Congressman Ron Paul U.S. House of Representatives February 7, 2002 Economic Concerns

Mr. Speaker:

Dealing with the slumping economy will prove every bit as challenging to Congress as fighting terrorism.

No one challenges the need to protect American citizens from further terrorist attacks, but there is much debate throughout the country as to how it should be done and whether personal liberty here at home must be sacrificed. Many are convinced that our efforts overseas might escalate the crisis and actually precipitate more violence. A growing number of Americans are becoming concerned that our efforts to preserve our freedoms and security will result in the unnecessary sacrifice of that which we've pledge to protect- our constitutionally protected liberty.

A similar conflict also exists once government attempts to legislate an end to a recession. In the 1970s, wage and price controls were used to suppress price inflation and to help the economy, without realizing the futility of such a policy. Not only did it not work, the economy was greatly harmed. Legislation, per se, is not necessarily harmful, but if it reflects bad policy, it is. The policy of wage and price controls makes things worse and represents a serious violation of people's rights.

Today, we hear from strong advocates of higher taxation, increased spending, higher budget deficits, tougher regulations, bailouts and all kinds of subsidies and support programs as tools to restore economic growth. The Federal Reserve recognized early on the severity of the problems and, over the past year, lowered short-term interest rates an unprecedented 11 times, dropping the Fed funds rate from 6 1/2 % to 1 3/4 %. This has not helped, and none of these other suggestions can solve the economic problems we face either. Some may temporarily help a part of the economy, but the solution to restoring growth lies not in more government but less. It is precisely too much government, and especially manipulation of credit by the Federal Reserve, that precipitated the economic downturn in the first place. Increasing that which caused the recession can't possibly, at the same time, be the solution.

The magnitude of the distortions of the 1990s brought on by artificially low interest rates orchestrated by the Fed, on top of 30 years of operating with a fiat currency worldwide, suggests that this slowdown will not abort quickly.

The Japanese economy has been in a slump for over 10 years and shows no signs of recovery. The world economies are more integrated than ever before. When they are growing, it is a benefit to all, but in a contraction, globalism based on fiat money and international government assures that most economies will be dragged down together. Evidence is abundant that most countries of the world are feeling the pressure of a weakening economy.

Many of our political and economic leaders have been preaching that more consumer spending can revitalize the economy. This admonition, of course, fails to address the reality of a record-high $7.5 trillion-and rising consumer debt. "Today, a party- tomorrow an economic hangover" has essentially been our philosophy for decades. But there's always a limit to deficit spending, whether it's private or governmental, and the short-term benefits must always be paid for in one form or another later on.

Those who felt and acted wealthy in holding the dot-com and Enron stocks were brought back to earth with a shattering correction. There's a lot more of this type of correction yet to come in the financial sector.

In recessions, to remain solvent, consumers ought to tighten their belts, pay off debt, and save. In a free market, this would lower market interest rates to once again make investments attractive. The confusing aspect of today's economy is that consumers and even businesses continue profligate borrowing, in spite of problems on the horizon. Interest rates, instead of rising, are pushed dramatically downward by the Federal Reserve, creating massive amounts of new credit.

This new credit, according to economic law, must in time push the value of the dollar down and general prices up. When this happens and the dollar is threatened on exchange markets, the cost of living is pushed sharply upward. The central bank is then forced to raise interest rates, as they did in 1979 when the rates hit 21%.

But even before any need to tighten, interest rates may rise or not fall as expected. This has just

happened in 2001. Even with Fed fund rates at 40-year lows, the 10 and 30-year rates have not fallen accordingly. Many corporate-bond rates have stayed high, and credit-card rates have stayed in double digits. This happens because the market discounts for debt quality and future depreciation of the dollar.

The Fed can't control these rates, and they can't control where the new credit they create goes. This means that resorting to, or trusting in, the Fed to bail out the economy and accommodate congressional spending is foolhardy and dangerous. This policy has led to a record default for U.S. corporate bonds. Worldwide, $110 billion of bonds were defaulted on last year.

Monetary inflation is the chief cause of recessions. Therefore, we must never expect that this same policy will reverse the economic dislocations it has caused.

