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MONEYBOX

End the Fed? Actually, Maybe Not.

Now that Ron Paul actually has some power over the Fed, what is he going to do with it?

By Annie Lowrey
Posted Wednesday, Feb. 9, 2011, at 6:45 PM ET

Rep. Ron Paul's feelings about America's central bank are a matter of public record. An extensive public record: In dozens of congressional hearings over the past four decades, he has ribbed, cajoled, harassed, or annoyed any representative or defender of the Federal Reserve brave or unlucky enough to appear before him.

Normally, his interrogations concern America's profligate money printing, Congress' unnecessary spending, the Fed's secrecy, and, especially, gold, which he believes should underpin the currency to render it sound. But his distrust runs wide and deep. Consider this comment from a 2007 hearing: "This whole notion that a central bank somehow has the wisdom to know what interest rates should be is, to me, rather bizarre. And also the source of so much *mischief.*"

That first sentence is a neat encapsulation of his economic worldview. And the second could well apply to Paul himself. His career in and out of public office has been devoted to two propositions: 1) The Fed is bad. 2) The gold standard is good. His consistency has been impressive—which is not to say he has been influential. He rarely gets satisfactory answers in hearings, and he'll probably never get satisfaction in his long, lonely crusade to radically alter America's monetary policy.

But if you tilt at windmills long enough, sometimes you hit. And on Wednesday, Paul did: He held his first-ever hearing as chairman of the House Financial Services Committee's subcommittee on monetary policy, inviting two Austrian-school economists and one lonely representative from the left-leaning Economic Policy Institute to debate how Fed policy affects the unemployment rate.

This may be Ron Paul's moment. The question now is what he does with it.

It was on Aug. 15, 1971, that Paul had his monetary-policy epiphany. That day, the Federal Reserve shut its "gold window," meaning foreign governments could no longer trade gold for dollars at the fixed rate of $35 an ounce. The Bretton Woods system officially ended and the dollar became fully "fiat currency," backed by nothing but the promise of the federal government. It shocked Paul, then a successful Texas obstetrician. "That's why I ran for Congress," Paul told me. He was first elected to the House in 1976, running as a Republican on a limited-government platform.

Paul has since bounced in and out of Washington, serving from 1976 to 1977, 1979 to 1985, and 1997 to the present. During that time, he has supported cutting defense spending, ending the Department of Education, stopping welfare, and slashing taxes. But he's best known for his unrelenting—and unchanging—skepticism of the Fed. Paul believes it stokes inflation and will harm the U.S. economy as long as it persists. Gold, he thinks, is the answer.

His monetary policy quest has been quixotic. The closest Paul came to getting the gold standard reconsidered—let alone reinstated—came in 1981. At the beginning of the Reagan administration, Paul sat on a commission appointed to debate whether the United States might benefit from returning to commodity-backed money. Reagan had a "slight bias toward gold and its disciplines," Treasury Secretary Donald Regan told reporters at the time. But in a final report, released March 31, 1982, the panel rejected the idea.

Despite the rejection, the next day's papers described Paul as jubilant. "For the first time in 50 years they seriously considered it," he said, releasing a dissent. "I do think that in due time, possibly even in this decade, there will be another serious discussion of gold as a monetary standard. I still do believe that gold is *the* money."

That serious discussion never really happened, though not for a lack of trying on Paul's part. "I think for 20 years or so, they just wished I would go away," Paul explains, referring to the Fed officials he repeatedly took to task on the Hill. "They thought I was a nuisance." But he kept bothering them. He promoted his ideas on monetary policy through his Foundation for Rational Economics and Education (acronym: FREE), his *Ron Paul Investment Letter*, and other publications. He brought national, if fleeting, attention to them during his failed 1988 presidential campaign. But for the most part, he and his ideas became something of a sideshow—he became seen as a crank, a radical, so far outside the mainstream he could be safely ignored.

That changed in 2008, when he ran for president again. This time, the run brought him cult-icon status. The very phrase "end the Fed"—the title of his most recent book—comes from his campaign. In it, he describes visiting a University of Michigan campus after an October 2007 Republican primary debate. To his surprise, when he "mentioned monetary policy, the kids started cheering. Then a small group chanted, 'End the Fed! End the Fed!' The whole crowd took up the call. Many held up burning dollar bills, as if to say to the central bank, you have done enough damage to the American people."

He remains an iconoclast even within his own party, and his actual legislative proposals tend to go nowhere. Since 1997, he has acted as the primary sponsor of 422 bills. Just four of those have ever made it to the floor of the House for a vote: a bill withdrawing the United States' support for the World Trade Organization, a bill recognizing the Hispanic

Chamber of Commerce, another commending a NASA mission, and one granting some property to the Galveston Historical Foundation. Only the last became law.

