CAN MONETARY POLICY REALLY CREATE JOBS?

HEARING

BEFORE THE

SUBCOMMITTEE ON
DOMESTIC MONETARY POLICY
AND TECHNOLOGY

OF THE

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U.S. HOUSE OF REPRESENTATIVES

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WITNESSES

WEDNESDAY, FEBRUARY 9, 2011

APPENDIX

CAN MONETARY POLICY REALLY CREATE JOBS?

Wednesday, February 9, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC MONETARY
POLICY AND TECHNOLOGY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Ron Paul [chairman of the subcommittee] presiding.

Members present: Representatives Paul, Lucas, Luetkemeyer, Huizenga, Hayworth, Schweikert; Clay, Maloney, and Green.

Ex officio present: Representative Frank.

Also present: Representative Renacci.

Chairman PAUL. This hearing will come to order.

I want to welcome everybody today, our guests as well as our Members.

And I think we will go ahead and introduce our Members now, and those who aren't here, we can do it later on.

Before I introduce our side, the members on this side, I do want to ask unanimous consent for a statement to be inserted into the record from Spencer Bachus. He is not here today. He would have liked to have attended, but he had to attend a funeral.

Also, I would like to just mention those individuals who are here.

First, we have Congressman Lucas from Oklahoma. He is an old hand at this. And I think sitting next to him is Blaine Luetkemeyer from Missouri.

Welcome.

And I think we have a guest who is not a member of the subcommittee, and that is Jim Renacci from Ohio.

As others come in, we can recognize them.

I will defer at the moment here to the ranking member to introduce his Members who are here.

Mr. CLAY. Thank you, Mr. Chairman.

First, let me congratulate you on your election as chairman of the subcommittee. And I look forward to working with you in the 112th Congress.

Joining us today is the overall ranking member of the Financial Services Committee, the gentleman from Massachusetts, Mr. Barney Frank. And I want to thank him for being here today.

Also with us is a fellow Texan of yours, Mr. Al Green, who represents the City of Houston. And thank you for being here.

And, of course, I am William Lacy Clay of Missouri.

Chairman PAUL. Thank you very much.

I do want to also welcome the Congressman and ranking member from Massachusetts. We have worked in the past on many of these issues, to the surprise of some people at times. But I am glad he is attending today.

Mr. FRANK. Thank you, Mr. Chairman. I would add, to the surprise and occasional dismay of other people.

Chairman PAUL. But the reason I said kind words is I expect him to behave today. That is all.

I would like to ask unanimous consent that all the statements of any member can be admitted into the record. If there is no objection, they will be admitted.

Oh, and I do need to ask unanimous consent for Jim Renacci to sit with us today.

No objection is heard.

I would like to go ahead and start with an opening statement, and then I will defer to the other Members who care to make statements, as well.

Today, we are talking mainly about unemployment. And, to me, this is a very significant issue that we all care about. I have not yet met anybody in the Congress or anywhere who thinks we shouldn't do something about it, so it is unanimous. Unemployment is too high, and the goal is to keep unemployment low and employment high. And this would make everybody happy.

But the disagreement seems to come from trying to understand how we got unemployment and what we should do about it. And I have argued that if you don't know exactly why we have unemployment, it is very hard to come up with a solution.

That is the purpose of these hearings, at least initially, to try to understand the ramifications and especially the connection of unemployment to monetary policy. Because people are thinking more about the Federal Reserve policy today than ever before. And everybody does have opinions. Some people think there is too much easy money and credit and interest rates are too low, and others complain on the other side and say that we need more of it, we need more expansion of credit and we need more spending.

So that is where the disagreements are. But I think there should be a lot of goodwill here in the goal of finding out just what causes our problems and what we can agree on and what we can do about it.

Between 2001 and 2010, we had a population growth of 26 million people. Yet, at the end of that decade, we had 2.3 million less people employed. So these numbers aren't very encouraging. It is terrible that there are 2.3 million people not employed, but I think it might even underestimate the problem since we had such a big population growth.

Just in the last 3 years, or between 2007 and 2010, we had 7 million jobs lost. I do know that we have had some increase in jobs in the last year, but we are still way behind the curve.

But even with the job increase, we here in Washington, the combination of the Fed and what the Congress has done, we probably have pumped in $4 trillion. And if you look at the new jobs we have created, I would say they are very, very expensive jobs. I imagine we could have given everybody $60,000 or $70,000, maybe

$100,000—I haven't done the calculation—just given them the money and they would have been better off. And that, of course, would have satisfied the people who say we have to stimulate spending; the money would be there. But, instead, the money went in different places, and the unemployment rates haven't dropped.

Another problem I see when we deal with the unemployment is sometimes we get confused on how we measure it. The lead figure from the Bureau of Labor Statistics comes up every month, and they tell us that unemployment is 9 percent. And, oh, it is down from 9.5 down to 9; there is a great recovery going on. But the people don't feel that way. The unemployment rate is still very high.

And if you look to some of the private sources of measuring unemployment, you find out that unemployment may well be much higher. Even the government statistics reveal that if you count all the people who are just partially employed or working part-time on weekends, that number can jump to 16 or 17 percent. But then if you include all those individuals who have given up looking for work, there are some who report that the unemployment rate could be 22 or 23 percent, reaching almost the height of the Depression.

So I would encourage all of us to think more seriously about how we measure unemployment, and if this is a real problem, that we ought to do something about defining how to measure unemployment.

I think in this discussion today, certainly we will be thinking about the results, the inefficiency of the Federal Reserve, because they have had a mandate, and the Congress gave them a mandate, and the mandate is that we should have stable prices and high employment. I can produce some statistics, and maybe later on will, to show that prices really aren't all that stable. And, certainly, unemployment reflects a failure. If that is their job, they didn't do a very good job. They haven't been very efficient in producing jobs.

So these are the things we want to talk about and try to resolve and then see what needs to be done. Because, like I said, who wants high unemployment? Nobody wants high unemployment. We want to get people employed. I work from the assumption that there is a direct connection between monetary policy and the business cycle, and, therefore, we should pay more attention to it.

Now I would like to yield to the ranking member, Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman.

We were all privileged to witness President Obama's stirring State of the Union Address. And part of his uplifting message was an appeal for all of us to find common ground in order to move our Nation forward. That applies here at home and around the world, as well.

But I am amazed that some of my colleagues in the Majority may have taken that concept a little bit too far. I never thought that I would see the day when allegedly conservative members of the Republican Party would side with the People's Republic of China over the best advice of the Chairman of the Federal Reserve. The Republican assertion that the Fed's actions to infuse the money supply in order to hold down interest rates and lower unemployment will somehow harm our currency is absolutely wrong.

The congressional mandate for the Federal Reserve is really a two-sided coin. The Fed has a mission to both maintain stable prices and to foster conditions that promote job growth. If we expect this recovery to continue, we need to support both sides of that equation.

As Chairman Bernanke has testified previously, this recession was unlike other post-war economic downturns. And I am thankful that the President, along with our congressional leadership and in coordination with the Federal Reserve, acted courageously to prevent a second Great Depression and to preserve the American middle class.

Over the last 19 months, with the help of the Federal Reserve's wise monetary policy, corporate profits have soared, financial markets have stabilized and regained much of the value equities that was lost, and the private sector has created more than 1 million new jobs. And we still have a long way to go, but that is more new job creation than during the entire two terms of the Bush Administration.

While we strive to restore our economic security, fear of future inflation is not today's most important problem. In fact, the core inflation rate is still near 1 percent. The real danger is if we impede the money supply; then deflation is next in the economic chain.

We see real growth and recovery in almost every sector of the economy, in part because of the Fed's actions. Manufacturing is up, orders for durable goods are up, and car sales are better than expected, although too few, which is why we cannot let up now. There is no doubt that the Fed's prudent actions to carefully expand the money supply were appropriate, and they are helping put Americans back to work.

I am not concerned about what the Chinese, the Brazilians, or the Europeans think about our monetary policy, especially when some of those who are complaining the loudest are guilty of manipulating their own currency to hamper American exports, which cost jobs here at home. The current monetary policy supports job creation here in America. Here in Congress, we have no higher priority.

I thank you, and I yield back the balance of my time.

Chairman PAUL. I thank the gentleman.

I would like now to yield to Congressman Luetkemeyer for his opening statement.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. Thank you for holding the hearing. And I am pleased to serve on the subcommittee and glad to see that we are focusing on the most important issues facing our constituents: jobs.

Since 1977, the Federal Reserve has been charged with two principal missions: controlling inflation; and maximizing employment. Despite recent attempts by the Fed, unemployment continues to hover at 9 percent for the 8th consecutive month, and the economy is still struggling, leaving one to wonder if the Fed is capable of affecting either or have they mismanaged the situation.

Then there is the question of whether the Fed should remain to have a dual mandate. And that one has been continually debated since 1977. It is unclear whether this dual mandate does much of anything to promote job growth.

Take, for example, Chairman Bernanke's quantitative easing plan. When first presented with the Fed's plan, Americans were told that this would be the vehicle to keep interest rates low in order to promote job growth and investment. By injecting hundreds of billions into the American financial system, the Fed sought to promote affordable business investment and economic recovery. This was a bold step, one that could ultimately our recovery by contributing to inflation. It is my hope that the $600 billion QE2 will promote lending and stimulate growth.

