December 4, 2000

ECONOMIC UPDATE

Statement of HON. RON PAUL OF TEXAS

[Page: H 11939]

- Mr. Speaker, more and more people now are talking about an oncoming recession. I tend to agree. I think we are moving into a recession, and for good reasons. But already the question that comes up so often among politicians is, who will get blamed? Will the current President be blamed for the recession or will the next President be blamed? Will the current Congress be blamed for the recession or the next Congress?

- I do not believe either should be blamed. I think we should deal with the real cause of the business cycle, and that is the Federal Reserve system. The FederalReserve system causes and brings about a boom period in a cycle, but it also brings about the bust. Because the bust, the correction, is inevitable consequence of the boom caused by unduly inflating the money supply.

- Soon we will hear from many, we have already heard some from the financial circles as well as from politicians, to lower interest rates. This will keep the economy from turning down. It will prevent the recession from coming. And if we do have a recession, it is always said, what you do is you lower the interest rates. But dwelling on the interest rates and not talking about what it takes to lower interest rates I think is a serious mistake.

- The only way the Federal Reserve can lower interest rates is by inflating the money supply, increasing the money supply, which is the cause of our problems. So if the cause of our problem is the inflation, increasing the money supply which causes a boom, we can hardly solve our problems by further inflating. And then, too, there is a period of time in the business cycle where inflating the money supply or lowering interest rates do not get the response that many people hope for.

- Take, for instance, what is happening in Japan today. There is no response whatsoever. They take interest rates down below one percent, and they cannot generate economic activity to really get them out of their slump.

- The other irony of all this is that when we have an economic boom, another reason given for raising interest rates to slow up the economy is to stop the inflation. This is fallacious thinking because the inflation comes from the money supply. The idea that economic growth and prosperity and productivity causes inflation, that is the price type of inflation, is wrong. If we have good productivity, prices go down, they do not go up. So the whole notion that we have to slow up the economy in order to prevent inflation is absolutely incorrect.

- The problem I see is that Congress for too long has conceded too much of their authority over control of the monetary system to the Federal Reserve system, which acts in secrecy.

- It is something that is directly stated in the Constitution that the Congress shall have the responsibility over the money supply, not a Federal Reserve system. Quite frankly, the Federal Reserve system is not even authorized by the Constitution.

- Now, if in the midst of a recession the Federal Reserve decides that they want to lower interest rates but the dollar is also dropping and we lower interest rates, we cause the dollar to go down and price inflation will occur because of that. So it is not quite so simple as saying, well, let us just tell the Fed what to do, lower the interest rates and it will solve our problems.

- We have the problem of the international debt. We, as Americans, now owe more than any other country in the world. We owe $1.7 trillion. Our current account deficit is over $400 billion a month. We borrow well over $100 billion a day to support the international debt.

- The reason we should be concerned about this more so than we are is the fact that, when we are in a recession, revenues go crashing down. The inflation that occurred over these past 10 years, which was artificially created, giant revenues from capital gains from this artificially high stock market. Well that is all being reversed now, so revenues are going to go down now, and we will have to deal with this in the next Congress.

- Unfortunately, there are some who are concerned about this who say there is going to be gridlock and the two sides will not get together and the Government is now divided, the House and the Senate and the Presidency is undecided and therefore there will be gridlock. Quite frankly, I do not think that will happen. I sort of would hope that we would have some gridlock.

- What I think is going to happen is that once the recession sets in and there is a need for additional spending and there will be no longer a concern at all about the deficit; and that is when the Congress will spend, the Federal Reserve will inflate. And it may temporarily help, but in the long-run it does not do the trick. It is not the way we gain economic prosperity out of a printing press. We just cannot allow a Federal Reserve to believe it creates capital by creating credit out of thin air.

- We will soon be hearing a lot about interest rates. There will be a loud clamor from all quarters for the Fed to lower interest rates. It will be argued that it is necessary in order to help stop the stock market slide/crash and also to stimulate a sagging economy.

