United States House of Representatives
Committee on Financial Services
Subcommittee on Domestic Monetary Policy and Technology
Hearing on: "Audit the Fed: Dodd-Frank, QE3, and Federal Reserve Transparency"
October 4th, 2011

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Statement for the Record

In his 1974 Nobel Prize address, the late Austrian economist Friedrich von Hayek attacked the pretense of knowledge, the idea that policymakers have sufficient knowledge and power to shape society as they wish. Our political leaders failed to take Hayek's message to heart, as succeeding generations have continued to allow this intellectual arrogance to continue unabated. Just as the New Mandarins squandered America's wealth, resources, and young men during the 1960s, today's economic Mandarins seem hell-bent on destroying every last vestige of the free market and driving the economy into ruin. Congress has abdicated its oversight over these "expert" economists at the Federal Reserve, to the detriment of the economic well-being of the American people. Despite overwhelming grassroots support behind auditing the Fed, only incremental progress has been made toward unmasking the Federal Reserve's activities. Full transparency of the Fed's operations remains an elusive goal, but one towards which I intend to devote my remaining time in Congress.

The Fed has been given a monopoly by Congress to conduct monetary policy, and in so doing it tinkers with the most important price of all, the rate of interest. Interest rates reflect the price of time, and changes in the interest rate affect the structure of production. Forcing changes to the interest rate, as the Fed does, has a more pronounced effect on the economy than any law Congress has ever passed. Interest rates are used by individuals to make decisions about what type of investments they undertake, how much money they invest, and for how long. The higher the interest rate, the more likely an individual is to save money; the lower the interest rate, the less likely he is to save. Borrowers take the interest rate into account when borrowing money to buy a house, pay college tuition, or start or expand a business. The lower the interest rate, the cheaper it becomes to borrow money and the more likely individuals are to borrow; the higher the interest rate, the less likely they are to borrow. In a free market, some people will want to save while others will want to borrow, and the interest rate is the price that coordinates the actions of borrowers and savers.

Manipulating the interest rate as the Federal Reserve does causes an enormous ripple effect throughout the economy. Most people do not think about how interest rates came to be, they merely make their economic calculations and decisions based on what the prevailing rate of interest is. Every day people go to work, buy and sell goods, and move their money in and out of the banking system. The isolated actions undertaken by individuals combine to create the market. The market is a truly awesome thing which most of us take for granted. No one marvels that bananas and oranges are available in supermarkets year-round, that cars from Germany and Japan travel our roads, or that our houses have electric lighting and indoor plumbing. Yet it was the actions of millions of people, each acting in his own self-interest and without any knowledge of how his actions might affect other people down the road, that resulted in each of those things happening. When government begins to interfere in that process, it leads to all sorts of problems.

As we meet here in this hearing room, the Federal Reserve is engaging in the second coming of Operation Twist, attempting to force already-low interest rates even lower. This crisis was begun because of the Federal Reserve's low interest rate policy which distorted the economy by shuttling resources and investment that would have been better allocated elsewhere into the housing sector. Instead of recognizing the futility of trying to inflate our way to prosperity with artificially low interest rates, and allowing the interest rates to reset to a true, market-determined rate, and allowing prices to fall so as to allow malinvested resources to be put to better use, the Fed repeated the mistakes of the past by pumping more money into the economy. With an official inflation rate of nearly four percent, interest rates on savings accounts of well less than one percent, and a stock market that has stagnated over the past three years, there is no incentive whatsoever for consumers to save or invest. Money sitting in the bank a year ago would have lost nearly four percent of its value by now, money invested in the stock market just as much, and money invested in Treasury bonds over one and a quarter percent. Is it any wonder that people have decided to consume rather than to save?

Savings and investment are required for economic growth, deferring present consumption in the hopes of gaining some greater future consumption. Imagine savings and investment in terms of wheat. Most of the wheat that is grown will be consumed after harvest, but a small amount will have to be saved for seed, in order to grow next year's crop. The more that is able to be saved for seed, the larger the crop will be in future years, enabling increased wheat consumption. What the Federal Reserve's actions are telling people is: don't save, there is no need. Consume that seed and don't worry about the future. And that is what this country has been doing for years. Capital is being consumed through the government's spurring of consumption, encouraging people to take on debt to fund frivolous spending and failing not only to increase present capital but also failing to replenish capital that is used up in the production process.