At the same time, I am concerned that the Fed and other Federal regulators seem to be ignoring a key problem: excessive regulation along the lines of a lack of forbearance among examiners. As a former bank examiner, I believe the lack of responsible forbearance practiced by our regulators is imprudent. Time after time, I have heard from Missouri bankers who are troubled by increasing pressure from examiners to shrink their portfolios, even when the loans are performing.

I fully support prudent financial regulatory oversight, but it is not in our best interest to promote economic policy that denies credit for viable projects and forces performing borrowers into insolvency.

Sound monetary policy will play a role in restoring our Nation's economic stability. We need to energize the private sector and get the government out of the way by creating a regulatory environment that protects the American people while promoting economic expansion.

With that, Mr. Chairman, I yield back. Thank you.

Chairman PAUL. I thank the gentleman.

I would now like to yield to the ranking member of the full committee, Mr. Frank, for an opening statement.

Mr. FRANK. Thank you, Mr. Chairman.

And I would begin by saying I agree with the comments just concluded. We have suffered from excessive rigidity on the part of the regulators. We have, on a bipartisan basis, over the past few years, the past year in particular, talked about the problem of mixed messages coming from Washington, of the top regulators saying they want to encourage lending but of our being told by bankers that they are encountering a great deal of excessive rigidity. And we will, I hope, continue to press for a reasonable approach on the part of the bank examiners.

And we also have been engaged in conversations with the accounting board so that banks are not forced to take steps that are artificial and lock in a temporary problem, with a reduction in lending.

But on the subject of today's hearing, I was, as the gentleman from Missouri was, surprised to see many of my Republican colleagues here and former members of Republican Administrations criticizing the Federal Reserve's quantitative easing partly because it was unfair to foreign countries. As the gentleman from Missouri pointed out, we had people explicitly agreeing with foreign critiques, saying that, among other things, what was wrong with what the Federal Reserve was doing was it was damaging the currencies of other countries. And as he noted, the People's Republic of China, in particular, was helping organize opposition to the Federal Reserve.

Let's be very clear: Being accused of currency manipulation by the People's Republic of China is like getting a lecture on family planning from the Octomom. This is a country which has engaged in very serious and significant and systematic manipulation of its currency to our economic disadvantage.

In fact, with regard to what the Federal Reserve has done, the negative predictions haven't come true. We have not seen inflation. We have not seen a great set of losses. We now know more about what the Federal Reserve is doing. And I know the gentleman from Texas does not think we went far enough in what we did last year in the bill, but we did make several steps that improved the transparency of what the Federal Reserve does. And under the law that we now have in place, no transaction between the Federal Reserve and any private entity will remain secret forever. There will be a publication of every transaction that the Federal Reserve does with any private entity, although, in some cases, with a time lag to prevent there from being market distortion.

But to go back to this, yes, it is true that unemployment is still too high. But when you are dealing with economics, the question is not simply what the reality is but what the reality would have been in the absence of actions, what the economists call the "counterfactual." And I think it is very clear that, as part of an overall approach, what the Federal Reserve has done has helped bring unemployment down below what it otherwise would have been, although not to a satisfactory level.

But it is very clear that, with regard to the charge that it was going to lead to inflation, whether that was going to be very costly to the Federal Government, or that the Federal Reserve would be engaged in activities which it could not unwind, they have all been disproven by the facts. And we do have speculation—inflation may be coming later. But there has not been an inflationary problem. The problem continues to be the lack of employment to catch up with other aspects of growth in the economy.

And I believe that Mr. Bernanke has been doing, with the overwhelming support of the other members of the Federal Reserve, including—remember, this is not just Mr. Bernanke. There have been a couple of dissents, but the Open Market Committee includes other appointees, and it includes Federal Reserve Bank presidents. They have most recently been unanimous on this. And I think that the effect has been a good one.

And I hope that we will, as a bipartisan approach, tell the rest of the world that any suggestion that America should be constrained in what we do to stimulate jobs in this country will be unaffected by their concerns that it might have some impact on their own currencies, particularly those whose manipulation of their own currencies has been to our disadvantage.

Chairman PAUL. I thank the gentleman.

Now, I would like to yield time for an opening statement to Mr. Lucas from Oklahoma.

Mr. LUCAS. Thank you, Mr. Chairman. And I appreciate the opportunity to offer an opening statement.

I would simply observe, I think, that we all realize that the Fed's, in effect, running the printing presses perhaps is the best policy alternative they have there right now in this situation. But if you believe that price stability ultimately is what the economy needs to be rational and make decisions and grow for the long-term period, then you have to ask the question: By dramatically increasing the supply of money—yes, the volatility, the circulation of the currency, of money through the economy slowed dramatically, so that increased supply has been offset by the reduced activity has provided price stability or close to it.

But if the Fed didn't see this mess coming in the beginning, will they see the inflation side in time also? If they didn't see this mess coming, will they see the inflation cycle starting up in time, the recovery in time to turn off the printing press, to shrink the supply, to offset the increased speed of circulation before we get into inflation? I am not sure, based on past history, that their vision in the future is going to be any better than it was in the past.

That, I think, is the question. Not so much what other countries think, but will we, by the printing press, cause more problems in the future than we can overcome?

I appreciate the opportunity to hear our witnesses, Mr. Chairman.

Chairman PAUL. I thank you.

I would like to now yield for an opening statement to Mr. Green from Texas.

Mr. GREEN. Thank you, Mr. Chairman. I thank the ranking member, as well, and I thank the witnesses for appearing. And, of course, I thank the ranking member of the full committee, the Honorable Barney Frank.

Mr. Chairman, I would like to start on a positive note and say that I concur with you 1,000 percent; we do have to ascertain what the cause was if we are to truly find a conclusion as to how to resolve the problem. We may differ on what the cause is, but I do agree that we have to know what the cause was.

And I would also concur with you that U6 is a good indicator of what the unemployment rate really is when you add all of those who are marginally employed. QE1 and QE2 are important because they have infused capital into the economy. But when we look at the cause and we connect these two, we find that we have to ask ourselves, was the cause a lack of regulation or was it overregulation? I suspect not, in terms of over. Was it a case of regulators not really regulating? Was it the exotic products? If it was the exotic products, why were the exotic products allowed to exist in the first place?

So there are plenty of questions to ask, and I plan to ask some of the witnesses today.

But with reference to the inflation, I believe that the chairman has embarked upon a path that is going to help us have a softer landing than we would have but for the QE1 and QE2. Without them, it is counterfactual, but there are economists that tell us that we would have a landing that may have been a crash, and it may have been devastating for the economy, much more so than where we are now.

I thank you for the time. I look forward to hearing from the witnesses. And I yield back.

Chairman PAUL. I thank the gentleman.

Now I would like to yield time to Congressman Huizenga from Michigan for an opening statement.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate the opportunity. In the interest of time, I have submitted my remarks, as well, and will try to shorten it up. And I appreciate you holding this subcommittee hearing today.

By trade, I am a small-business owner and involved in both real estate and construction. And I now represent a district currently suffering an unemployment rate well above the national average, in Michigan. And one of the hearing's topics—and this particular hearing holds special significance for us back in Michigan.

Earlier this month, the Bureau of Labor Statistics reported that the national unemployment rate fell from 9.4 percent to 9 percent. That does not include the hundreds of thousands who have, frankly, stopped looking. That equates to 14 million people without a job. While this is a staggering number, in my home State of Michigan we are far worse off: 11.7 percent. And, again, that is not including those who have stopped looking. And in some of the areas in my particular district, along the lakeshore, it is well over double the national average.

As previously mentioned, I am a small-business owner at heart and believe such businesses are the backbone of the U.S. economy and provide more than two-thirds of American jobs. I understand the universal principles of successful business, and it is important that we recognize the appropriate role for government in that process. Simply put, the private sector creates jobs, not the public sector. And that is ultimately where that prosperity lies.

It is clear to all small-business owners that responsible fiscal policy includes reduced government spending and the implementation of friendly tax and regulatory environments. They go a long way in creating an atmosphere for success.

As we are having this discussion on QE1 and QE2, ultimately I believe that they have not proven to be an effective method in creating jobs. And I appreciate today us examining the effects that the Federal Reserve open market operations have on those long- and short-term unemployment rates. And, in addition, I look forward to carefully inspecting what potential role the Fed policies played in such artificial asset bubbles as that of the housing market between 2001 and 2008.

So I look forward to today's, I would guess, robust conversation on the short-term effects. And I appreciate your holding this hearing, Mr. Chairman. So thank you very much. I yield back.

Chairman PAUL. I thank the gentleman.

Now, I would like to yield time to Congresswoman Hayworth from New York, a new member to the committee.

Dr. HAYWORTH. Thank you, Mr. Chairman.

My home district is New York's 19th. It is the Hudson Valley. And we have a large portion of our constituency who have jobs in the financial services sector. And, frankly, all of our citizens are quite directly affected by what the Federal Reserve is doing and has done in the past. So I am honored to be working on this subcommittee, because examining the role of monetary policy in the financial crisis and in our response to it is crucial.

History shows that an independent central bank that is making monetary decisions free of political influence can certainly enhance economic growth. It stabilizes the currency. That is very important. But that is very different from requiring a central bank to be held accountable for its decisions and to explain why it is making them. And it is certainly incumbent upon us to set that policy for monitoring and holding accountable.

So that is our role here. And we are in service of the far larger goal, as my colleague from Michigan has said, of getting Americans back to work throughout the country. So I look forward to your testimony regarding how monetary policy has affected unemployment. I am sure it has.

And I yield back the remainder of my time. Thank you, Mr. Chairman.

Chairman PAUL. Thank you.

