Statement before the Financial Services Committee

September 20, 2007

Mr. Chairman, the situation facing us now in the mortgage industry has its roots in the Federal Reserve's inflationary monetary policy. Without addressing the roots of the current crisis, any measures undertaken to improve the situation will be doomed to fail.

As with asset bubbles and investment manias in past history, the fuel for the current housing bubble had its origins in monetary manipulation. The housing boom was caused by the Federal Reserve's policy resulting in artificially low interest rates. Consumers, misled by low interest rates, were looking to consume, while homebuilders saw the low interest rates as a signal to build, and build they did.

One of the primary means the Federal Reserve uses to stimulate the economy is manipulation of the federal funds rate and the discount rates, which are used as benchmark rates throughout the economy. The interest rate is the price of time, as the value of a dollar today and the value of a dollar one year from now are not the same. Just like any price in the market, interest rates have an important informational signaling purpose. Government price fixing of the interest rate has the same deleterious effects as price controls in other areas.

Reduction in the interest rate has two major effects: it encourages consumption over saving; and it makes long-term, capital-intensive projects cheaper to undertake. Under Chairman Greenspan's tenure, the federal funds rate was so low that the real interest rate (that is the nominal interest rate minus inflation) was negative. With a negative real interest rate, someone who saves money will literally lose the value of that money.

The Federal Reserve continued and still continues to increase the money supply. After ceasing the publication of M3 last February, private economists have calculated that M3 has risen at an annual rate of almost 12%, which is faster than we have seen since the 1970's.

Millions of Americans now find themselves stuck in a financial quandary that is not their fault. The result of manipulation of the interest rate, money supply, and mortgage markets are the recently popped housing bubble.

Further regulation of the banking sector, of mortgage brokers, mortgage lenders, or credit rating agencies will fail to improve the current situation, and will do nothing to prevent future real estate bubbles. Any proposed solutions which fail to take into account the economic intervention that laid the ground for the bubble are merely window dressing, and will not ease the suffering of millions of American homeowners. I urge my colleagues to strike at the root of the problem and address the Federal Reserve's inflationary monetary policy.