcibly transfers it to others. This is akin to government-sponsored theft, and is a clear violation of the basic biblical principle, "Thou shall not steal" (Exod. 20:15).

The Federal Reserve and the inflation it produces violate the basic right of private property on many levels and, therefore, cannot be considered an ethical economic policy. Government manipulation of the money supply through the Federal Reserve has proven both to be economically and ethically disastrous. We continue to violate God's economic and ethical laws at our own peril.

Dr. Shawn Ritenour received a bachelor of arts degree in economics from Northwestern College in Orange City, Iowa, and completed his Ph.D. in economics in 1997 at Auburn University in Auburn, Alabama. Dr. Ritenour is currently Professor of Economics at Grove City College in Grove City, Pennsylvania.

The Institute for Principle Studies
•
P.O. Box 278
Modesto, CA 95353
•
(209) 575 2005
•
www.principlestudies.org