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E-conomy

Struggling economy puts Ron Paul's views in spotlight

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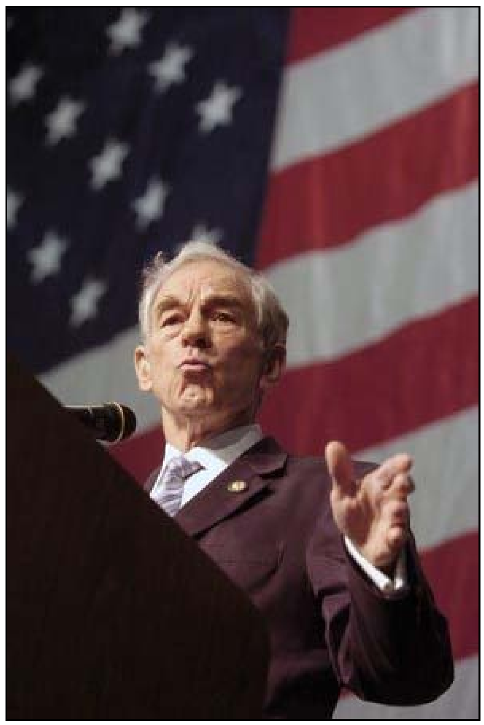

enlarge — JEFF GENTNER / AP

Rep. Ron Paul, R-Texas, unsuccessfully ran for president, but his anti-Fed message has drawn support because of the central bank's failure to restrain the flood of cheap money.

No longer. With the economy still struggling and political divisions deepening, Paul's ideas are gaining a wider audience and are helping to shape a potentially historic battle over economic policy, a struggle that will affect everything including jobs, growth and the nation's place in the global economy.

Paul's long-derided proposal to give Congress supervisory power over the traditionally independent Federal Reserve appears to be on its way to becoming law. His warnings on deficits and inflation are Republican mantras.

And, with this year's congressional election campaign looming, the Texas congressman's deep-seated distrust of activist government has helped fuel protests such as the tea-party movement, harden partisan divisions in Washington, D.C., and stoke public fears about federal spending and the deficit.

"People are wondering what went wrong. And they're not happy with what the government is offering up," said James Grant, editor of Grant's Interest Rate Observer, offering an explanation for why seemingly wonkish arguments over interest-rate policy and the money supply are spilling into the lives of ordinary Americans.

Some of Paul's most extreme views remain beyond the pale for most economists. Despite the eroding value of the dollar, no one expects the United States to return to the gold standard, as Paul advocates; most economists believe that could wreck the economy.

In less drastic forms, however, Paul's ideas are being welcomed by conservatives and viewed with foreboding by liberals. For conservatives, runaway inflation constitutes the biggest potential threat to the nation's future. Liberals worry that cutting back stimulus efforts too soon could slow or halt the current recovery.

The debate over that question — what the basic thrust of U.S. economic policy should be — is likely to dominate coming elections and federal policymaking.

Paul and his fellow conservatives are on the offensive. President Obama and congressional Democrats are repeatedly pledging not to increase the deficit and to begin cutting back soon.

"I think we're going to be in for more revival of fiscal responsibility," said William Niskanen of the libertarian Cato Institute, who headed the Council of Economic Advisers under President Reagan.

Niskanen sees the Texas Republican's increasing influence as stemming from the continued economic weakness. "To this extent, Ron Paul gains voice," he said.

Paul would go a lot further in cutting back the government's role than even free-marketers such as Niskanen support. If Paul had it his way, for example, he would do away with the Fed entirely.

Such rhetoric once might have been dismissed as extremism. But Paul's anti-Fed message has drawn broad support because of the central bank's failure to restrain the flood of cheap money and excessive risk-taking in the years leading up to the financial crisis.

It has stirred rallies on college campuses and supportive commentaries from Wall Street pundits. More than 300 representatives in Congress have embraced Paul's ideas for reining in the Fed.

The response "is even more than I ever dreamed," Paul said, reminiscing about one evening during his 2008 White House run when University of Michigan students chanted "End the Fed" and burned dollar bills.

Paul, 74, understands that historical circumstances have thrust his ideas to the fore. "An intellectual fight is going on," he said.

He traces his economic views to his frugal upbringing in Pittsburgh at the tail end of the Great Depression. He saved pennies from delivering newspapers and helping out his father's small dairy business.

His first economics class at Gettysburg College was an eye-opener, Paul said. When a professor explained how banks keep only a tiny part of their deposits on hand and earn money by lending the rest, Paul discovered one of the "tricks" of the financial system.

Beyond that, his ideas are grounded in the work of economic thinkers from an earlier era who focused on problems similar to those besetting the United States today.

In particular, Paul is a disciple of Ludwig von Mises, an Austrian theorist born at the end of the 19th century who contended that government intervention in an economy would fail because free markets were better at allocating resources and fueling growth.

Having lived through Germany's devastating hyperinflation in the early 1920s, which helped pave the way for Adolf Hitler, Mises wrote long before the Great Depression that overgenerous credit policies would encourage excessive borrowing, creating a boom and then a bust.

Mises' ideas became central to what is known as the Austrian School of Economics, which emphasized tight controls on credit and money supply, a strategy that discouraged financial ups and downs but tended to slow growth.

By 1940, when Mises arrived in America, most Western economists had embraced the competing theories of Britain's John Maynard Keynes, who called for government to stimulate the economy by spending on infrastructure and cutting interest rates.

Obama largely has followed the Keynesian script, as George W. Bush did when the economic crisis broke.

Paul's once-lonely espousal of the Austrian School's ideas has received new impetus from conservative economists and Republican political strategists

"A lot of good ideas were shoved aside because of the Depression and the rise of the Keynesian view of the world," said George Selgin, an economics professor at the University of Georgia.

Paul contends that Austrian economics explains the most recent financial meltdown: "It says if you inflate too much, if you have no restraint on monetary authorities, you're going to bring on a crisis."

Now, Paul says, administration policies are leading the country toward disaster.

Selgin and many mainstream economists agree that pumping too much money into the economy can lead to trouble, but they say Paul goes too far.

The U.S. economy began pulling out of the Depression in the 1930s, thanks to federal easing of monetary policy, say Selgin and many other economists, including Fed Chairman Ben Bernanke.

The economy tipped back into depression after the reins were tightened too soon.

"In this aspect of the monetary system," Selgin said of Paul, "he's just blown it."

Like Mises, whose portrait hangs on his Washington, D.C., office wall, Paul is intransigent, however, and that has earned him an ardent following.

"His views are strong and hardheaded, but you've got to stand firm or you'll get blown over in this world," said Mark Skousen, editor of the newsletter Forecasts & Strategies and a former economics professor at Columbia University.

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