For over a year, the Fed has been massively inflating the money supply, and there is no evidence that it has done much good. This continuous influx of new credit instead delays the correction that must eventually come- the liquidation of bad debt, and the reduction of overcapacity. This is something Japan has not accomplished in 12 years of interest rates around 1%. The market must be left to eliminate the misdirected investments and allow the sound investments to survive.

There are other policies that will assist in a recovery that the Congress could implement. All taxes ought to be lowered, government spending should be reduced, controls on labor costs should be removed, and onerous regulations should be reduced or eliminated.

We should not expect any of this to happen unless the people and the Congress decide that free-market capitalism and sound money are preferable to a welfare state and fiat money. Whether this downturn is the one that will force that major decision upon us is not known, but eventually we will have to make it. Welfarism and our expanding growing foreign commitments, financed seductively through credit creation by the Fed, are not viable options.

Transferring wealth to achieve a modicum of economic equality and assuming the role of world policeman, while ignoring economic laws regarding money and credit, must lead to economic distortions and a lower standard of living for most citizens. In the process, dependency on the government develops and Congress attempts to solve all the problems with a much more visible

hand than Adam Smith recommended. The police efforts overseas and the effort to solve the social and economic problems here at home cannot be carried out without undermining the freedoms that we all profess to care about.

Sadly lacking in the Congress is a conviction that free markets- that is truly free markets- and sound money can provide the highest standard of living for the greatest number of people. Instead, we operate with a system that compromises free markets and causes economic injury to a growing number of people, while rewarding special interests and steadily undermining the principles of liberty. Unfortunately, the policy of monetary inflation is most harmful to the poor and the middle class, especially in the early stages.

Since rejecting the current system and endorsing economic freedom diminishes the power and influence of politicians, it's difficult to get political support for such a program. The necessary changes will only come when the American people wake up to the reality and insist that the Congress pursues only those goals permitted under the Constitution.

Instead of moving in that direction of freer markets, the more problems the western countries face, the more government programs are demanded. If one looks at Europe, the United States, or even Japan as their economies weaken, government involvement in the economy increases. But in China and Russia, the horrible conditions that communism causes, ironically, made these two countries move toward freer markets when they encountered serious troubles. Even the central banks of these two countries today are accumulating gold, while western central banks are selling.

The reason for this is that the conventional wisdom of the west's political and economic leaders is that there's a third way that is best, or an alternative to the extremes of too much freedom- laissez faire capitalism- and too little freedom- authoritarianism, socialism or communism.

But this is a myth. One can only justify intervention in the market on principle or argue against it. There's always the hope that government will be prudent and limit its intrusion in the economy with low taxes, minimal regulations, a little inflation, and only a few special interest favors. Yet the record is clear. Any sign of distress prompts government action for any and every conceivable problem. Since each action by the government not only fails in its attempt to solve the problem it addresses, it creates several new problems in addition while prompting even more government intervention.

Here in the United States we have seen the process at work for several decades with steady growth in the size and scope of the federal bureaucracy and the corresponding reduction in our personal freedoms. This principle also applies to overseas intervention. One episode of meddling in the affairs of other nations leads to several new problems requiring even more of our attention and funding.

This system leads to a huge bureaucratic government, manipulated by politicians, and generates an army of special interests that flood the system with money and demands. To achieve and maintain political power in Washington, these powerful special interests must be satisfied.

This is a well-known problem and prompts some serious-minded and well-intentioned Members to want to legislate campaign finance reforms. But the reforms proposed would actually make the whole mess worse. They would regulate access to the members of Congress, and dictate how private money is spent in campaigns. This merely curtails liberty, while ignoring the real problem- a government that ignores the Constitution naturally passes out largesse. Even under today's conditions, where money talks in Washington, if enough members would refuse either to accept or be influenced by the special interests, government favors would no longer be up for sale. Since politicians are far from perfect, the solution is having a government of limited size acting strictly within the framework of the Constitution. No matter how strictly campaign finance laws are written, they will do only harm if the rule of law is not restored and if Congress refuses to stop being manipulated by the special interests.

Most people recognize the horrible mess that Washington is and how campaign money and lobbyists influence the system. But the reforms proposed only deal with the symptoms and not the root cause. There is sharp disagreement in what to do about it, but no one denies the existence of the problem. It=s just hard for most to acknowledge that the welfare state is out of control and shouldn't be in existence anyway. Therefore, they misdirect our attention toward campaign-finance reform rather than deal with the real problem.

