United States House of Representatives
Committee on Financial Services
Monetary Policy and Rising Prices
March 17, 2011

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Statement for the Record

There is perhaps no topic as important to the average American today as rising prices. Whether we consider food, gasoline, or clothing, the cost of living is increasing significantly. At a time of high unemployment, rising prices trap American families between a rock and a hard place. While rising prices colloquially are referred to as "inflation", true inflation is defined as an increase in the money supply, and all other things being equal, an increase in the money supply leads to a rise in prices. Inflation is and always has been throughout history a monetary phenomenon, and its destructive effects have ruined societies from the Roman Empire to Weimar Germany to modern-day Zimbabwe.

Blame for the most recent round of price increases has been laid at the feet of the Federal Reserve's program of quantitative easing, and rightly so in my opinion. This program, known as QE2, sought to purchase a total of $900 billion in US Treasury debt over a period of 8 months. Roughly $110 billion of newly created money is flooding into markets each month, markets which still have not fully recovered from the financial crisis of the last few years. Banks still hold billions of dollars in underperforming mortgage-backed securities on their books, securities which would render numerous major banks insolvent if they were "marked to market." These nervous banks are hesitant to loan out further money, instead holding well over a trillion dollars on reserve with the Fed. Is it any wonder, then, that the Fed's new hot money is flowing into commodity markets?

The price of cotton is up more than 170% over the past year, oil is up over 40%, and many categories of food staples are seeing double-digit price growth. This means that food, clothing, and gasoline will become increasingly expensive over the coming year. American families, many of whom already lve paycheck to paycheck, increasingly will be forced by these rising prices into unwilling tradeoffs. Rising prices lead to consumers purchasing ground beef rather than steak, drinking water rather than milk, and choosing canned vegetables over fresh. Clothes are worn until they are threadbare, in order to conserve money that keeps food on the table and pays the heating bill. While some might argue that this new frugality is a good thing, frugality is virtuous only when it results from free choice, not when it is forced upon the citizenry by the Fed's ruinous monetary policy.

While the Fed takes credit for the increase in the stock markets, it claims no responsibility for the increases in food and commodity prices. Even most economists fail to understand that inflation is at root a monetary phenomenon. As the supply of money increases, more money chases the same amount of goods, and prices rise. There may be other factors that contribute to price rises, such as famine, flooding, or global unrest, but these effects on prices are always short-term, not long-term. Consistently citing rising demand, bad weather, or energy supply uncertainty while never acknowledging the effects of monetary policy is a cop-out. Governments throughout history have sought to blame price increases on bad weather, speculators, and a whole host of other factors, rather than acknowledging the effects of their inflationary monetary policies. Indeed, tyrants of many stripes have debased their nations' currencies while denying responsibility for the suffering that results.

The unelected policymakers at the Fed are also the last to feel the effects of inflation, in fact, they benefit from it, as does the government as a whole. Inflation results in a rise in prices, but those who

receive this new money first, such as government employees, contractors, and bankers are able to use it before prices begin to increase, while those further down the totem pole suffer price increases before they see any of this new money. By reducing the purchasing power of the dollar, the Fed's monetary policy also harms savers, encouraging reckless indebtedness and a more present-oriented pattern of consumption. Hard work and thrift are punished, so economic actors naturally respond by spending more, borrowing more, and saving less. After all, why save rapidly depreciating dollars?

We must also remember that those policymakers who exercise the most power over the economy are also the least likely to understand the effects of their policies. Chairman Bernanke and other members of the Federal Open Market Committee were convinced in mid-2008 that the economy would rebound and continue to grow through 2009, even though it was clear to many observers that we were in the midst of a severe economic crisis. Chairman Greenspan before him was known for downplaying the importance of the growing housing bubble, even while it was reaching its zenith. It remains impossible for even the brilliant minds at the Fed to achieve both the depth and breadth of knowledge necessary to enable centralized economic planning. As Friedrich von Hayek stated in his Nobel Prize address:

> "The recognition of the insuperable limits to his knowledge ought indeed to teach the student of society a lesson of humility which should guard him against becoming an accomplice in men's fatal striving to control society - a striving which makes him not only a tyrant over his fellows, but which may well make him the destroyer of a civilization which no brain has designed but which has grown from the free efforts of millions of individuals."