- What we must remember though, is that every time someone pressures the Fed to lower interest rates, they are saying to the Fed that the money supply must be inflated. The only tool the Fed has for lowering interest rates is to increase the supply of money. They are arguing the case for further systematic and deliberate debasement of the US dollar. Those who chant for lower interest rates are literally attacking the dollar.

- And yet, depending on many variables, a deliberate attempt by the Federal Reserve to lower interest rates may instead lead to higher interest rates and precipitate a period of accelerating price inflation. Instead of boosting the stock market, this effort can do the opposite by producing conditions that will lower the stock market and do nothing to avert the economic slump that more people are now worried about.

- Congress should be prepared for some surprises in the not-to-distance future. A slumping economy or definite recession will obviously lower revenues. This will reverse the illusion of the grand surpluses that everyone has been anxious to spend. Instead of expenditures being held under control, expect them to rise rapidly.

- Many are starting to talk now about a legislative stalemate with no clear majority in the House or Senate and the Presidency being uncertain. This concern about a stalemate is overblown. Not that the problem isn't serious, but I am certain that under the conditions that we are about to experience, the Congress and the President will be all too willing to deal with the deteriorating conditions with increased spending and with a concerted bi-partisan effort to pressure the Federal Reserve to further inflate the currency in pursuing the fiction that the Federal Reserve can prevent a "hard landing" by merely increasing the money supply in an effort to dictate short-term Fed funds rates.

- Although this will not be the impasse that many anticipate, the actual capitulation by both parties to deal with the oncoming economic slowdown will actually be more harmful than gridlock because Congress will undoubtedly do more harm than good to the economy.

- For decades now the Federal Reserve has followed a policy of "fine-tuning" the economy and with the relative success of the recent boom cycle, it has been deceived into believing its ability is more than it actually is. But in this effort to fine-tune the economy the Federal Reserve, since the middle of 1999 until May of this year, has systematically raised the Fed's fund rates from 4.75% to 6.5%.

- The explanation was that economic growth, when not controlled, leads to price inflation and therefore the economy had to be "cooled." A healthy free market economy should never have to be cooled, it should only be encouraged.

- Ironically it's argued that the deliberate raising the cost of borrowing money for everyone is that this will hold prices in check. Yet consumers and businesses suffer from this additional cost - pushing all prices upward. But even more ironic is the claim that they now care about "inflation" after a decade of massive monetary inflation-the real culprit.-The Federal Reserve meanwhile ignores the fact that the money supply is key to monetary policy, not admitting the damage has already been done.

- Signs of economic slowdown are now all around with the seriously slumping stock market being the most visible and eliciting the most concern. As the slowdown spreads and accelerates the politicians will be anxious to advise the Chairman of the Federal Reserve, Alan Greenspan. Politicians from both sides of the aisle will become deeply and especially concerned when the evidence is clear that the revenues are plummeting and the "surplus" is disappearing. Since this will challenge the ability of the politician to continue the spending spree many will become deeply and vocally concerned.

- The big debate already started in the financial and political circles is when, how much, and how quickly the Federal Reserve should lower interest rates. Indeed all will clamor to lower rates to revive the economy again. With the signs of rising prices in many sectors, especially energy, and in spite of the weak economy we can expect the Federal Reserve chairman to issue precautionary statements. He will reiterate that he must watch out for the resurgence of (price) inflation. In spite of his statements about concerns for inflation, if the stock market slumps and the economic slowdown is significant enough, we can be certain of one thing, the money supply will continue to grow rapidly in an attempt to keep interest rates low. But Mr. Greenspan will never admit that inflating is exactly what he's been generously doing for the past 13 years.