Very few in Washington, however, recognize the dire consequences to economic prosperity that welfarism, warfarism, and inflationism cause. Most believe that the occasional recession can be easily handled by government programs and a Federal Reserve policy designed to stimulate growth. It's happened many times already, and almost everyone believes that in a few months our economy and stock market will be roaring once again.

This is where I disagree.

Every recession in the last 30 years, since the dollar became a purely fiat currency, has ended after a significant correction and resumption of all the bad policies that caused the recession in the first place. Each rebound required more spending, debt and easy credit than the previous recovery did. And with each cycle, the government got bigger and more intrusive.

Bigger government with more monetary debasement and deficit spending means a steady erosion of the free market and personal freedoms. This is not tolerated, because the people enjoy or even endorse higher taxes, more regulations and fewer freedoms. It's tolerated because most people believe that their financial and economic security is the responsibility of the government. They believe they are better off with government assistance in facilitating the free market, having been taught for decades that it is necessary for government to put a human face on capitalism. Extreme capitalism, i.e. freedom, we have been told is just as dangerous as extreme socialism. As long as this belief prevails, our system will continue in its inexorable march toward fascist-type socialism.

However, support for today's policies is built on the fallacy that material wealth and general prosperity are best achieved with this third way- interventionism- while avoiding the dangers of communism and socialism. This is coupled with the firm conviction that the sacrifice of freedom will be minimal and limited and that the very rich can be adequately taxed and regulated to help the poor.

This is a fallacy because more freedom will be lost than is expected, and the productivity of the market will suffer more than anticipated. Once this realization occurs, it will suddenly be discovered that the apparent wealth of the nation is a lot less than calculated.

An economy that depends on ever-increasing rates of monetary inflation will appear much healthier and the people much richer than is the actual case. Owners of the dot-com companies or Enron stocks know what it's like to feel rich one day and very poor the next. This is not a unique experience but one that should be expected and is predictable.

Countries that inflate their currencies must adjust their values periodically with sudden devaluations, which destroy the pseudo-wealth of the middle class and poor. The wealthy, more

often than not, can protect themselves from the sudden shocks to the monetary system. However, they can't protect from the insidious loss of liberty that accompanies these adjustments, and eventually everyone suffers.

Our dollar system is quite similar to the Argentine and Mexican peso systems that periodically make sudden and painful adjustments. But ours is different in one respect, because the dollar is accepted as the reserve currency of the world- the paper gold of the world financial system. This gives us license to inflate- that is, steal- for longer periods of time, and we can avoid sudden and sharp devaluations since the world's currencies are "defined" by our dollar. But this doesn't permit the ultimate devaluation that will bring a significant increase in the cost of living to all Americans, but hurt the poor and the middle class the most.

This special status of the dollar only makes the problem of the illusion of wealth much worse. Since our bubble can last longer due to our perceived military and economic strength, it appears that our wealth is much greater than it actually is. Because of our unique position as the economic powerhouse of the world, we're able to borrow more than anyone else. Foreigners loan us exorbitant sums, as our current account deficit soars out of sight. The U.S. now has a foreign debt of over $2 trillion. Perceptions and illusions and easy credit allow our consumers to spend, even in recessions, by rolling up even more debt in a time when market forces are saying that borrowing should decrease and the debt burden lessen. Our corporations follow the same pattern, keeping afloat with more borrowing.

Ideas regarding the national debt have been transformed. Presidents Jefferson and Jackson despised government debt and warned against it. Likewise, both detested central banking, which they knew inevitably, would be used to liquidate the real debt through the mischievous process of monetary debasement.

Today, few decry the debt, except for the purpose of political demagoguery when convenient. The concern about deficits expressed by liberal big spenders does not merit credibility, but even conservative spenders now are less likely to decry deficits and some actually praise them.

Just recently, the conservative Institute for Policy Innovation (IPI) announced in a national press release: "National debt can lead to a growing economy," claiming government borrowing, "produces steady long-term growth, greater security, and a higher standard of living."

