U.S. House of Representatives
Committee on Financial Services
Hearing on Monetary Policy and the State of the Economy
March 25, 2010

Statement for the Record
Congressman Ron Paul

Mr. Chairman, today the Federal Reserve finds itself in an unprecedented and unenviable position. It has boosted the monetary base by nearly $1.5 trillion since September of 2008. Excess bank reserves remain at historically high levels, and the Fed's balance sheet has ballooned to over $2 trillion. If the Fed pulls this excess liquidity out of the system, it risks collapsing banks who rely on this newly created money to boost their balance sheets. However if the Fed fails to pull this excess liquidity out of the system we risk hyperinflation.

The Federal Reserve has never had such an inflated balance sheet, nor has it ever pumped up the monetary base by such a large amount. During the belt-tightening years of the late 1970s and early 1980s, both the balance sheet and the monetary base continued to expand during a severe recession. We have to look back to the 1920s and 1930s before we see the Fed lowering the monetary base, and even then the Fed lowered the base only by 16%. What we are talking about now is a 60% lowering of the monetary base in order to return to pre-crisis levels. That is a major decrease in the monetary base and, if it is undertaken once these excess reserves have begun to enter the system, it could undermine the viability of banks and lead to the collapse of the financial system that the Fed sought to avoid.

What the Federal Reserve still fails to realize is that intervention in the economy is always harmful. Unlike the late French economist, Frederic Bastiat, the Fed only sees what is seen, the superficial results of its policies, and not what is unseen, the effects of its monetary intervention throughout the economy. Monetary inflation leads to malinvestment and causes the boom phase of the business cycle. Once the malinvestment is realized the bust phase occurs, and these malinvested resources need to be liquidated in order for the economy to recover. But the Fed actively works to prevent this liquidation and does everything in its power to continue inflating in order to prolong the boom. The first act of intervention begets the second and subsequent interventions, each bigger than the first, as each economic bust gets larger and more severe.

The idea that a handful of brilliant minds can somehow steer the economy is fatal to economic growth and stability. The Soviet Union's economy failed because of its central planning, and the United States economy will suffer the same fate if we continue down the path toward more centralized control. We need to return to sound money, bring back free markets, and rein in the Fed.