The Congressman from North Carolina, Walter Jones, has arrived. He is the vice chairman of this committee.

Would you like to make an opening statement?

Mr. JONES. No.

Chairman PAUL. We would like to announce and celebrate the notion that Walter is going to have a birthday tomorrow. So we want to wish him a happy birthday.

Mr. JONES. Thank you.

Chairman PAUL. Okay. If we don't have any more opening statements, we are going to go to the guests that we have, those who are going to testify. I want to welcome all three of the individuals here today. And I will read a brief resume of each one, and then we will go to the discussion.

First, on the left, we have Professor Thomas DiLorenzo, professor of economics at the Sellinger School of Business at Loyola University in Baltimore, Maryland, and a senior fellow at the Ludwig von Mises Institute in Auburn, Alabama. He received his Ph.D. in economics from Virginia Polytechnic Institute and State University at Virginia Tech.

Next, will be Professor Richard Vedder, the Edwin and Ruth Kennedy Distinguished Professor of Economics at Ohio University and an adjunct scholar at the American Enterprise Institute. He received his B.A. in economics from Northwestern University and his M.A. and Ph.D. in economics from the University of Illinois. He is the author of, "Out of Work: Unemployment and Government in Twentieth-Century America."

And finally, we will hear from Dr. Josh Bivens, an economist at the Economic Policy Institute in Washington, D.C. He received his B.A. in economics from the University of Maryland and his Ph.D. in economics from the New School of Social Research.

Each will be given time for an opening statement, and their full statements will be put into the record.

So I will first now defer to Dr. DiLorenzo.

STATEMENT OF THOMAS J. DILORENZO, PROFESSOR OF ECONOMICS, SELLINGER SCHOOL OF BUSINESS, LOYOLA UNIVERSITY, BALTIMORE, MARYLAND

Mr. DILORENZO. Thank you, Mr. Chairman, and members of the committee for giving me this opportunity to appear here.

To answer the basic question that has been posed by this hearing, can monetary policy really create jobs, as an academic economist, you are not surprised to hear from me that the answer is "yes and no."

And the reason why I say "yes and no" is that the history of the Fed has been that it has created boom-and-bust cycles in the economy ever since it began its existence in 1914. And so, during the boom period, of course, it does create jobs, but the jobs that it creates, many of them are unsustainable jobs. I can recall hearing that Home Depot, when they laid off 7,000 people in 1 day, these were jobs that people had invested in, they invested their lives, their careers, and then the rug was pulled out from under them. That is the sort of thing that happens with what we call the artificial boom and bust created by the Fed's monetary policies.

And the key to it is that the monetary expansion that the Fed creates, it sometimes produces price inflation, but that is not the only problem. Another part of the problem is that it artificially lowers interest rates and induces businesses to engage in especially long-term investments that end up being unsustainable.

In the latest boom-and-bust cycle, that was mostly in real estate and everything related to real estate. But it is not necessarily just real estate. And so, in this latest cycle then, you had people, mortgage bankers and insurance companies and everyone related in every way to housing construction investing years and years of their careers, and then they are out of work; they have to retool.

The lower interest rates are not necessarily an unmixed blessing to everyone because they tend to reduce savings, and savings and investment are the key to productivity growth and job creation. And so, the downside of the Fed policy of lowering interest rates lower and lower is that it deters savings. And savings investment is really the key to having sustainable economic growth and job creation.

The real damage occurs, then, during the boom cycle of the business cycle, where capital is misallocated. Too much of it goes into unsustainable areas, such as real estate in the latest bout here. And the best part, the good part, if you can say there is a good part to this boom-and-bust cycle, is now the bust is where the adjustments have to take place. And we have to get back to realistic prices, realistic interest rates.

One problem the Fed creates, though, is, with its constant manipulation of interest rates, it really is an attempt at price controls. And I think the economics profession is almost unanimous in opposition against price controls. And interest rates are prices. And so, when the Fed tries to manipulate interest rates, it is really engaging in a policy of price controls. And a lot of people in this room, I am sure, remember what a disaster that was in the 1970s, with price controls on oil and gas.

Now, government policies that bail out businesses, which we have seen, is really a contradiction of an age-old rule of economics with regard to monetary policy. The rule was, in the case of a recession like this, it is a good idea for the Fed to make credit available to sound businesses that have been responsible and made good decisions, but not make more credit available to those businesses who have made bad decisions. And it is better off to let them go bankrupt, out of business, and have those resources be picked up, reallocated by people who will make better use of them. But, of course, the Fed has done exactly the opposite of that in the recent years.

And so, as applied to today's situation, I think a very strong case could be made that the cause of the boom was the Greenspan Fed's low-interest policies. So the Fed did create some jobs with the boom; it is responsible for creating those jobs. But I think it is also responsible for the high unemployment that we now suffer to a very large extent because of the bust that has occurred.

It also has created mismatched unemployment, what economists used to call mismatched unemployment, which I referred to a minute ago, in terms of people investing in jobs and careers that ultimately are not sustainable for a long period of time.

Historically, the Fed, right from the very beginning, as soon as it started in 1914, it doubled the money supply by that date in 1920 and created the Depression of 1920. It was the worst depression in the first year of the Great Depression. And a strong case can be made—and I can refer any of the Members to literature if they would ask me for it, as to where you can read up on how the boom and bust of the 1920s was caused by the Fed, as was, I would even argue, the Great Depression was ignited by the expansionary monetary policy of the Fed, not the restrictive monetary policy of the Fed, that occurred from 1929 to 1932.

I see my time is about up. So, in summary, I will say that the Fed's monetary policies do create temporary but unsustainable increases in employment, while being the very engine of recession and depression, even, that creates unemployment in the long run. And it needs to step back, in my view, and let the market work and create a lot more stability by quitting its attempts to manipulate the price of credit, interest rates.

Thank you very much.

[The prepared statement of Dr. DiLorenzo can be found on page 72 of the appendix.]

Chairman PAUL. I thank the gentleman.

I would like to now defer to Professor Vedder for his statement.

STATEMENT OF RICHARD K. VEDDER, DISTINGUISHED PROFESSOR OF ECONOMICS, OHIO UNIVERSITY

Mr. VEDDER. Thank you, Dr. Paul.

The one-word executive summary of my answer to the hearing's question, can monetary policy really create jobs, the one-word answer is "no." And I would agree with Dr. DiLorenzo, no, not in the long run, or no, not on a sustainable basis.

A little historical context: The first decade of this century had the lowest rate of economic growth of any decade since the Great Depression. Employment growth was the lowest in 6 decades. Inflation-adjusted equity prices fell sharply.

In large part, I think this reflects a multitude of faulty government policies, certainly on the fiscal side. Federal spending soared, increasingly financed by borrowing. The ratio of national debt to output is at a historic high for a relatively peaceful period. And on the monetary side, we had the worst financial crisis since the Depression, with many iconic financial institutions closing their doors or only surviving because of Federal bailouts. And despite all these huge Federal exertions on both the fiscal and monetary side, we have had the weakest recovery going on now in the lifetime of most persons in this room.

Moreover, I think the huge run-up in the ratio of Federal debt to output will be a significant drag on the economy for many years and may well lead the Fed to monetize this debt or part of this debt, unleashing a wave of inflation that can only undermine our economy.

Turning to the 2008 fiscal crisis, financial crisis, certainly private irrational exuberance may have occurred to some extent. The crisis largely resulted from three types of government policies, failures.

First, as Tom DiLorenzo indicated, the Federal Reserve for years prior to the crisis pursued an easy money policy, reducing interest rates below levels justified by human behavior and market conditions. This led to the artificial boom in housing prices.

Second, the Feds encouraged imprudent lending practices through such things as the Community Reinvestment Act, HUD policies going back to the 1990s designed to promote homeownership.

Third, Fannie Mae and Freddie Mac, government-sponsored corporations, promoted totally inappropriate lending practices that contributed to the housing bubble and the foreclosure mess. Congress blocked attempts to rein in these companies, no doubt, frankly, because of the campaign contributions these companies made to Members of this body.

I am an economic historian. And both economics and historical experience demonstrate that Federal intrusions into economic activity are counterproductive. Some textbooks even talk about the "policy ineffectiveness theorem." Aggressive deficit spending and Federal Reserve monetary expansion led to stagflation in the 1970s. Japan went on a huge binge of stimulus spending in the 1990s, and economic growth virtually ground to a halt. The excesses of the European welfare state and its funding are causing crises all over the European Union, from Ireland to Greece. The stimulus plans of the Obama Administration were accompanied by rising, not falling, unemployment. Bailouts and "too-big-to-fail" policies have created a huge moral hazard problem. The Federal Reserve has engaged in huge purchases of government long-term bonds and mortgages to keep interest rates low. But long-term interest rates are not falling, as concerns about potential inflation justifiably have risen.

So, by many indicators, this is the weakest post-war recovery, not because we have tried too little, but because we have tried too much. The Fed and the government have monetary and fiscal time bombs that are threatening both the short-term recovery but, more importantly, long-term financial and economic stability.

So what do you do? I would point out that our economy achieved economic supremacy in the world from 1871 to 1914, a period of the gold standard, near-stable prices, and no central bank. Consumer prices in 1914 were within 10 percent of what they were in 1871. We can learn from that experience.

To restore monetary stability, ideally we would ultimately consider retreating somewhat from the fractional reserve banking system we have, where even moderate declines in confidence potentially lead to devastating consequences. But more immediately, we need to limit monetary growth. And, given human weaknesses, probably the best way to do this ultimately is having a gold standard or some variant that removes or dramatically reduces the discretion of central bankers.

