Cato's 27th Annual Monetary Conference

Financial Harmony Praised, Fiat Money Condemned

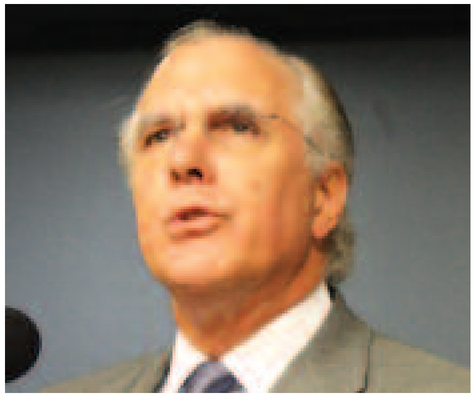
The government's response to the financial crisis has exposed serious and destructive problems with our fiat money regime. Cato's 27th Annual Monetary Conference, "Restoring Global Financial Stability," directed by James A. Dorn, vice president for academic affairs at Cato and editor of *Cato Journal*, brought together a diverse group of scholars to examine alternatives to the ruinous fiat regime. In particular, how can a more transparent, rules-based global monetary and financial system be created that limits government intervention and allows a spontaneous market order to emerge—such as a commodity-based regime that allows the supply of money to adapt smoothly to demand and maintain its long-run value?

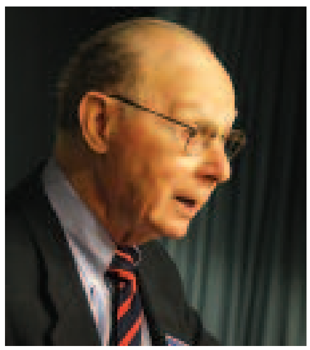
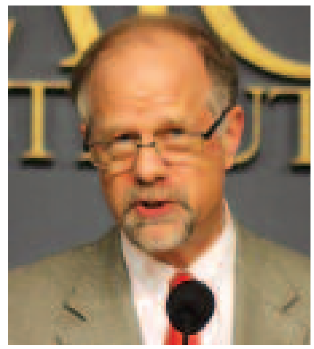
Participants discussed those and related issues, including the vast powers the Federal Reserve has acquired during the financial crisis—in effect, becoming a branch of the U.S. Treasury and buying up billions of dollars of toxic assets and bailing out institutions deemed "too big to fail."

Nobel laureate economist Vernon Smith, who attended the conference, called it "lively and informative." Thomas Humphrey, a noted monetary economist who presented a paper at the conference, said, "I will be honored to have it published in the *Cato Journal*, which is among the best and most accessible policy journals in the world."

In his keynote address Allan H. Meltzer discussed the history of the Fed and faulted the central bank for not adhering to a clear rule for guiding monetary policy. Zanny Minton Beddoes of *The Economist* argued that "the search for 'financial harmony' will be quixotic" unless the "big underlying distortions" in the global economy are dealt with, including the underpricing of risk—that is, the moral hazard problem when governments socialize losses.

Lawrence H. White, James Grant, Judy Shelton, Leland Yeager, George Selgin, and Richard Rahn all argued for reforming the present discretionary government fiat money system to ensure sound money, adaptability, and wealth creation under a stable rule of law. Contrary to conventional wisdom, there is a strong case for privatizing or abolishing the central bank and allowing competing currencies resting on a commodity base.




At Cato's annual monetary conference, "Restoring Global Financial Stability," Dallas Fed president Richard Fisher (top left) examined the "too big to fail" problem. Former IMF economist Miranda Xafa warned against a global surveillance role for the IMF. Bottom row, left to right, keynoter Allan Meltzer stressed the need for a clear rule to guide monetary policy; Lawrence H. White wondered if gold isn't a better standard than rules; and James Grant questioned the conference theme, saying that "instability is the way of the world."

Peter Wallison blamed the subprime and ensuing financial crisis largely on government-sponsored enterprises (Fannie and Freddie) and other interventions that distorted the housing market. Benn Steil pointed to the excessive public and private debt in the U.S. and to fiscal and monetary policies that contributed to that debt buildup and to the financial crisis. He noted that the large global imbalances and excessive build-up of U.S. debt could not have occurred under a gold standard.

Bennett McCallum said he was "appalled" by the Federal Reserve's actions during the last two years, in the sense that the Fed overstepped its mandate and engaged in credit allocation and in bailing out insolvent institutions. Likewise, Thomas Humphrey, a former vice president at the Federal Reserve Bank of Richmond, argued that the Fed has strayed far from a classical lender of last resort role. Instead of lending on good collateral at a penalty rate for a short duration, the Fed has accepted toxic assets as the basis for making massive loans at low rates for extended periods.

In the discussion of the role of the IMF in assessing systemic risk and preventing future financial crises, Cato research fellow Swaminathan Anklesaria Aiyar noted that no one, including the IMF, has sufficient knowledge or foresight to predict financial crises in a complex global economy.

Eswar Prasad considered the medium-term risks from the current monetary and fiscal stimulus policies and warned that the G-20 needs to embark on fundamental reforms and avoid destructive protectionism to ensure future growth.

Papers presented at the conference will appear in a special issue of the *Cato Journal*.