- A short time after Chairman Greenspan took over the reigns of the Federal Reserve the stock market crash of 1987 prompted him to alleviate concerns with a heavy dose of monetary inflation. Once again, in the slump of 1991 and 1992, he again re-ignited the financial bubble by more monetary inflation. There was no hesitation on Mr. Greenspan's part to inflate as necessary to alleviate the conditions brought about by the Mexican financial crisis, the Asian crisis, the Russian ruble crisis, and with the Long-Term Capital Management crisis. Just one year ago the non-existent Y2K crisis prompted huge, unprecedented monetary inflation by the Federal Reserve. All these efforts kept interest rates below the market rate and contributed to the financial bubble that is now starting to deflate. But, there is no doubt that this monetary inflation did maintain an economy that seemed like it would never quit growing. Housing markets thrived, the stock market and bond market thrived, and in turn, the great profits made in these areas, especially gains made by stock market transactions, produced profits that inflated greatly the revenues that flowed into the Treasury. The serious problem that we now face, a collapsing stock market and a rapidly weakening economy, was caused by inflating the money supply along with artificially low interest rates. More inflation and continuing the policy of artificially low interest rates can't possibly be the solution to the dilemma we face.

- We should never blame economic growth as the culprit. Instead artificial growth, mal-investment, overcapacity, speculation, and excessive debt that comes from systematic monetary inflation should be blamed, since these are all a result of Federal Reserve Board policy. Let there be no doubt political and financial leaders will demand lower interest rates in order to alleviate the conditions that are developing. But just because a boom can come from generous Fed credit, it doesn't mean the bubble economy can be maintained or re-inflated by easy credit once a correction sets in.

- Besides, Alan Greenspan knows full well that the scenario we are now experiencing can be made worse by lowering interest rates. Under the conditions we are facing it's very likely the dollar will weaken and deliberately lowering interest rates will accelerate this trend. Price inflation, which the Fed claims it is so concerned about, will not necessarily go away even with a weak economy. And the one thing we will come to realize that even the best of all central bankers, Alan Greenspan, will not be able to determine interest rates at all times of the business cycle. Inflation premiums, confidence, the value of the dollar, and political conditions all can affect interest rates and these are out of the control of the Federal Reserve Board.

- Congress definitely should be concerned about these matters. Budgetary planning will get more difficult as the revenues spiral downward and spending does the opposite. Interest on the national debt will continue and will rise as interest rates rise. The weak dollar, lower stock markets and inflation can affect every fixed income citizen, especially the Social Security beneficiaries. We can expect the World Trade Organization=s managed trade war will actually get much worse under these conditions. Military conflict is not out of the question under the precarious conditions that are developing. Oil supplies are obviously not secure, as we have already seen the run up of prices to dangerously high levels.

- The question is what should one expect the Federal Reserve Board to eventually do? We can expect it to continue to inflate as they have always chosen with every crisis. There's no evidence that Alan Greenspan would choose to do anything else regardless of his expression of concern about inflation and the value of the dollar. Greenspan still believes he can control the pain and produce a weakened economy that will not get out of control. But there's no way that he can guarantee that the United States might not slip into a prolonged lethargy, similar to what Japan is now experiencing. We can be certain that Congress will accommodate with whatever seems to be necessary by bailing out a weakened financial sector.

- But all this will be done at the expense of the dollar. This is a dangerous process and makes our entire economic and financial system vulnerable.

- We must someday recognize that neither Congress nor the Fed is supposed to "run" the economy. Yet we still live with the belief that the Administration, our Presidents, our Congress and the Federal Reserve should run the economy. This is a dangerous concepts and always leads to the painful corrections to so-called the good times for which everyone is anxious to take credit.

- Congress does have responsibility for maintaining a sound dollar and a free market and not much else. Unfortunately this responsibility that is clearly stated in the Constitution is ignored.

- A major financial crisis is possible since the dollar is the reserve currency of the world, held in central banks as if it were gold itself. The current account deficit for the United States continues to deteriorate, warning us of danger ahead. Our foreign debt of $1.7 trillion continues to grow rapidly and it will eventually have to be paid.

- Action by the Congress and the Federal Reserve will most likely make the correction that is now starting much worse. Also, under conditions such as these, personal liberty is always vulnerable to the advocates of big government. It is well known that during the times of military wars personal liberties are in endangered. Social wars such as the war on drugs are notorious for undermining the principles of liberty. So too, under economic conditions that are difficult to understand and deal with, personal liberty comes under attack. This should concern us all.