This wouldn't be so bad if it came from a typically Keynesian think tank. But this is the growing conventional wisdom of many conservatives whose goal is to generate government revenues, painlessly of course, not to drastically shrink the size of government and restore personal liberty.

What they fail to recognize, once they lose interest in shrinking the size of government, is that government borrowing always takes money from productive enterprises, while placing these funds in the hands of politicians whose prime job is to serve special interests. Deficits are a political expedience that also forces the Federal Reserve to inflate the currency while reducing in real terms the debt owed by the government by depreciating the value of the currency.

Those who would belittle the critics of the deficit and national debt are merely supporting a system of big government, whether it's welfare or warfare, or both.

Debt, per se, is not the only issue. It's also because debt always encourages the growth in the size of government. Allowing it to be seductively financed through inflation or borrowing is what makes it so bad. Just because it's less painful at first and payment is delayed, we should not be tempted to endorse this process.

If liberty is our goal and minimal government a benefit to a sound economy, we must always reject debt and deficits as a legitimate tool for improving the economy and the welfare of the greatest number of people. The principle of authoritarian government is endorsed whenever deficits are legitimatised. All those who love liberty must reject the notion that deficits and debt perform a useful function.

It's possible this recession may end in a few months as the optimists predict, but if it does, our problems are only delayed. The fundamental correction will still be necessary to preserve the productivity of a market economy. If we do not change our ways, the financial bubble will just go back to inflating again. The big correction, like that which Argentina is now experiencing with rapid disappearance of paper wealth, will eventually hit our economy. The longer the delay, the bigger will be the bust and greater the threat to our freedoms and institutions.

Since we're moving toward the big correction, we're going to see a lot more wealth removed from our balance sheets and our retirement accounts. The rampant price inflation that results

will erode the purchasing power of all fixed-income retirement funds like Social Security and mean a lower standard living for most people. The routine government response of increasing benefits for living expenses and medical care will never keep up with the needs or demands. Eventually we will have to give up, and a new economic system will have to be devised, as occurred in the Soviet system after 1989.

Wealth- the product of labor, investment and savings- can never be substituted by government spending or by a central bank that creates new money out of thin air. Governments can only give things they first take away from someone else. Printing money only diminishes the value of each monetary unit. Neither can create wealth; both can destroy it.

The dilemma is that early on, and sometimes for many years as we have experienced, transferring wealth and printing money seem to help more than it hurts. That's because the wealth is not real, and the trust funds, like Social Security hold no actual wealth. A pension fund with dot-com and Enron stock held no wealth either. Unfortunately, the stocks and bonds remaining are worth a lot less than most people realize.

The Social Security system depends on the value of the dollar and on future taxation. The Fed can create unlimited amounts of money that Congress needs, and Congress can raise taxes as it wants. But this policy guarantees that the dollar cannot maintain its purchasing power and that there won't be enough young people to tax in the future. Increasing benefits under these circumstances can only be done at the expense of the dollar. Catching up with the current system of money and transfer payments is equivalent to a person on a treadmill who expects to get to the next town. It tragically doesn't work.

The economic loss is bad enough, but whether it's fighting the war on terrorism, acting as the world's policeman, or solving the problems of vanishing wealth, the real insult will come from the freedoms we lose. These freedoms, vital to production and wealth formation, are necessary and represent what the American dream is all about. They are what made us the richest nation in all of history, but this we will lose if Congress is not careful with what it does in the coming months.

The Dangers We Face

Mr. Speaker, if nothing else, the knowledge that we are now vulnerable from outside attack is

shared by all Americans. The danger is clear and present and everyone wants something done about it.

There is, however, no unanimity as to the cause of the attacks, who is responsible, and what exactly has to be done. The President has been given congressional authority to use force "against those responsible for the recent attacks launched against the United States." A large majority of Americans are quite satisfied that his efforts have been carried out with due diligence.

But a growing number of Americans are becoming aware that anti-terrorist efforts, both at home and abroad, will have unintended consequences that few anticipated and that, in time, will not be beneficial to U.S. security and will undermine our liberties here at home.

Let me name a few potential dangers we face.