But last year Paul had what may be his greatest triumph as a legislator. He and other members of Congress successfully placed a provision to perform an audit of the Federal Reserve into the Dodd-Frank law, against the strong opposition of both the Fed and the Obama administration. The bill also forced the bank to release the details of 21,000 loans granted to financial firms during the credit crunch. Now Paul is in charge of the House subcommittee that actually oversees the Fed. That might cause some awkward moments, to say the least. The title of his book is not misleading. The central bank "is immoral, unconstitutional, impractical, promotes bad economics, and undermines liberty," he writes.

That's part of the reason he supports reinstating the gold standard, which would obviate the need for a monetary policymaking apparatus as well as rein in government spending and end inflation. Talk of a return to a gold (or silver) standard for the dollar has moved from the fringe toward the mainstream, if not into it. A dozen state legislators have proposed locally instating gold standards or, at least, commodity payment systems.

"I believe that freedom itself is at stake in this struggle," Paul says in *End the Fed.* Just a few years ago, he reiterated the point to *New York Times*: "We will go back to the gold standard, even if it takes the near-destruction of the dollar to get there."

The financial crisis and ensuing recession brought about an enormous wave of anti-Fed sentiment. In 2009 a poll found the Fed less popular than any other federal entity, including the Internal Revenue Service. "In the minds of the public, the Fed was the great enabler of this huge catastrophe that we've had since the panic of 2008," says Steve Hanke, a professor at Johns Hopkins University and senior fellow at the Cato Institute. "And I think the general consensus is that they remain the source of a lot of the problems we're facing right now as well."

In the sweep of the Fed's history, such criticism is hardly unusual, says Sarah Binder, a George Washington University professor and fellow at the Brookings Institution. "There is always Fed-bashing that ebbs and flows, coming from the strange bedfellows, from the far left and the far right," Binder says. (This remains true: Paul joins politicians like social democrat Sen. Bernie Sanders in his Fed-bashing.) "When the economy sours, we hear more criticism."

Still, there is a case to be made that this time is different. The severity of the recession prompted the Fed to take truly extraordinary measures to stabilize the banking sector during the credit crunch—measures that even Fed officials admit might not have been totally legal. It accepted more than $1 trillion in junk-rated assets as collateral, something it never had never done before the crisis. And it was not just Goldman Sachs and Lehman Bros. availing themselves of the Fed's largesse—it was Caterpillar and the Korean Development Bank.

"It was a little surprising, in the scope of the data dump, seeing just how impaired some assets were," says Vincent Reinhart, a fellow at the American Enterprise Institute and former Fed official, referring to the 21,000 released transactions. "The Fed did overstate the quality of loans."

Binder also acknowledges that the Fed might have overstepped far enough to generate some real headaches. "The independence of the Fed has really been compromised by what happened during the financial crisis," she says. The bank "went far [beyond] what we think of as traditional monetary policy. And the Fed's independence, which it could always fall back on—they don't have that cushion of comfort anymore. There is aggressive and ambitious criticism coming from a lot of fronts."

The Fed has noticed and is taking steps to respond. Bernanke himself has deigned to appear on *60 Minutes,* going so far as to give a tour of his childhood home in Dillon, S.C. He has visited college campuses, explaining the crisis in clear if professorial terms. He has courted members of Congress and journalists. More overt pandering comes from the St. Louis Federal Reserve Bank, which is hosting a $1,000 competition for the best YouTube video stressing the importance of an independent central bank. "What makes independence for a nation's central bank important?" the promo asks. "Let us know through your video creation!"

But Paul's adversary is not only the Federal Reserve. It is also mainstream monetary economics itself. As a devotee of the Austrian school, whose luminaries include Friedrich Hayek and Ludwig von Mises, Paul stands firmly outside current policymaking and academic circles, a point he enthusiastically admits. (The Austrian economists also often quibble with other libertarians, like those at Cato.) His beef is not with how central bankers do their jobs; it's with central banking itself.

"The Fed, rightly so, criticizes Congress for spending too much—but they make the money available to us!" he told me. "It buys debt, keeps interest rates low, and *sticks it* to the people who want to save and make money. It is so unfair. And I think it is the first time in the history of the Fed that people realize it is not their friend. It just gives us booms and busts."