This all leads us to the need for Federal Reserve transparency. Congressional oversight of the Fed amounts to about twelve hours of hearings per year, and that's as far as it goes. Of those twelve hours, no more than five or ten minutes goes to any one Congressman, who has the opportunity to ask at most one question of Chairman Bernanke every six months. To claim that this is effective oversight is laughable. Even the increased amount of data disclosure mandated by the Dodd-Frank Act, a relative sea change, is only due to be released two years after the fact. The legislative cycle in Congress is so fast that many of us up here do not even remember what took place two weeks ago, let alone two years ago. Trying to set up a hearing such as this one requires weeks, if not months, of advance planning. To imagine that two years after the fact Congress will really seek to dig into the details of the Federal Reserve's lending activities defies common sense. Two years ago the Fed was already well into its first round of quantitative easing, it has since completed a second round, and it is now embarking on a third intervention into bond markets.

Attempting to audit the Fed through passage of new legislation is time-consuming as well. It took nearly a year and a half of effort to enact the few measures that made it into the Dodd-Frank Act. And this year my Audit the Fed bill has been referred, not to the Financial Services Committee as Fed audit bills have been for 40+ years, but to the Oversight and Government Reform Committee. While I am hopeful that Chairman Issa will act on that bill, which has over 180 cosponsors, time is quickly slipping away for this Congress to act.

While the Federal Reserve is not fully transparent, what is transparent are the effects the Fed's policy actions have on everyday people. A young couple is thrilled that interest rates are at historic lows so they take out a mortgage in order to buy the house they had always wanted. But as the Fed continues to print money in order to suppress interest rates, the price of food and heating begins to rise. Expenses rise faster than their paycheck, and they find themselves falling behind on their mortgage and eventually face foreclosure. Or imagine the elderly retiree dependent on Social Security and a small amount of savings. She has not received a cost of living increase to her Social Security in years, despite the ever-increasing cost of food and health care. Extended low interest rates mean that her savings account earns almost no interest each year, so her savings are rapidly depleting. She fears that within a couple of years she may be left with no money and no way to support herself. And then there is the single mother who has been laid off from work for the past 18 months because the rising prices of production inputs caused by the Fed's inflationary monetary policy forced her employer to downsize the company in order to reduce costs. And with prices for the company's finished goods continuing to rise as the Fed continues pumping new money into the economy, consumer demand has dropped, making it all the more likely that her company will never be able to rehire her.

But rest assured, the Fed tells us, as long as the bankers are doing alright, everything will be fine. Indeed, the banks do appear to be doing fine. Flush with cash and receiving interest payments from the Fed on their excess reserves, the financial sector has continued to record amazing profits. Every time a new piece of disappointing economic data comes out, we hear renewed cries from Wall Street for more action on the part of the Federal Reserve. Amazingly, some people are complaining that the latest round of $400 billion in bond purchases is too small. The fact that a $400 billion operation, equivalent to half the size of the Fed's pre-crisis balance sheet, is considered paltry is a sad indicator of how easily so many Americans are willing to accept big government. Bailouts of the financial sector are the new normal, only now they are conducted covertly through the Fed rather than through Congressional action so as not to arouse public ire as in 2008.

The Federal Reserve is a creature of Congress and should be treated as such, not as an organization exempt from Congressional oversight. Claims from the Fed and its defenders that a full audit of the Fed would endanger the Fed's independence are an attempt at provoking fears that Congress would directly intervene in the conduct of monetary policy. A bill that sets interest rates would endanger the Fed's independence; a bill that audits the Fed does not. Nowhere in any audit proposals has anyone ever expressed the desire that Congress dictate monetary policy or attempt to set interest rates. Congress does not have this power, nor should it, but it is accountable to the people through the ballot box; not so with the Federal Reserve, which tries to remain unaccountable both to Congress and to the American people. Pumping trillions of dollars into the economy with no oversight and accountability cannot be allowed to continue. Audit the Fed now.