Liberty Dollars

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WASHINGTON—Recently, *The Washington Post* carried a front-page story about a federal raid on the headquarters of the National Organization for the Repeal of the Federal Reserve Act and Internal Revenue Code (Norfed). The Indiana-based company, which advocates “sound money,” has been selling coins and paper certificates backed by gold and silver for years, in effect trying to compete with the dollar.

The government ignored Norfed’s “Liberty Dollars” for a long time—until the group started selling thousands of coins with Ron Paul’s likeness to show support for the Republican presidential candidate. Paul also wants to abolish the Federal Reserve.

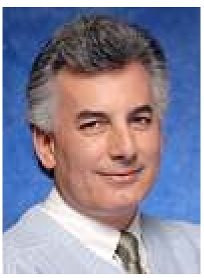
To the public at large, the activities of Norfed seem utopian, naive and even downright fraudulent. The idea that the world’s greatest economy could be run without a central bank and private parties could replace the government as issuers of currency is one that many people will find scary. With the dollar in something of a free fall and the United States in the midst of a housing and credit crisis that has sent some of the nation’s top CEOs packing, Americans will be looking for financial security, not monetary adventures.

And yet it is precisely in such a financially wobbly environment that the actions of Norfed should invite a critical look at the way money is managed. Some of the country’s greatest economists, including Nobel Prize winners, have been saying for years that the Federal Reserve has probably caused more problems than it has solved since its creation in 1913. Its role in the last century’s boom and bust cycles is a matter of record; it looks as though it played a similar role in the current housing market crisis too.

While the creation of the Federal Reserve was essentially a response to a series of bank runs, those crises were mild compared to the ones that were to follow. In 1913, the United States was under the gold standard. Although the government issued currency, the fact that currency was tied to gold meant the authorities could not manipulate the money supply easily. The Fed’s initial mission was to guarantee the convertibility of deposits into currency on demand. A few decades later, the United States abandoned the gold standard and the Federal Reserve became the country’s most powerful economic institution, exercising its monopoly in issuing currency based on the discretionary power of its board of governors.

All in all, financial instability has been far greater since the creation of the Federal Reserve. What did the Great Depression teach us? Essentially that even with the best of intentions, it is impossible for the authorities to manage the supply of money in accordance with the exact needs of the economy. A country's economy is the sum of millions of people making decisions that no single individual is in a position to anticipate. As economist Murray Rothbard showed in his book "America's Great Depression," in the 1920s the Federal Reserve pumped up the money supply, expanding credit by more than 60 percent. Because the economy was very productive, this monetary expansion did not show up in the regular inflation figures. But, as is always the case with inflation, many resources went to the wrong kind of investments—until the crisis hit. The late Milton Friedman showed how the Fed made things worse by not providing the system with enough liquidity once the Depression was obvious.

The current housing market and debt market crises are in good part the children of the Federal Reserve. By cutting rates 13 times between 2001 and 2003, and then keeping them very low for years, monetary policy contributed to the housing bubble. That is not to say other factors—including financial instruments that made it difficult to see that the underlying foundation was not as solid as it seemed—did not play a part too. But, once again, the Fed has turned out to be a factor of financial instability.



In this context, Norfed's attempt to prove to the Fed that the market is ready to trust private currency backed by gold is a welcome occasion to take a second look at some of the economic institutions we take for granted. Naive and utopian? You bet. But that is probably because of how far the world has moved from the time when money was too important to be left to the politicians.

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