Debt and Monetary Easing: Dad Was Told by Mother, You Can’t Have One Without the Other

The basis of monetary policy is trickery. Can you make people *feel* wealthier by printing more money? Expanding the money supply, either by printing money or engaging in open market operations, doesn’t inherently create wealth. If it did, Zimbabwe would be one of the richest countries in the world instead of one of the poorest.

For every new dollar in the money supply (think QE1 and QE2) each existing dollar becomes worth less. Over the last two years the US dollar has fallen by more than 30% vs. the Australian dollar. It’s not just the Australian dollar, the US dollar buys less of almost all currencies since the US has begun monetary easing. This means that everything we buy from abroad (think oil) is more expensive.

Here’s what has happened to [the value of the dollar over the last forty years.](http://www.economist.com/blogs/dailychart/2011/05/exchange_rates) The dollar has been in decline for a while. The two periods where the dollar was gaining strength were in the early 1980’s (the Fed was reducing the money supply) and the late 1990’s (Congress and President Clinton were running budget surpluses). Now that Congress and the President are running massive budget deficits financed by quantitative easing, the dollar’s decline will only accelerate.

This begs the question of why would the Fed keep goosing the money supply? Monetary policy only works if the increase in money supply is unexpected. The Fed, however, has made public statements regarding their plans for quantitative easing. The reason that Fed Chairman Ben Bernanke can’t point to jobs gained by easing monetary policy is they don’t exist (except maybe for bond traders at Goldman Sachs).

More than anything else, monetary easing is being done to finance the federal budget deficit. The federal government is borrowing money so fast that they would naturally be running short of people who want to give them low interest rate loans. In absence of the Fed, government borrowing would be crowding out private investment with higher interest rates.

High interest rates aren’t the cause of our economic problems, but they would be a symptom. Much like a credit abuser has to pay ever higher interest rates on their credit card, so too would sovereign governments (see Greece). Greece doesn’t have a central bank to print money to buy its new debt. If it did, they would be doing what we are doing. Our Federal Reserve is aiding and abetting the mortgaging of the US for future generations.

The best central banks are politically independent and bound by rules regarding the increase in the money supply. Our fed is neither politically independent, nor bound by rules. As a result, the Fed is quickly losing credibility.