1. There's a danger that the definition of terrorism will become so vague and broad that almost any act internationally or domestically will qualify. If our response in Afghanistan becomes the standard for all countries in their retaliation, negotiated settlements of conflicts will become a thing of the past. Acts of terror occur on a regular basis around the world, whether involving Northern Ireland and Britain, India and Pakistan, the Palestinians and Israel, Turkey and Greece, or many other places. Traditionally, the United States has always urged restraint and negotiations. This approach may end if our response in Afghanistan sets the standard.

2. Another danger is that the administration may take it upon itself to broadly and incorrectly interpret House Joint Resolution 64- the resolution granting authority to the President to use force to retaliate against only "those responsible for the recent attacks launched against the United States." Congress did not authorize force against all terrorist attacks throughout the world if the individuals involved were not directly involved in the 9-11 attacks. It would be incorrect and dangerous to use this authority to suppress uprisings throughout the world. This authority cannot be used to initiate an all-out attack on Iraq or any other nation we might find displeasing but that did not participate in the 9-11 attacks.

3. An imprecise definition of who is or who is not a terrorist may be used to justify our massively expanding military might throughout the world. For every accused terrorist, there will be a

declared "freedom fighter." To always know the difference is more than one can expect. Our record in the past 50 years for choosing the right side in the many conflicts in which we have been involved is poor, to say the least. Many times, there is no "right side," from the viewpoint of American security, and our unnecessary entanglements have turned out to be the greater threat to our security.

4. There's risk that our massive deployment of troops in the many countries of the world may contribute to a greater conflict. We are today in the middle of a dangerous situation between Pakistan and India over Kashmir, both of whom possess nuclear weapons and both of whom we generally finance. Exposing ourselves to such risk, while spending endless sums supporting both sides, makes no sense.

5. Our pervasive military presence may well encourage alliances that would have been unheard of a few years ago. Now that we've committed ourselves internationally to destroying Afghanistan and rebuilding it, with a promise that we'll be there for a long time, might encourage closer military alliances between Russia and China, and even others like Pakistan, Iran and Iraq, and even Saudi Arabia- countries all nervous about our military permanency in this region. Control of Caspian Sea oil is not a forgotten item for these countries, and it will not be gracefully conceded to U.S. oil interests. If these alliances develop, even U.S. control of Persian Gulf oil could be challenged as well.

6. Limits exist on how extensive our foreign commitments should be. We have our military limits. It's difficult to be everyplace at one time, especially if significant hostilities break out in more than one place. For instance, if we were to commit massive troops to the overthrow of Saddam Hussein, and Iran were to decide to help Iraq, and at the same time the North Koreans were to decide to make a move, our capacity to wage war in both places would be limited. Already we're short of bombs from the current Afghanistan war. We had to quit flying sorties over our own cities due to cost, while depending on NATO planes to provide us AWACs cover over U.S. territory. In addition, our financial resources are not unlimited, and any significant change in the value of the dollar, as well as our rapidly growing deficits, could play a significant role in our ability to pay our bills.

7. In the area of personal liberty, we face some real dangers. Throughout our history, starting with the Civil War, our liberties have been curtailed and the Constitution has been flaunted. Although our government continued to grow with each crisis, many of the liberties curtailed during wartime were restored. War was precise and declared, and when the war was over, there was a desire to return to normalcy. With the current war on terrorism, there is no end in sight and there is no precise enemy, and we've been forewarned that this fight will go on for a

long time. This means that a return to normalcy after the sacrifices we are making with our freedoms is not likely. The implementation of a national ID card, pervasive surveillance, easy-to-get search warrants, and loss of financial and medical privacy will be permanent. If this trend continues, the Constitution will become a much weaker document.

8. A danger exists that the United States is becoming a police state. Just a few decades ago, this would have been unimaginable. As originally designed, in the American republic, police powers were the prerogative of the states and the military was not to be involved. Unfortunately today, most Americans welcome the use of military troops to police our public places, especially the airports. Even before 9-11, more than 80,000 armed federal bureaucrats patrolled the countryside, checking for violations of federal laws and regulations. That number since 9-11 has increased by nearly 50%- and it will not soon shrink. A military takeover of homeland security looks certain. Can freedom and prosperity survive if the police state continues to expand? I doubt it. It never has before in all of history, and this is a threat the Congress should not ignore.

