Ron Paul mines for gold in quest to bury Fed

By Dan Freedman
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WASHINGTON - In Rep. Ron Paul's fantasy playbook, abolition of the Federal Reserve and restoration of the gold standard would usher in an era of reduced government, economic growth and jobs, jobs, jobs.
Conversely, maintenance of the Fed's hand on the money printing press - with no substance to back up the dollar - would mean more and more government spending, economic stagnation and continuing high unemployment.

Paul is a long-shot candidate seeking the GOP presidential nomination, so it's unlikely he'll have a chance to realize his economic visions anytime soon. But that doesn't stop the wily 76-year-old Texas lawmaker, a libertarian conservative, from railing against the Fed and the missing gold standard, casting them as the twin boogeymen underpinning the economic degradation of America.

His cadre of followers continues to eat it up.

"You have this deep recession, people are angry, and they want someone to blame," said Larry Sabato, director of the Center for Politics at the University of Virginia.
"Well, the Fed is a great target because most people don't have a clue about it. If you have to find a scapegoat, find one that's anonymous and can't fight back."

So even in the long run, what would a Ron Paul economy look like? What would be the impact of abolishing the Fed and returning to the gold standard?

Congress established the Fed in 1913 in the wake of a financial downturn in 1907. The aim, then and now, was to get a grip on gyrating prices and interest rates, promote employment and control inflation.

The Fed controls the money supply and sets a key interest rate. In this way, the Fed keeps its foot alternating between the clutch, the gas pedal and the brakes, trying to make sure the economy is on cruise control through good times and bad.

But Paul and other critics contend that's not how it really works.

The Fed permits the government to accumulate debt while it sets interest rates artificially low in an effort to stimulate the economy.

The result, critics say, is a devalued currency, disincentives to save and invest, low job growth and possible inflation.

Doing away with the Fed would end "the uncertainty and politicization of money," said James Dorn of the libertarian Cato Institute, who also teaches economics at Towson Universityoutside Baltimore.

Risk to stability

More mainstream economists dismiss the idea of ending the Fed as risky, arguing that it remains the bulwark of economic stability, whatever its flaws.

"If you take away the Fed's ability to maneuver interest rates, recessions would be a lot deeper and it would take much longer to recover," said Josh Bivens, an economist at the liberal-leaningEconomic Policy Institute.

Because of the Fed's active role in the economy, recent downturns have been less severe, Bivens argued. "In a way, the Fed is a victim of its own success," he said.

Gold's heyday

In its heyday before World War I, the gold standard guaranteed the exchange rate between printed dollars and ounces of gold. Conservative economists grow misty-eyed at the thought of the years between 1880 and 1914 - the "classical gold standard" era - when gold was pegged at $20.67 an ounce and inflation remained low. Despite peaks and troughs, the economy often steamed ahead and jobs were relatively plentiful.

The government's spending needs during two world wars and the Great Depression eroded the gold standard.

Nixon's choice

President Richard Nixon, a Republican, ended it for good in 1971 to bolster confidence in the dollar at a time of high inflation and a growing trade deficit.

Gold standard defenders believe its downfall essentially set the dollar adrift in a sea of speculation, making it an easy mark for manipulation by the Fed. The dollar became what the financial world calls a "fiat currency," money without intrinsic value.

"The dollar has no anchor," Dorn of the Cato Institute said. "Its value has steadily fallen since President Nixon closed the gold window."

Opening that window again, he added, would shore up the dollar, stabilize interest rates at realistic levels, reduce the size of government, and encourage savings and investment.

Opponents of the gold standard aren't so sure.

A dollar tied so closely to the price of gold would put pressure on interest rates at times when the government has to sell large quantities of bonds, such as during World War II.