United States House of Representatives
Committee on Financial Services
Hearing on Monetary Policy and the State of the Economy
July 18, 2012

Congressman Ron Paul
Statement for the Record

Mr. Chairman, I thank you for calling this hearing today on monetary policy and the state of the economy. For the past few years the Federal Reserve has received criticism from all sides of the political spectrum, and rightly so, for its unprecedented intervention into the economy and its bailouts of large Wall Street banks and foreign central banks. Yet this criticism risks losing sight of the most insidious result of the Fed's actions, which is to enable the growth of government.

For nearly the first 40 years of its existence, the Fed operated as an adjunct of the Treasury Department, tasked with purchasing government debt in order to keep the government's borrowing costs low. Even after gaining its vaunted "independence" from Treasury in 1951, the Fed never shrank from enabling the growth of government. The extraordinary monetary policy of the last four years has reaffirmed that the Fed, its protestations to the contrary notwithstanding, is only too willing to enable growing government spending and massive fiscal deficits.

For centuries, banks have received special privileges from government in exchange for funding the government's wars. The creation of the Federal Reserve System in 1913 formalized and centralized this arrangement in the United States. From the very beginning, the Fed was intended to provide a more liquid market for federal government debt, enabling the growth of big government.

What we've seen over the last century is nothing less than the remaking of American government, thanks in large part to the Fed. Its loose monetary policy gave rise to: (i) the welfare state, encouraging dependency on government largesse and destroying the work ethic and family life of lower-income Americans; (ii) the warfare state, allowing the U.S. government to involve itself in wars of aggression around the world; and (iii) the regulatory state, the mammoth bureaucracy that relentlessly grinds away at the rights of the American people.

Little more than a decade ago, Fed economists were wringing their hands over the prospect that the federal government might pay off the national debt. Nothing could be worse for the Fed, because the Fed's monetary policy operations require the existence of government debt. Treasury debt is purchased from or sold to banks on the open market in order to influence interest rates. Without government debt, the Fed would have no idea how to conduct monetary policy. From a free market perspective this would be wonderful, as it is Fed monetary policy which largely creates the booms and busts of the business cycle. Unfortunately, the federal government has run up the national debt to unprecedented levels over the past decade, and the Federal Reserve has been right there, monetizing that debt to ensure that none of it goes unsold.

While the desire of foreign countries and private investors to purchase Treasuries was drying up, the Federal Reserve was only too willing to step in and enable the government to continue its deficit spending. The Fed's balance sheet exploded as it purchased over one trillion dollars in Treasury debt over the past few years. And before it did that, the Fed also purchased over a trillion dollars of overrated mortgage-backed securities from Wall Street banks, giving those banks the cash they needed to purchase Treasury debt of their own. Were it not for the Federal Reserve's actions, the federal government would not have been able to run trillion-dollar deficits for the past several years.

In fact, had the Federal Reserve never been created, the federal government never would have been able to run up a $16 trillion debt. No market actor would lend money to such a major debtor at such low interest rates. The only reason that banks are willing to buy Treasury debt at such low interest rates is because they can easily resell that debt to the Fed.

Without the Fed, interest rates would rise to such levels that the federal government would have no choice but to curtail its expenditures and focus only on doing what is truly necessary. With market discipline allowed to prevail, the size of the federal government would be drastically smaller. If Congress were really serious about limiting the size of government, it would eliminate the most important enabler of government profligacy by ending the Fed.