But on the fiscal side, politicians, unfettered by rules, behave, I would say, like unsupervised alcoholics in liquor stores. We need some sort of constitutional restraints on government fiscal actions. Practically, changes of this magnitude take time, but, in the short run, however, I think you could start holding the Fed's feet to the fire. Perhaps, for starters, you should establish price stability as the single monetary mandate for the Fed. Perhaps you should repeal the Humphrey-Hawkins Act and privatize or abolish Fannie Mae or Freddie Mac.

After that, you can rest on Sunday.

[The prepared statement of Dr. Vedder can be found on page 77 of the appendix.]

Chairman PAUL. I thank the gentleman.

We will move on now to Dr. Josh Bivens for his statement.

STATEMENT OF JOSH BIVENS, MACROECONOMIST, ECONOMIC POLICY INSTITUTE, WASHINGTON, D.C.

Mr. BIVENS. Thank you. I would like to thank the committee and the chairman for inviting me here today.

The subject of this hearing is, can monetary policy really create jobs? I am going to say the answer is a barely equivocal "yes," and the equivocation just being it can create jobs as long as the economy is performing below potential. And the economy is performing below potential today.

The argument—I am going to start with just a little bit of theory. Of course, theory alone can't end the discussion, so then I will talk about some evidence on monetary policy's effects.

So the theory—sometimes the cause of recessions are pretty hard to reconstruct. Not so in what we are now calling the "great recession." The bursting of the housing bubble led to home builders waking up, realized they had massively overbuilt, so residential investment collapsed. The 30 percent fall in home prices also erased about $7 trillion in wealth from household balance sheets, so they predictably radically curtailed their spending.

These initial shocks then cascaded throughout the economy. Businesses stopped investing because customers aren't coming in the door. Why would you build a new factory when the one you have can't even sell what it is producing?

And so, in the jargon—and, for once, the jargon is kind of important—the economy suffered a shock to aggregate demand. The clear fact that this recession was the result of a shock to aggregate demand is key. Americans workers didn't lose their skills in December 2007. American factories didn't become obsolete in that month. American managers didn't forget how to organize production in that month. Nothing changed about the American economy's ability to supply goods and services. All that changed was the ability of households and businesses to purchase them. The erasure of all the wealth from the housing bubble was a shock to aggregate demand.

So what the Fed tried to do is stabilize economic activity by providing a countervailing spur to demand with the levers they have. The primary lever they have is short-term interest rates. By lowering these short-term rates, or policy rates, the hope is that interest rates up and down the term and risk structure fall in sympathy. That makes it cheaper for businesses to borrow to expand capacity. That makes it cheaper for households to borrow to buy new houses, and durable goods. It also provides a one-time boost to asset prices. And so this decline in policy interest rates is meant to provide a countervailing, positive spur to the aggregate demand that was quashed by the bursting of the housing bubble.

And all this happened as the great recession approached. The Fed started cutting these policy rates in August 2007. They provided extraordinary support to failing financial institutions early in 2008. And about halfway through the great recession, the policy rates they controlled had kind of run out of ammunition. They were sitting at zero.

They could have just stopped there. As the economy was in a complete free fall, as the primary parachute they have available to them obviously wasn't sufficient, they could have stopped there. They didn't. And it is a good thing they didn't. They continued to try to find other ways to provide support to the economy with the quantitative easing programs.

And these interventions worked. If you look at when the Fed introduced the Term Asset-Backed Securities Loan Facility, the day that was introduced, credit spreads on asset-backed securities started to rapidly fall. That was very good for the economy. It meant people could actually get credit again.

Researchers from the San Francisco Fed say that the announcements of both rounds of quantitative easing caused interest rates to fall up and down the term structure. Some of the members of the committee may have noticed that 30-year home mortgages fell to something like 4 percent in the past couple of months. Some of us in this room may have even refinanced their mortgages. I actually did. It saved me a lot of money, and provided a spur to my spending power. That is very good for the economy. That is one channel that is supposed to work.

Just that channel alone, the ability to refinance, some researchers at JPMorgan Chase have estimated that, if all the mortgages guaranteed by Fannie Mae and Freddie Mac had been able to take advantage of those 4 percent rates we saw a couple of months ago and refinance, that would be a permanent $50 billion spur to spending potential in the economy. That is just one channel through which monetary policy can help people start spending again, and businesses.

And if you look back, you look at studies of what ended the Great Depression, Christina Romer, eminent economic historian, the former CEA chair for the Obama Administration, she says that monetary easing was a key part of what ended the Great Depression. I would say she is actually criticized in this view by, say, Milton Friedman, probably the most famous conservative economist, only because he thinks the Fed should have done much more, loosened much more to fight the Great Depression.

If you look at Adam Posen, probably the closest observer of what happened in Japan in the 1990s, he points to the fact that Japan actually had a pretty good recovery from 2002 to 2008 when they finally started engaging in the unconventional monetary easing that the Fed has done during the great recession. It was the first time Japan had seen serious growth in decades.

The Japanese case is also instructive because they had a 20-year period where they kept the short-term interest rates that they controlled, the Bank of Japan, near zero. They engaged in lots of quantitative easing. The cumulative inflation rate over those 2 decades was less than 5 percent. The United States has seen inflation of over 5 percent, or close to 5 percent, in a single year in the 2000s. So this idea that monetary easing always leads to inflation, no matter what, is just not supported by the facts.

And so, my time is up, and I just want to say one thing. I would say that the Fed has been by far the policymaking institution most aggressive in its response to the job crisis caused by the great recession. It acted first, it acted most aggressively, and it continues to display a real sense of urgency about the need to support the economy and create jobs.

Thank you for your attention.

[The prepared statement of Dr. Bivens can be found on page 51 of the appendix.]

Chairman PAUL. I thank the gentleman.

We will now go into our question session. Each Member gets 5 minutes to ask questions.

And just to let you know that if the discussion is still going on, we will have a second or even a third round of questions if you are interested in the subject and you want to hang around.

First, I will start off with asking Dr. Bivens a question, because you have talked a little bit about interest rates and how valuable it has been to the economy for the Fed to lower interest rates. But isn't it true that there comes a point where they can't accomplish that, where the effort to lower interest rates doesn't actually lower interest rates?

And we may be even entering that period right now. There is a lot of monetary inflation right now with QE2, and there are signs that bonds aren't doing as well and they may be shifting.

What happens to those who agree with your policy? What do they do if the more they inflate, the higher the interest rate goes? And, in a way, we had that in the 1970s, as well. Then what do you do? What is the policy that is necessary to counteract that when interest rates are going up when you don't want them to go up?

Mr. BIVENS. A couple of things—one, you mentioned the experience of the 1970s. To me, the experience of the 1970s, why interest rates were high was because inflation rates were high. And so, my best guess over the next couple of years—and it is a guess based on a firm historical relationship between how much slack is in the economy and inflation rates—we do not have to worry about spiking inflation in the economy any time in the next couple of years.

So your scenario where the Fed continues to ease, maybe undertakes even another round of quantitative easing and somehow interest rates in the long term start rising, I would say they would need to reassess the policy then. But my read of the evidence so far is that, with each announcement of the rounds of quantitative easing, you have seen a robust fall in interest rates across the risk and term structure, which was exactly the target. And it has filtered through to more spending in the economy.

Chairman PAUL. I thank you.

And I would like to get a comment from Dr. Vedder or Dr. DiLorenzo on that subject.

Mr. VEDDER. Let's first talk about—the QE2 was announced on November 3rd. It is now February 9th. What has happened to the interest rates on 10-year or 30-year Federal Government securities in that interim? My read of the evidence—and I just look at the interest rate yesterday versus November 3rd—is that the interest rate on 30-year government bonds has risen somewhere between 65 and 70 basis points. The interest rates on 10-year notes has gone up more than 100 basis points. This has not moved down. It is not even staying still. It is going up.

Now, in that period, we are buying, what, $50 billion of bonds a month? We bought several hundred billion—the Fed now owns a trillion dollars' worth of long-term securities, I believe, or close to it, the better part of that.

To me, that is just the evidence. And it suggests that your concern, Dr. Paul, is correct, that the increased inflationary expectations have overwhelmed the effects, the immediate effects the Fed has when it pushes up bond prices when it buys securities. So I think your concern is valid.

Mr. DILORENZO. Yes, I agree, that is what we are seeing, is inflationary expectations driving up those interest rates. And it might not be hyperinflation, but we are beginning to see it. And you have seen some of the inflation around the world, too. A lot of the U.S. dollars that are in circulation end up overseas. And I think there is probably a connection between the high food prices that you are seeing in different places around the world with this inflation.

But that is not the only problem that can be created by monetary expansion. It is the misallocation of resources. The Fed is creating a different kind of boom with its quantitative easing. And no one can predict what will happen, but in the next couple of years we could see another bubble. And I think it is likely to be much bigger than the housing bubble was. And then we will really be in trouble.

Chairman PAUL. I would like to ask Dr. Bivens first about his statement on page 7. He says, in short, the Fed saw the economic downturn coming before any other major macroeconomic policymaker body. And there have been a lot of others. What do you do with the free-market Austrian economists? And there were more than a few. How do you dismiss them so easily? Because they did predict it correctly.

Mr. BIVENS. Yes, I would absolutely not say the Fed was the first to see it coming of any economist. I have colleagues who warned in 2002 that home prices were getting too high. I meant to say they were the first major macroeconomic policymaking institution. They acted first.