9. There is a danger that personal privacy will be a thing of the past. Even before 9-11, there were attacks on the privacy of all Americans- for good reasons, or so it was argued. The attacks included plans for national ID cards, a national medical data bank, and "Know Your Customer" type banking regulations. The need for enforcement powers for the DEA and the IRS routinely prompted laws that violated the Fourth amendment. The current crisis has emboldened those who already were anxious to impose restrictions on the American people. With drug and tax laws, and now with anti-terrorist legislation sailing through Congress, true privacy enjoyed by a free people is fast becoming something that we will only read about in our textbooks. Reversing this trend will not be easy.

10. Flying commercial airlines will continue to be a hassle and dangerous. Even travel by other means will require close scrutiny by all levels of government in the name of providing security. Unfortunately, the restrictions and rules on travel on all American citizens will do little, if anything, to prevent another terrorist attack.

11. The economic ramifications of our war on terrorism are difficult to ascertain but could be quite significant. Although the recession was obviously not caused by the attacks, the additional money spent and the effect of all the new regulations cannot help the recovery. When one adds up the domestic costs, the military costs and the costs of new regulations, we can be certain that deficits are going to grow significantly, and the Federal Reserve will be further pressured to pursue a dangerous monetary inflation. This policy will result in higher rather than lower interest rates, a weak dollar and certainly rising prices. The danger of our economy spinning out of control should not be lightly dismissed.

12. In this crisis, as in all crises, the special interests are motivated to increase their demands. It's a convenient excuse to push for the benefits they were already looking for. Domestically, this includes everyone from the airlines to the unions, insurance companies, travel agents, state and local governments, and anyone who can justify a related need. It's difficult for the military-industrial complex to hide their glee with their new contracts for weapons and related technology. Instead of the events precipitating a patriotic fervor for liberty, we see enthusiasm for big government, more spending, more dependency, greater deficits and military confrontations that are unrelated to the problems of terrorism. We are supposed to be fighting terrorism to protect our freedoms, but if we are not careful, we will lose our freedoms and precipitate more terrorist attacks.

13. Understandably, not much empathy is being expressed for members of the Taliban that we now hold as prisoners. The antipathy is easily understood. It's not only that as a nation we should set a good example under the rules of the Geneva Convention, but if we treat the Taliban prisoners inhumanly, there is the danger it will surely be used as an excuse to treat U.S. prisoners in the same manner in the future. This certainly is true when we use torture to extract information, which is now being advised. Not only does that reflect on our own society as a free nation, but torture notoriously rarely generates reliable information. This danger should not be ignored. Besides, we have nothing to gain by mistreating prisoners who may have no knowledge of the 9-11 attacks. The idea that those captured are "terrorists" responsible for the 9-11 attacks begs the obvious question.

Optimism or Pessimism?

Many realists who see the world as it really is and who recognize the dilemma we face in the United States to preserve our freedoms in this time of crisis are despondent and pessimistic, believing little can be done to reverse the tide against liberty. Others who share the same concern are confident that efforts to preserve the true spirit of the Constitution can be successful. Maybe next month or next year or at some later date, I'm convinced that, in time, the love for liberty can be rejuvenated. Once it's recognized that government has no guarantee of future success, promoting dependency and security can quickly lose it allure.

The Roman poet, Horace, two thousand years ago spoke of adversity: "Adversity has the effect of eliciting talents which in times of prosperity would have lain dormant." Since I believe we will be a lot less prosperous in the not-too-distant future, we will have plenty of opportunity to elicit the talents of many Americans.

Leonard Read, one of the greatest champions of liberty in the 20th Century, advised optimism:

 In every society there are persons who have the intelligence to figure out the requirements of liberty and the character to walk in its ways. This is a scattered fellowship of individuals- mostly unknown to you or me- bound together by a love of ideas and a hunger to know the plain truth of things. He was convinced that this remnant would rise to the occasion and do the necessary things to restore virtue and excellence to a people who had lost their way. Liberty would prevail.

Let us be convinced that there is not enough hate or anger to silence the cries for liberty or to extinguish the flame of justice and truth.

We must have faith that those who now are apathetic, anxious for security at all costs, forgetful of the true spirit of American liberty, and neglectful of the Constitution, will rise to the task and respond accordingly.