Many economists disagree, with varying degrees of vehemence. One of the gentler responses comes from Reinhart, the former Fed official and current AEI scholar: "There is tremendous complexity in the monetary and banking systems now, and Ron Paul is basically saying: 'Let's make everything simple again. If we could make market discipline effective, we wouldn't need such complicated regulation. If we had the gold standard, we wouldn't need complex monetary policy. But the issue is: How do we get from here to there? There might not be a way. And at some point, it is just nostalgia for a time that never really existed."

Indeed, many economists point to evidence that banking crises and recessions were much, much more severe leading up to the Great Depression and the advent of modern monetary policymaking. They also note that the Fed's extraordinary monetary policy in 2008 and 2009 did stabilize the banking sector, boost GDP, and keep up employment.

But Paul is not always happy to entertain such counterfactuals or criticisms. For instance, I asked him who he considers his most trenchant critic. He paused before responding, "I did like talking to Paul Volcker." I also asked whether there were any economists or economic theories that had changed his views since the 1970s, when he first became a devotee of the Austrian school. "I mostly go back to the Austrian economists," he said, matter-of-factly.

In testimony, Paul's dogmatism also shines through. Bernanke—whom Paul described today as "arrogant" and "cocky"—has, for instance, tried to convince him that the dollar is in no danger of crisis in numerous testimonies. Paul has swatted the notion away.

When I asked Paul about this, he maintained the Fed has set us up for a currency crisis down the road. "It won't be as bad as Zimbabwe," he says. "But perhaps something like 1979 or 1980." He noted that geopolitical events often kick of economic ones. "The revolutions in the Middle East, that could end up being the precipitating event," he said. "Tunisia, Egypt—they may well tumble."

Paul might be steadfast in his beliefs, but he has few plans to impose them on an unsuspecting America. He is, in fact, honest about what would happen if his fondest wishes came true. "If tomorrow we closed the Fed and started using a gold standard, it would be so chaotic nobody would know what to do," he says. "There are interim positions, such as allowing competition in currencies." But, he admits, "People aren't ready for that. It's complicated—it is very complicated."

Rather than returning America to the banking system of the 1890s, then, Paul has adopted a somewhat more modest mission: Keeping alive the current conversation about the Fed. It's a conversation that some economists and think tank scholars say can't hurt. "We have not seen a lot of hearings on monetary policy from the monetary policy subcommittee," notes Mark Calabria, the director of financial regulation studies at the Cato Institute. "To a certain extent, a lot of members of Congress don't want to bother with the topic. The way I see it, Paul will attempt a public-information campaign. It is not going to be the end of the world for the Fed."

On Wednesday, that first hearing came to pass. Paul's subcommittee invited three economists to debate the question that was also the hearing's title: "Can Monetary Policy Really Create Jobs?" The economists were Thomas DiLorenzo of Loyola University Maryland, Richard Vedder of Ohio University, and Josh Bivens of the Economic Policy Institute. The answers were no, no, and yes.

Committee hearings are rarely enlightening, as members of Congress and testifying witnesses compete to get their sound bites into the record. But this hearing proved particularly shambolic. The conversation lurched from the Fed's dual mandate to quantitative easing to the Dodd-Frank bill to China to price stability to the money supply to money volatility to universal default laws—resting only briefly on the subject of monetary policy and unemployment. The economists were so ideologically at odds—DiLorenzo and Vedder both from the tiny, heterodox Austrian school and Bivens representing nonpartisan but progressive EPI—that they agreed on virtually nothing except for the faults of the North American Free Trade Agreement.

Then, the ranking committee member, Democrat Rep. Lacy Clay, really set off fireworks. He began by criticizing the Austrian school, saying it was marked by its "lack of scientific rigor and rejection of empirical data." (Paul sat next to him poker-faced.) Then he attacked DiLorenzo, noting he is perhaps best known for a "revisionist" history of Abraham Lincoln—and, more to the point, holds an affiliation with the League of the South, a "neo-Confederate" "hate group" that seeks to build a society dominated by those of European backgrounds. "After reviewing your work and the so-called message you employ, I still do not understand you being invited to testify today on the unemployment situation," Clay said. "But I do know that I have no questions for you."

But Paul seemed upbeat at the hearing's end: The subcommittee accomplished his stated goal of bringing outside perspectives into Congress and letting criticism of the Fed fly. "Everybody knows that I believe in free markets and sound money and I'm a critic of Federal Reserve policy," he said. "That was the point I wanted to get across." In this Congress, he will have ample opportunity to do so.

*Annie Lowrey reports on economics and business for **Slate**. Previously, she worked as a staff writer for the* Washington Independent *and on the editorial staffs of* Foreign Policy *and* The New Yorker. *Her e-mail is annie.lowrey@slate.com.*

Article URL: http://www.slate.com/id/2284503/