There are three big arms of macroeconomic stabilization: there is fiscal policy, Congress; there is monetary policy, the Fed; and there is exchange rate policy controlled by the Treasury. And of those three institutions, the first one to start providing lots of easing to the U.S. economy was the Fed.

Chairman PAUL. Okay. My time is about up, but I just want to go on to the next speaker by quoting Mr. Bernanke, and this was in the fourth quarter of 2007: "We may see somewhat better economic conditions during the second half of 2008. This baseline forecast is consistent with our recently released projections, which also see growth picking up."

He had no idea that it was coming. He was so reassuring, and he misled so many people. And I just think there is a lot—and if I had more time, I would get other comments, but maybe later on. But it just seems like the Fed was way behind on this whole issue. I would hate to think they were the first ones to warn us. I think they were the last ones to even recognize what was going on.

Okay. And I will now yield to the ranking member, Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman. And, again, let me commend you for calling this hearing. The causes of unemployment and how government and the private sector can respond to and mitigate this crisis are extremely important. And I thank you for your leadership on this issue right at the start of this Congress.

Dr. DiLorenzo, you belong to the Austrian school. And we don't have time for a debate on various economic theories. However, the Austrian school is different from mainstream theories in its lack of a scientific method and rejection of empirical data. You don't use the scientific method and instead employ deductive reasoning. You apply preconceived generalizations to your work. You are kind of asking us to take your word for it.

Without data, without providing verifiable results, it is difficult for others to evaluate the merits of your work, and we must rely on your body of work itself.

Doctor, you are here today representing yourself as an economist. However, it has been difficult for my staff to locate any recent work of yours as an economist. It seems that for the past 15 years or so you have published books, written many articles, and given lectures as an historian.

The lines among the social sciences can sometimes get blurry, and I am not going to quibble about academic distinctions. But if your work was on labor history, historical patterns of unemployment, even the history of the Federal Reserve on monetary policy, I can understand you being here today. But I am a little confused. It seems to me that the bulk of your work has been in revisionist history about our 16th President, Abraham Lincoln, and the Civil War.

Also—and this is where my confusion deepens to concern—you work for a Southern nationalist organization that espouses very radical notions about American history and the Federal Government. This organization, The League of the South, has been identified as a hate group by the Southern Poverty Law Center.

Now, the Law Center is an organization that I deeply respect, and so naturally this concerns me. The League of the South is a neoconfederate group that advocates for a second Southern secession and a society dominated by European Americans. It officially classifies the U.S. Government as an organized criminal enterprise.

Dr. DiLorenzo, you are listed on their Web site as teaching for their League of the South Institute. A short list of your many articles includes: "More Lies About the Civil War"; "The First Dictator-President", referring to Abraham Lincoln; "In Defense of Sedition"; "Libelist Leftist Lynch Mobs," insensitively using a loaded term to refer to academic criticism of a White professor; "Abe the Mass Murderer"; "Hurrah for 'Sweatshops'"—I guess you could sort of claim that the title at least is somewhat connected or something to do with economics; and "Hitler Was a Lincolnite."

After reviewing your work and the so-called methods you employ, I still do not understand your being invited to testify today on the unemployment crisis, but I do know that I have no questions for you.

Let me go to Dr. Bivens.

And there are some factual errors in the testimony presented here today that I believe need to be corrected. First, even though it was suggested that it was the excessive expansionary monetary policy of the Fed that caused yet another boom-and-bust cycle that spawned the Great Depression, the facts do not bear this out.

And, according to congressional research, between 1925 and December of 1928, the money supply increased at a very modest rate of 3.4 percent. Even if we look at a larger timeframe from July of 1921 to July of 1929, it grew at a rate of 4.8 percent per year. There is nothing particularly rapid about these rates, much less anything approaching excessive expansion.

Dr. Bivens, can you confirm this for us?

Mr. BIVENS. The exact numbers, no. But they definitely comport with my sense of that period, which is there was no excessive monetary expansion before the Great Depression. And even again, Milton Friedman, conservative economist, if he has a criticism of the Fed during the Great Depression, it is that they did not ease quickly enough, they did not provide enough monetary support to the economy. So they comport with my sense of what happened during that period.

Mr. CLAY. Thank you for responding.

Mr. Chairman, I yield back.

Chairman PAUL. I now yield to Congressman Jones from North Carolina.

Mr. JONES. Mr. Chairman, thank you very much, and thank you for holding this hearing.

I want to thank the panelists.

And, Mr. Chairman, about a week ago, I decided that the frustration of the American people in the 3rd District of North Carolina, which I represent, was so great and their disappointment in the United States Congress and things we have done—talking about both parties—that I would take it upon myself to say, if you will help me with questions for the panelists for this whole year—I am delighted to be on this subcommittee, by the way—that I will use some of your questions when my time comes.

So, Mr. Chairman, in a week's time, we got over a thousand e-mails from my district. I am going to read two; then I want to get to a point:

"Our Congress Members, for the most part, must be the most financially illiterate group of men and women on the planet. Why would they need a study group on domestic monetary policy and technology to figure out you don't print more money to create jobs that are backed by virtual money, or funny money? I believe we need to fire all these people and get a couple of housewives who have been managing their family budget over the years without credit cards, lines of credit, and other creative ways to rob Peter to pay Paul."

This is a great example of how frustrated the American people are. That is why I do think this hearing today is important.

Let me read the next one; then I want to get to the question:

"As an owner of small businesses and a family borrower, I have not understood how the Federal Reserve can keep its interest rates at almost zero and then make lendable funds more available to the banks, while at the same time the banks have increased interest rates, decreased lines of credit, and restricted availability of loans to high-rated creditors like my businesses and other households. I can only see that the banks have improved their financial position on the backs of small businesses and families."

That basically is going to be my question. I am very frustrated; I am sure my colleagues in both parties are, as well. What you hear back home is this issue of how the banks have been empowered with the Federal Reserve and the other agencies so that they are able to swell their financial state and, at the same time, they are saying to those of us who are creditors, we are going to raise your interest rates on your credit cards, we are going to deny you loans because we have a certain criteria now.

And this is why this country is in deep trouble, and it is going to continue in deep trouble. And that is why I think it is important that we hold these hearings about monetary policy, because the average American is out there strangling to death because of things that we do and don't do here in Washington.

How would you answer the question to that constituent who wrote me that question? Anyone who would like to answer.

Mr. VEDDER. I think your constituent ought to be made a member of the Council of Economic Advisors or something of—it wouldn't be any worse than it is now, maybe a little bit better.

Why are interest rates for the ordinary—why are people not borrowing a lot of money now? Is it because—the reason, of course, is—why are businesses sitting on $2 trillion in cash, roughly, right now? They are sitting on $2 trillion. You can have interest—interest rates don't matter. I don't say they don't matter. They are not the key thing.

They are scared. People are scared. They are scared of a $4 trillion increase in the Federal debt over the last 3 years. The housewife may not be sure why that is bad, but she knows that is basically not a good thing to do. She knows that printing money and dropping it out of airplanes, or the equivalent, which is what the Fed does, will not create jobs, will not create wealth. It might temporarily lead to some behavioral modifications that leave the appearance of some stimulus in the short run, but not in the long run.

I happen to like Abraham Lincoln, by the way, and I went to the Lincoln Memorial today to read the Gettysburg Address. And I noticed that they have torn up—that they have drained the reflecting pool. And there is a sign in front of it that says, this is part of the stimulus—whatever, the reinvestment—I don't remember the name of that thing—reinvestment act. And they also had a sign next to it that said, we are going to fill it back up again. We can drain the reflecting pool and fill it back up again and probably put a few people to work for a day or 2, but that doesn't create jobs.

People are scared. And banks have partly raised interest rates, to get more specific, on some types of credit because they feel they have to because of the Dodd-Frank bill. Another thing, when they see light at the end of the tunnel, you add on more tunnel. Not you, personally, Congressman, but your colleagues add more tunnel. And we have added more tunnel.

So we have the Dodd-Frank bill that has all kinds of new restrictions on banks and financial institutions. They have to make up the money somewhere. They are not going to just simply say, oh, we are going to let our profits fall to zero, and we are going to become a charitable institution, a not-for-profit. That is not the way banks operate. So they have raised a lot of fees and so forth. So that has added to the frustration.

Mr. JONES. Would you like—

Mr. BIVENS. Yes, could I have a very quick response to that, as well?

I will say one thing. If you look at the survey of small businesses, the National Federation of Independent Business recently over the past year, you ask them, what is the number-one problem facing you, overwhelming highest response in history: sales; there are no customers.

And so then the question is, can monetary policy actually create some customers for those businesses? And it absolutely can. When you saw the ability to refinance mortgages at 4 percent, that freed up a lot of money for households. When you lower interests up and down the term and risk structure, you make it much cheaper for businesses who are on that razor's edge—"Should I borrow a little money to expand? It is uncertain out there"—but you make it much easier for them to do that.

And the idea that there are inflationary expectations driving up long-term rates, there just are not. The clearest indicator of inflationary expectations that economists use is the tip spread, the spread between inflation index treasuries and nominals. That was at historically low levels a couple of months ago. Now it is still below 2 percent lower than it was at any point during the 2000s. There is just no sign that inflationary expectations are out of line and that is what is driving anything like long-term rates rising.

