Editor's Note

The Federal Reserve Act was passed on December 23, 1913. It was designed to provide an elastic currency that would respond to the needs of trade. There was nothing in the Act about price stability, interest rates, or full employment. The expectation was that the United States would continue to define the dollar in terms of gold, and that the operation of the international gold standard would ensure long-run price stability.

It was widely accepted that "the highest moral, intellectual, and material development of nations is promoted by the use of money unchanging in its value," as declared by the U.S. Monetary Commission of 1876. The classical gold standard ended with the First World War, and, in August 1971, the dollar became a pure fiat money when President Richard Nixon closed the gold window.

Today the Federal Reserve System is much different than a century ago. How well has the Fed performed? Was the Fed a good idea? Can we do better? To address those and related questions, the Cato Institute brought together some of the most respected monetary scholars and policymakers at its 31st Annual Monetary Conference in Washington, D.C., on November 14, 2013. The papers from that conference are featured in this volume.

In the lead article, Charles I. Plosser argues for a rules-based monetary policy and a "limited central bank" devoted to the primary task of safeguarding the dollar's long-run purchasing power. Jerry L. Jordan considers the lessons learned from a century of U.S. central banking, while George A. Selgin provides a detailed account of how the Fed has twisted its true record. Athanasios Orphanides, like Plosser, makes a strong case for a "price stability mandate."

Lawrence H. White examines the Fed's "troubling suppression of competition from alternative monies" using the examples of the liberty dollar and e-gold. Legal restrictions are also noted by Richard H. Timberlake in his article on "clearing house currency."

Scott B. Sumner advocates rules rather than discretion in the conduct of monetary policy. His preferred rule is to target nominal GDP rather than inflation or the price level.

Since the Panic of 2007, the Fed's balance sheet and power have expanded dramatically. The Fed's ultra-low interest rates and quantitative easing have distorted capital markets, increased risk taking, politicized credit allocation, monetized government debt, and allowed the government to expand its size and scope. Moreover, the Fed's regulatory powers have increased uncertainty and dampened the disciplinary forces of private free markets.

Rep. Jeb Hensarling, the chairman of the House Financial Services Committee, pledges to conduct hearings to hold the Fed accountable and help improve its performance. John A. Allison draws on his experience as chairman and CEO of BB&T Corporation to discuss the unintended adverse consequences of top-down financial regulation as opposed to the spontaneous positive results of market-based discipline, given the appropriate institutional framework making individuals responsible for their actions. Kevin Dowd and Martin Hutchinson look at the institutions that helped mitigate moral hazard and harmonize financial markets in the pre-Fed era and compare them to changes in the financial architecture since the creation of the Fed. Their main conclusion is that competitive markets bound by laws of contract and an overarching rule of law that protects private property rights provide incentives to manage risk and avoid the problem of "too big to fail"—a central bank and hordes of government regulators do not.

Rep. Kevin P. Brady, chairman of the Joint Economic Committee, makes the case for a bipartisan Centennial Monetary Commission to examine the Fed's history and consider alternatives to pure discretionary government fiat money. He takes seriously the constitutional mandate for Congress to ensure stable-valued money. Gerald P. O'Driscoll Jr. considers the prospects for fundamental monetary reform and the strategies to promote such reform. R. David Ranson argues that the Fed's overreliance on conventional statistics to guide its policy and its politicization have led to failed policies. In particular, by distorting interest rates and trying to "stimulate" the economy, the Fed has actually slowed recovery. Ultimately, real reform of the monetary and financial system requires that voters understand the limits of central banking and the benefits of limited government and free markets.

In the final article, Lewis E. Lehrman, a member of the President Ronald Reagan's Gold Commission in 1981, makes a compelling case for returning to a classical gold standard, not only to protect the purchasing power of the dollar but to prevent the federal government from using the printing press to pay its bills.

It is hoped that these articles will stimulate debate about the choice of monetary arrangements consistent with a free society, individual responsibility, and the constitutional call for Congress to safeguard the purchasing power of the dollar.

—J. A. Dorn