Has the Fed been a failure?

George Selgin\textsuperscript{a,}\textsuperscript{*}, William D. Lastrapes\textsuperscript{a}, Lawrence H. White\textsuperscript{b}

\textsuperscript{a}Department of Economics, Terry College of Business, University of Georgia, Athens, GA 30602, United States
\textsuperscript{b}Department of Economics, George Mason University, Fairfax, VA 22030, United States

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\textbf{Abstract}

As the 100th anniversary of the 1913 Federal Reserve Act approaches, we assess whether the nation's experiment with the Federal Reserve has been a success or a failure. Drawing on a wide range of recent empirical research, we find the following: (1) The Fed's full history (1914 to present) has been characterized by more rather than fewer symptoms of monetary and macroeconomic instability than the decades leading to the Fed's establishment. (2) While the Fed's performance has undoubtedly improved since World War II, even its postwar performance has not clearly surpassed that of its undoubtedly flawed predecessor, the National Banking system, before World War I. (3) Some proposed alternative arrangements might plausibly do better than the Fed as presently constituted. We conclude that the need for a systematic exploration of alternatives to the established monetary system is as pressing today as it was a century ago.

\section{Introduction}

In the aftermath of the Panic of 1907 the US Congress appointed a National Monetary Commission. In 1910 the Commission published a shelf-full of studies evaluating the problems of the post-bellum National Banking system and exploring alternative regimes. A few years later Congress passed the Federal Reserve Act.

Today, in the aftermath of the Panic of 2007, and as the 100th birthday of the Federal Reserve System approaches, it seems appropriate to once again take stock of our monetary system. Has our experiment with the Federal Reserve been a success or a failure? Does the Fed's track record during its history merit celebration, or should Congress consider replacing it with something else? Is it time for a new National Monetary Commission?

\textsuperscript{*}Corresponding author.

\textit{E-mail addresses:} Selgin@uga.edu (G. Selgin), last@uga.edu (W.D. Lastrapes), lwhite11@gmu.edu (L.H. White).

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The Federal Reserve has, by all accounts, been one of the world’s more responsible and successful central banks. But this tells us nothing about its absolute performance. To what extent has the Fed succeeded or failed in accomplishing its official mission? Has it ameliorated to a substantial degree those symptoms of monetary and financial instability that caused it to be established in the first place? Has it at least outperformed the system that it replaced? Has it learned to do better over time?

We address these questions by surveying available research bearing upon them. The broad conclusions we reach based upon that research are that (1) the full Fed period has been characterized by more rather than fewer symptoms of monetary and macroeconomic instability than the decades leading to the Fed’s establishment; (2) while the Fed’s performance has undoubtedly improved since World War II, even its postwar performance has not clearly surpassed that of its (undoubtedly flawed) predecessor; and (3) alternative arrangements exist that might do better than the presently constituted Fed has done. These findings do not prove that any particular alternative to the Fed would in fact have delivered superior outcomes:

1. Although Feldstein (2010, p. 134) recognizes that “[t]he recent financial crisis, the widespread losses of personal wealth, and the severe economic downturn have raised questions about the appropriate powers of the Federal Reserve and its ability to exercise those powers effectively,” and goes onto ask whether and in what ways the Fed’s powers ought to be altered, his conclusion that the Fed “should remain the primary public institution in the financial sector” (Feldstein, 2010, p. 135) rests, not on an actual review of the Fed’s overall record, but on his unsubstantiated belief that, although the Fed “has made many mistakes in the near century since its creation in 1913. . . it has learned from its past mistakes and contributed to the ongoing strength of the American economy.”

2. Blinder (2010) argues that, given the premise that the Fed as presently constituted will continue to be responsible for conducting US monetary policy, it ought also to have its role as a supervisor of “systematically important” financial institutions preserved and even strengthened. Goodhart and Schoenmaker (1995) review various arguments for and against divorcing bank regulation from monetary control.
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