And then just one last thing. I am no defender of the banks, but, actually, if you are worried the banks are having too easy of a time by borrowing cheap, short term from the Fed, and then raising long rates on what they are lending to their customers, quantitative easing actually squashes that spread. It actually makes it less hospitable for banks to do that. So if you don't like the banks, kind of, riding the easy term structure created by what the Fed is doing to short-term rates, you should like the quantitative easing program.

Mr. JONES. Thank you.

Mr. DILORENZO. Is there time for one more comment on that?

Chairman PAUL. Go ahead.

Mr. DILORENZO. I would add, since I have written three books that include a history of banking, so contrary to what Mr. Clay had to say about me, what we have been experiencing is what economists call "regime uncertainty." With all the uncertainty of the Fed changing policy month by month—the threat of huge taxes for socialized medicine, the re-regulation of banking with the Dodd-Frank bill—businesses sit back and wait because there is so much great uncertainty about the future with all of these regulatory changes and tax changes.

And that is one of the things that is keeping them from lending to businesses. The businesses are putting a lot of their business plans on hold. And the economist Robert Higgs is best known for research on this whole area of regime uncertainty, and I think that is an important thing to factor in there.

Chairman PAUL. I now yield 5 minutes to the Congressman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman.

I thank the witnesses, as well, again.

What we have, apparently, is this philosophical debate about how jobs are created. Do millionaires create jobs, or do millionaires simply respond to demand and, as a result, they facilitate the creation of jobs because there is demand?

Smart money doesn't create jobs just because it exists. Smart money creates jobs when there is a demand to be met. Is that, in essence, what you are trying to say or have been saying, Dr. Bivens?

Mr. BIVENS. Yes, I think that is a fair summary.

Mr. GREEN. And is it true, sir, that jobs and employment, that these factors are considered lagging economic indicators, employment?

Mr. BIVENS. That is right. I think that is fair to say, as well. The last couple of recessions, you have seen GDP go up.

Mr. GREEN. Right. And while other things will come back at a relatively different pace—let's say it this way: Jobs will be among the last things that will return, especially when you have a sharp downturn in the economy. And it is also fair to say that, because of some of the structural changes in the economy, there are some jobs that won't return. Is this a fair statement?

Mr. BIVENS. I think we will have a different-looking economy coming out of this than we did. We are going to have fewer construction jobs when we eventually get out of this and get out of the jobs hole. Hopefully we have some more manufacturing jobs. So, yes, I think there is something to that.

Mr. GREEN. Also, changes in technology. A few years ago, we had technology that was greatly different. Something as simple as developing film, the technology has changed. So you won't have those jobs. Record companies won't have jobs. The structure of the economy is changing as well.

So I would like for you, if you would, to just do this for me. Take a moment and explain, if you would, how the lagging indicator of jobs returning, employment, how that will manifest itself as we go forward. Is that something that will happen immediately, or will we see signs of it?

And, also, does it rise and fall based upon people who are out of the employment market coming back into the market? Does that then cause the job numbers to go up again? And then as more people are employed, it comes down again? Please talk about it.

Mr. BIVENS. Yes, you raise a lot of interesting points.

First, I will say that the observation that jobs are a lagging indicator should absolutely not be taken as "everything is fine, and the jobs will come back," even at the current pace of economic growth. That is not the case. If you want jobs to come back really quickly, you need to boost economic growth that much quicker. And so I would say monetary ease.

But, yes, then the other issue is, you are right. If you look at the number of jobs lost between 2007 and today, it is roughly 7 million. But we should have created well over 3 million in that time period just to keep pace with population growth. Those people who didn't join the labor force over the past 3 years will start joining it if jobs start becoming available again. And so that means the unemployment rate is going to be very, very stubborn in coming down over the next couple of years, even if we get some good output growth, some good employment growth.

But that said, if you look at the agonizingly slow recovery, the 2001 recession, or the very slow recovery of today compared to the quick recovery of the early 1980s; the thing that distinguishes them is that output grew much faster in the 1980s. And part of what explains that output growth, as I say in my written testimony, is the Fed had a lot of room to provide a lot of monetary support to the economy, and they did. They cut interest rates by 10 percent. That sparked both output and jobs growth.

So I think you are right. I think, even as jobs come back, the unemployment rate is going to be very, very stubborn because of all those jobs that were not created. But we really should say we cannot be satisfied with this pace of economic growth.

Mr. GREEN. Thank you.

Let me quickly respond to something that was said about the CRA, and Fannie and Freddie to a certain extent. We do have to make a distinction between causes and contributing factors. The CRA did not create 3/27s, 2/28s, teaser rates that coincided with prepayment penalties, no-doc loans. All of these exotic products were not created by the CRA. It may have been a contributing factor, Fannie may have been a contributing factor, as well as Freddie. But we shouldn't label contributing factors as causes.

These products that were created were created in an environment where you had either a lack of regulation or regulators that were not properly adhering to regulations, following the law, making others follow the law.

Mr. Bevins, could you just comment on this briefly?

Mr. BIVENS. Yes, I think I agree with all of that. The idea that especially Fannie Mae and Freddie Mac were prime drivers of the housing bubble just doesn't work when you look at the evidence.

As the housing bubble gets under way in the early 2000s, as home prices go through the roof, and as these exotic mortgages come online, Fannie and Freddie hemorrhage market share. They lose it to all of the private servicers.

They, unfortunately, start to try to get into the game a little later in the decade, and they shouldn't have. That is clear. But they were not—they were followers. They were absolutely not leaders. And so, the idea that the housing bubble can be laid at their feet, I think, is just wrongheaded.

Mr. GREEN. Thank you, Mr. Chairman.

Chairman PAUL. I now yield 5 minutes to Congressman Luetkemeyer from Missouri.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

A while ago, Dr. DiLorenzo, you talked about another bubble coming. Can you elaborate on that just a little bit?

Mr. DILORENZO. With all the so-called quantitative easing that the Fed is engaging in, it is more of the same policy that created the real estate bubble in the first place. And, at that time, it reallocated a lot of capital into housing and housing-related industries. And so, even if we are not seeing price inflation, we have all this credit out there, the potential for lending. And, of course, the banks aren't lending as much as a lot of people would like to see them lend.

And so we can't really predict where the next bubble will be, but it was in the stock market—before the housing bubble, there was a stock market bubble. And the Fed responded to that bubble with the policy of low interest rates that created the housing bubble. And so I fear that we are going to have another one because of the amount of money that is being put in circulation is orders of magnitude greater than what the Greenspan Fed did.

But no one can forecast or predict what industry it is going to hit, and so I am afraid I can't help you there. But I am pretty confident that we should be worried about it.

Mr. LUETKEMEYER. What you are saying, though, is that, as a result of the money supply, there will be another bubble, because you are putting into the system some sort of an anomaly that will cause something else to happen somewhere else, such as—

Mr. DILORENZO. Yes. What happened with real estate is the low interest rates made it much more profitable to invest in long-term investments when interest rates go down. And so, all that money and resources is poured into real estate especially, and it ended up not being sustainable.

Mr. LUETKEMEYER. Do you have a best guess as to where it may happen next?

Mr. DILORENZO. We have some criteria. Like, one of the reasons why I think it happened in real estate and it was such a catastrophe was all these new products, new financial products, and there were a lot of people who really were confused by them.

And so, just as a general rule, in industries that are relatively new, where there is uncertainty on the side of the consumer, that is where the trouble can be. And so that might lead to a lot of possibilities. But I can't—I don't have any particular industry that I could—maybe Professor Vedder does. I don't.

Mr. VEDDER. I think economists who make predictions are foolish.

Mr. LUETKEMEYER. Are there a lot of Fed economists around?

Mr. VEDDER. A lot of failing economists?

Mr. LUETKEMEYER. No. Aren't there a lot of economists at the Fed?

Mr. VEDDER. There are a lot, and there are a lot of mistakes that are made. Dr. Bivens mentioned with great admiration Christina Romer, whose most famous quote in modern times was her quote early in 2009 when she said, "If the stimulus package passes, the unemployment rate will not go above 8 percent." It is at 9 percent now and has been to 10 percent.

And so, I agree with Tom that we have a ticking time bomb out there, and exactly what the shape of the disaster will be I don't know. We have these mammoth excess reserves at banks.

And Dr. Bivens is actually right, he is absolutely right, we haven't had a huge amount of inflation now. And it is true people aren't spending a lot of money now. Why aren't they spending money? Is it because interest rates are too high? No. It is because they are scared. They are just downright scared. They are scared because, "Oh, we don't know this Obamacare, what it is going to do to us." We have had a regime change. People are scared. We are not used to big changes all at once. And because of that—but we have the potential for a disaster.

Mr. LUETKEMEYER. Okay. Very good. Thank you.

Dr. Bivens, you made a comment a while ago—you were discussing Japan. And they have had many, many influxes of cash into their economic system, QE2, 3, 4, 5, 6, whatever. And you made the point that it was able, as a result of that, to sort of help keep inflation low and interest rates low.

My concern is that their economy still is struggling. And it has been that way for 15, 20 years. If QE2 is supposed to be the end-all, be-all to help us create jobs and get our economy going, how do you correlate those two?

Mr. BIVENS. If you look at Japan, it pretty much had a lost decade of the 1990s, and they were sort of riven with internal debate about just how aggressive to get with monetary policy. And they never actually did, sort of, the unconventional large-scale asset purchases that the Fed has been doing. And—

Mr. LUETKEMEYER. Yes, but didn't they put a lot of money into the system, though?

Mr. BIVENS. They kept interest rates very low, yes.

