May 15, 2000

MANIPULATING INTEREST RATES

Statement of HON. RON PAUL OF TEXAS

[Page: H3034]

- The national debt is rising at an annual rate of a $100 billion per year while the federal government obligation to future generations is rising even faster. Yet, little concern is shown in Congress as our budgets grow and new programs are added on to old. Ordinary political deception has been replaced with the dangerous notion of invincibleness as members claim credit for imaginary budgetary surpluses. The percent of our income that government now takes continues to rise, while personal liberty is steadily compromised with each new budget. But the political euphoria associated with the "New Era" economy will soon come to an end.

- Although many have done well during the last seven years of economic growth, many middle-income families have had to struggle just to keep up. For them, inflation is not dead and the easy fortunes made on Wall Street are as far removed as winning the lottery. When the economy enters into recession, this sense of frustration will spread.

- Business cycles are well understood. They are not a natural consequence of capitalism but instead result from central bank manipulation of credit. This is especially true when the monetary unit is undefinable as it is in a fiat monetary system, such as ours. Therefore, it is correct to place blame on the Federal Reserve for all depressions/recessions, inflation, and much of the unemployment since 1913. The next downturn, likewise, will be the fault of the Fed.

- It is true that the apparent prosperity and the boom part of the cycle are a result of the Federal Reserve credit creation, but the price that must always be paid and the unfairness of inflationism makes it a dangerous process.

- The silly notion that money can be created at will by a printing press or through computer entries is eagerly accepted by the majority as an easy road to riches, while ignoring any need for austerity, hard work, saving, and a truly free market economy. Those who actively endorse this system equate money creation with wealth creation and see it as a panacea for the inherent political difficulty in raising taxes or cutting spending.

- A central bank that has no restraints placed on it is always available to the politicians who spend endlessly for reelection purposes. When the private sector lacks its appetite to lend sufficiently to the government, the Federal Reserve is always available to buy treasury debt with credit created out of thin air. At the slightest hint that interest rates are higher than the Fed wants, its purchase of debt keeps interest rates in check; that is, they are kept lower than the market rate. Setting interest rates is an enormous undertaking. It's price fixing and totally foreign to the principles of free market competition.

- Since this process is economically stimulating, the politicians, the recipients of government largess, the bankers, and almost everyone enjoys the benefits of what seems to be a gift without cost.

- But that's a fallacy. There is always a cost. Artificially low interest rates prompt lower savings, over-capacity expansion, mal-investment, excessive borrowing, speculation, and price increases in various segments of the economy. And since money creation is not wealth creation, it inevitably leads to a lower value for the currency. The inflation always comes to an end with various victims, many of whom never enjoyed the benefits of the credit creation and deficit spending.

- This silly notion of money and credit gives rise to the conventional wisdom that once the economy gets really rolling, it's time for the Fed to stop economic growth. The false supposition is that economic growth causes higher prices and higher labor costs, and these evils must be prevented by tightening credit and raising interest rates. But these are only the consequences of the previous monetary expansion and blaming rising prices or higher labor costs is done only to distract from the real culprit-monetary inflation by the Federal Reserve.

- In a free market, economic growth would never be considered a negative and purposely discouraged. It is strange that so many established economists and politicians accept the notion of dampening economic growth for this purpose. Economic growth with sound money always lowers prices-it never raises them. Deliberately increasing rates actually increase the cost of all borrowing, and yet it's claimed that this is necessary to stop rising costs. Obviously, there's not much to the soundness of central economic planning through monetary policy of this sort.

- There are some who see this fallacy and object to deliberately slowing the economy but instead clamor for even more monetary growth to keep interest rates low and the economy booming. But this is just as silly because that leads to even more debasement of the currency, rising prices, and instead of lowering interest rates will in time, due to inflationary expectation, actually raise rates.

- Fine-tuning the economy, through monetary manipulation is a dangerous game to play. We are now completing nearly a decade of rapid monetary growth and evidence is now appearing indicating that we will soon start to pay for our profligate ways. The financial bubble that the Fed manufactured over the past decade or two will burst and the illusion of our great wealth will end. In time, also the illusion of "surpluses for as far as the eye can see" will end. Then the Congress will be forced to take much more seriously the budgetary problems that it pretends do not exist.