Mr. LUETKEMEYER. That is my point. My point is, if we go along with the Fed's mindset here and policy of throwing more money into the system and we look at Japan as an example, over many years and on many QE2s or QE1s or whatever, and it didn't really do what we are hoping that this QE2 over here is going to do, what is the thought process that would lead one to believe that ours is going to be different than theirs?

Mr. BIVENS. It won't be different. They only saw a real recovery between 2002 and 2008 when they started doing the QE2s. Before that, they sat at zero, but they did no more. They said, we can't do anything else unconventional, you just don't do that. Everyone—not everyone—many people said, no, the economy needs more.

When they finally started doing more on the monetary side, they actually saw a pretty decent recovery during 2002 to 2008. And then, of course, everybody, globally, went into the great recession.

Mr. LUETKEMEYER. Okay. I see my time is up. Thank you, Mr. Chairman.

Chairman PAUL. Thank you.

I want to yield 5 minutes now to Congresswoman Hayworth from New York.

Dr. HAYWORTH. I yield my time at this time, Mr. Chairman. Thank you.

Chairman PAUL. Okay. Thank you.

I yield 5 minutes to Congressman Huizenga from Michigan. Is he not here?

Okay. I yield 5 minutes to Congressman Schweikert from Arizona.

Mr. SCHWEIKERT. Thank you, Mr. Chairman, committee members, and witnesses.

I may be one of those who is a little less interested in what is going on now or the last couple of years. I can grab a financial paper and read that. What I am trying to get my head around is a central bank and the monetary policy as we run it as a country for the last, let's call it, 100 years. Does it exacerbate the swings and, therefore, in many ways, unemploy more people and make the troughs much deeper?

For any of you, if someone like myself wanted to sit and read and get better educated, where in the literature do I find the best scholarly, fairest, and most detailed papers? Let's start from the left.

Mr. DILORENZO. There are several treatises on the history of money and banking. One of them is authored by Richard Timberlake, who has taught economics at the University of Georgia for many years. He is retired now. There is another one by Murray Rothbard, "A History of Money and Banking in the United States." And those are both very good books.

And since you are a very busy Member of Congress, that sounds like a tall order to begin with, but—

Mr. SCHWEIKERT. One of the joys of being from Arizona is that I have a 5-hour flight both ways.

Mr. DILORENZO. Okay, those are two books I would pick up.

But, also, this weekend there is a conference at Wake Forest University under the title, "The Fed Was a Mistake." And there is a professor from the University of Georgia named George Selgin who is giving a presentation based on an academic paper. And he has looked at the last hundred years of the Fed's performance, the very question you are asking. And I can put you in touch with Professor Selgin, if you really would like to, for your next flight back to Arizona.

But he was actually at my university last week and gave this presentation, a PowerPoint. And he looked at all the Fed's obstensible goals—price stability, unemployment—and makes the case that the Fed has, in general, failed, although it has not been a dramatic failure, but it was a failure nevertheless to stabilize prices and unemployment.

Mr. SCHWEIKERT. I appreciate it. I know I have only 5 minutes, so I want to, sort of, drive through this.

Mr. VEDDER. Congressman, there is a new history of the Federal Reserve written by a very distinguished scholar, Allan Meltzer of Carnegie Mellon University. It is up through the 1980s or the

1990s. And it is not a complete history, but it is a second volume of a history. He is a very well-renowned monetary scholar. I haven't read the book entirely, but I sat in on a conversation with him and Chairman Volcker a couple of weeks ago at AEI, and it strikes me that it would be a very instructive kind of work, as well.

Mr. SCHWEIKERT. All right.

Mr. BIVENS. Just quickly, spanning the spectrum of ideology, "A Monetary History of the United States," Milton Friedman and Anna Schwartz.

Mr. SCHWEIKERT. Okay, which I actually have.

Mr. BIVENS. "Secrets of the Temple" by William Greider. What is that?

Mr. SCHWEIKERT. No, go on.

Mr. BIVENS. And I would say an absolute classic and very readable, "Manias, Panics, and Crashes" by Charles Kindleberger, formerly of MIT.

Mr. SCHWEIKERT. All right.

Mr. Chairman, witnesses, when I see monetary expansion in the way—let's just take the most current case scenario. And, at the same time, I have been spending tremendous amounts of time reading about the GSEs and the overhang and the mortgages and all the nonperforming debt we have at so many different levels.

Does this monetary policy end up creating a situation where we are not taking nonperforming assets and either writing them down or getting them off the books? And does this end up creating a huge overhang here that this monetization makes it so I can keep them on the books, basically sort of creating sort of a flat line?

Mr. DILORENZO. Yes, that is exactly what has to happen, the liquidation of all of those bad assets and those bad investments. Historically, that is how recessions end. The bust period, as I said earlier, of the boom-and-bust cycles that we have is really the recovery period where businesses become stronger on the way out, at the end of the recession.

And the Fed seems to have been doing everything it can to delay that process of the liquidation of these bad assets. And I think that is a very bad idea.

Mr. VEDDER. I am going to defer an answer on this because—I think Tom is probably right, but I haven't studied the specifics of the nonperforming assets closely enough to make an informed—

Mr. SCHWEIKERT. All right.

Doctor?

Mr. BIVENS. I don't think it is—I think it is true that some writing down of bad assets is going to be part of a good recovery. I have to say, though, I think the Fed's actions by avoiding deflation, outright falling prices, is actually going to make people climbing out of their debt burdens over the next 5 to 10 years easier.

If you have a mortgage that is fixed at $150,000, and every other price in the economy starts plummeting around it, then all of a sudden your mortgage payment has just gotten a lot more onerous for you. And so I think, by avoiding deflation, it is actually going to make the debt overhang less of an impediment to recovery in the next 5 to 10 years.

Mr. SCHWEIKERT. Okay.

Mr. Chairman, how much time do I have?

Chairman PAUL. I think your time has expired.

Mr. SCHWEIKERT. Oh. And I was just getting to the really good questions.

Chairman PAUL. If you hang around, you will get another 5 minutes.

Mr. SCHWEIKERT. All right. Thank you.

Chairman PAUL. I would like to yield 5 minutes now to Congressman Renacci from Ohio.

Mr. RENACCI. Thank you, Mr. Chairman.

I have been a small-business owner for 28 years, and I actually created jobs at the age of 24 with very little money in the bank. But I did have the opportunity to have banks willing to lend me money and the opportunity to create over 1,500 jobs in my career.

I want to ask all three gentlemen on the panel whether they believe the new duties given to the Fed in the Dodd-Frank Wall Street Reform and Consumer Protection Act will have an effect on employment growth. Because I am a believer that the free-market system will create jobs. I am a little concerned about that. I wanted to hear all three of your opinions.

Mr. DILORENZO. The Fed has a publication that has a title something like, "The Structure and Functions of the Federal Reserve." And it lists, I think, at least 30 or 40 different areas where it regulates different types of financial markets.

And for those of you who are businesspeople, you know that there is a very big cost involved in that. As Professor Vedder mentioned about the Dodd-Frank bill, it is not a free lunch. It is very costly to banks to enforce the provisions of that bill, and they are going to pass on some of the costs to their customers.

And so, expanding the prerogatives of the Fed is going to add more layers of regulation and make the banking business that much more costly. There may be benefits along, but it is going to make it more costly and more costly to consumers, as well, and more burdensome for businesspeople like yourself, in my view.

Mr. VEDDER. The cause of unemployment is too high a price for labor. When labor cost go up too much, employers hire fewer workers. It is the law of demand. It is very simple, not very complicated. I wrote a book about this, which a lot of people have praised to the skies. I thought it was the simplest concept in the world.

Dodd-Frank, other things being equal, does not lower the cost of labor. If anything, it raises costs generally to employers, making it difficult to employ workers. So the net effect of a mechanism like Dodd-Frank is probably to reduce, rather than increase, employment and, thus, increase unemployment in the United States.

Mr. BIVENS. I would say quickly, it is going to have little effect on what happens to unemployment.

I will make two distinctions here. One, I have been mostly talking about, sort of, monetary ease and interest rates and I think that the Fed has mostly gotten it right, at least in direction. It is true, I do think that the Fed and every other institution in the 2000s had too light a regulatory touch. And so I think booms and busts are caused by light regulatory touches.

I think the way that Dodd-Frank empowers the Fed to actually provide some tighter regulation, I think that is going to be a good thing, reduce boom-and-bust cycles in the future. And so I think it is an improvement.

Mr. RENACCI. Thank you, Mr. Chairman. I yield back.

Chairman PAUL. I thank you.

We will now go into a second round of questioning.

I would like to address this question to Dr. Bivens. This has to do with the debt that we have and its relationship to monetary policy. Even the Chairman of the Fed, Chairman Bernanke, has indicated that he thinks debt and deficits are a problem and has admonished the Congress to get their budget under control.

Do you have similar concerns? Is there a limit to how much debt we can have and how high these deficits should run? Or is that of no concern at all when we are in the midst of a recession?

Mr. BIVENS. I absolutely have concerns over, sort of, the long-run debt limits that are on the United States. And I think we should definitely move to, sort of, long-run, closer budget balance than is currently forecast.

I will say, it is not a concern of mine over the next, say, 2 years. To me, what the economy needs now is spending power, support from both the fiscal and monetary side. Some moving in the next couple of years to radically reduce deficits and debt would be very counterproductive.

But, absolutely, in longer-run periods, as unemployment returns to a tolerable level, that should absolutely be a concern.

Chairman PAUL. Thank you.

I would like to suggest to Dr. DiLorenzo and Dr. Vedder that there is a connection between monetary policy and deficits. Because if we didn't have the facilitator there, the ability of the Fed to buy debt and manipulate interest rates, wouldn't there be a self-mechanism where Congress would literally be unable to spend the money because interest rates would go up? And interest rates—of course nobody wants them high and they are bad politics, but wouldn't that be a way of holding a check on government?

And, really, it isn't just the Congress; it is the fact that the monetary system there accommodates the Congress because there is a lot of bipartisanship in the Congress. Sometimes, there are big-government conservatives who like to spend money, and sometimes, there are big-government liberals who like to spend money, and there is too much bipartisanship. They get together and they spend this money. And they figure, if we can get away with it, we are just going to allow the Fed to monetize this.

And, for a long time, they can get away with it. And they have done this, especially since 1971, until they finally got this huge bubble that finally burst, and we are in the midst of this great recession. For those who are employed, it is a depression.

But do you agree with that connection, that the Fed has something to do with encouraging the Fed to act irresponsibly?

Mr. DILORENZO. I would. I think you hit the nail on the head. I would agree completely with that.

And, of course, when the Fed gets involved, it reduces the perceived cost of government. If you raise taxes to pay for government services, it is much more explicit and hits you in the face; you get a bill. But when the Fed prints money and expands the money supply, it has what economists call a "fiscal illusion effect." And it makes it that much easier for this bipartisanship to occur that you referred to.

Chairman PAUL. Dr. Vedder?

Mr. VEDDER. I agree with Dr. DiLorenzo and with your analysis, Dr. Paul. And, indeed, in my statement, I was worried I was talking a little bit too much about fiscal policy and debt, but I was doing it for exactly the reasons you indicated. I think there is a real connection.

And throughout the history of the Fed, even going back before 1951, when the Fed was tied into the Treasury to keep interest rates down during the war, the Fed just keeping buying bonds and so forth. It was a deliberate policy to help the government manage its fiscal affairs. The Fed accommodated it by monetizing a lot of the debt.

This has been going on and on and on. And it will go on as long as Congressmen have to be re-elected every 2 years and as long as the Fed has some connection to the Federal Government. It is inevitable that it will go on.

Chairman PAUL. Thank you.

This is a question for Dr. Bivens. This has to do with a reference to what Dr. Vedder said earlier. He said that part of the reason we go into recessions is because labor costs get too high. Of course, nobody likes to hear that.

But if this is true—and I believe Keynes spoke to this at one time, because labor costs get too high, but you can't go and, say, cut your labor. You can't cut nominal costs. But he argued that real costs could go down by inflation. And you raise it and you lower the value of the dollar, so real cost goes down. And that helps you get out of the recession.

Do you buy into that argument? Or how would you look at that, on the need to get labor costs down?

Mr. BIVENS. I actually don't buy into that argument.

The way I read Keynes is, sort of, as follows: that the first shot fired against his idea, that the way to fight recessions is to try to have the Fed and to have fiscal policymakers add more support to the economy, the first shot was, no, no, you just need to get the price of labor down. And he said basically, one, it is hard to get the price of labor down, even if all workers in the economy said, "Yes, we all agree to a 10 percent wage cut today, cut our wages," all that would do is lead to a 10 percent fall in prices, as well. So the real wage actually would not fall much. It is actually very hard—

Chairman PAUL. Wouldn't that be good? Wouldn't that be good, to see prices come down?

Mr. BIVENS. No, because—

Chairman PAUL. It would help the consumer.

Mr. BIVENS. I am sorry?

Chairman PAUL. It would help the consumer, with prices going—what is so bad about prices going down?

Mr. BIVENS. Because their wages went down the exact same amount, and so their purchasing power has not changed at all.

Chairman PAUL. Yes, but—

Mr. BIVENS. What you would do is you would make the value of their debt more onerous. Basically, by increasing the value of debt, again, you have a $150,000 fixed mortgage and all of a sudden your wage is 10 percent lower, all of a sudden you are more constrained by your nominal debt payments. And that will make the economy worse.

And so, Keynes is pretty clear, wage-cutting is absolutely not the way to get out of a recession.

Chairman PAUL. Okay.

I now will yield 5 minutes to Congressman Clay.

Mr. CLAY. Thank you, Mr. Chairman.

And, Dr. Bivens, we were told by Dr. Vedder that private markets handled mortgages and other lending for generations successfully without Federal intervention. Again, the data shows otherwise.

According to the Congressional Research Service, during the years 1920 through 1945, the last period of time when the Federal Government had a very small role in homeownership, rates were only between 40 and 50 percent of homeownership nationally. Now that rate, at a time when the Federal Government is supposedly inappropriately involved, is 67 percent. The homeownership rate was even higher within the last few years, as high as 69 percent.

So I don't see how the numbers back up these claims about supposed excessive, expansionary policies on home lending. Can you help explain this error?

Mr. BIVENS. I think my assessment, sort of, agrees with yours, that I think the government support of homeownership played a key role in having that increase a lot in the post-war era. I am willing to quibble a bit that maybe some of the homeownership rates we saw in 2006, 2007 were bubble-inflated. But the trend is clear as day: With the introduction of Fannie and Freddie, with government support for homeownership, those rates rose pretty quickly.

Mr. CLAY. Thank you for that response.

Do you think there is value in having the Fed maintain a dual mandate for monetary policy?

Mr. BIVENS. I do, and especially if the alternative is to drop the full employment mandate. I think that would be a disaster.

To my mind, if there is a criticism of the Fed over a longer run, the last 30 years, it is that they have actually allowed that part of their dual mandate, the full employment part of it, to sort of go by the wayside and focused excessively on the price stability part.

And so, a Fed that actually took that dual mandate seriously, I think, would be a very good thing.

Mr. CLAY. Do you think that if the Fed were operating with a single price stability mandate, that its execution of monetary policy since the onset of the financial crisis of September of 2008 would have been materially different or would have led to significantly different outcomes in the economy?

Mr. BIVENS. It is a good question. I think where that single mandate of price stability would really be a bad thing is during expansions.

The irony here is that most people think the Fed have something like a 1 to 2 percent inflation target, seems to be—they are pretty consistently missing that, on the low side, these days. Inflation rates are coming in well below 1 percent.

So even if they only had a commitment to 1½ percent inflation—forget the employment side—if that was their only commitment, they should still loosen. And so that is how bad the economy is today. Even if all they had was a pretty conservative price target, they should still be providing all the support they are and maybe even a little more.

Mr. CLAY. Thank you for that response.

And, Mr. Chairman, I yield back the balance of my time.

Chairman PAUL. Thank you.

I now yield 5 minutes to Mr. Huizenga from Michigan.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate that.

And my colleague from Missouri just, actually, started going down a road that I wanted to explore a little bit.

Dr. Vedder, from the historical perspective, I think it would be helpful to have a very brief explanation about the dual mandate. How long has it been in place? Why was it really implemented?

And then, moving on to all three of you, is the dual mandate a proper mandate? I think Dr. Bivens was starting to talk a little bit about that, but I would like to hear the remainder of the panel's views on that.

Mr. VEDDER. The dual mandate—when I think of the history of this, I think first of the Employment Act of 1946, where the government committed itself to a policy of encouraging full employment. And even in that bill, price stability was mentioned, and it was part of the so-called mandate. Again, it was more a statement of intent rather than a prescriptive statement.

The Humphrey-Hawkins bill, which I think was, what, 1977 or something like that, was a more explicit widening of that mandate and made much more explicit.

And all of this precedes, sort of—there was almost implicit in some of this, a lot of this, as relates to what we might call the "Phillips curve" idea, that if you have price stability—can you have price stability and full employment? That is the empirical issue.

We can have that discussion. I do not think that the manipulation of prices in the long run impacts on employment, period. I think it does in the short run. I have written a book which indicates it does. There is a Phillips curve in the short run sometimes, but in the long run—higher inflation, lower unemployment. But in the long run, I don't see that that relationship exists.

Mr. DILORENZO. In terms of the price stability, we have price indexes that go all the way back to the 1790s or even a few years before that. And the price level in 1913, when the Fed was created, was roughly the same as it was in 1790, with some ups and downs. But ever since the Fed was created, the price level is 22 times higher now. So when I hear the idea that the Fed has a mandate to stabilize prices, it is almost farcical.

And I don't think, overall, it has done a very good job in stabilizing employment either. You can mandate that is the Fed's job, but I think, historically, it hasn't done a very good job in either one.

Mr. BIVENS. Yes, in regards to that, I will say that I would much rather have average economic growth and the frequency of duration of recessions we have had post-1914 than in the 150 years prior. Basically, some moderate rate of inflation is the price you pay for having economic growth and fighting recessions in a serious way.

Again, to the degree that there has been a problem with the dual mandate over the past 25, 30 years, it has been that one-half of it, the full employment commitment, has really been sort of the neglected part.

Mr. HUIZENGA. So if I am hearing you, Dr. Bivens, you want to see the dual mandate remain, correct?

Mr. BIVENS. Yes.

Mr. HUIZENGA. Okay.

And I guess, the other two panelists, do you believe it is appropriate for that language to remain in there as goals and objectives? Dr. Vedder and Dr. DiLorenzo?

Mr. VEDDER. I think we ought to repeal the Humphrey-Hawkins Act, period, just do away with it.

Mr. DILORENZO. I agree with that. We have mentioned Christina Romer several times. One of her academic articles revises some data and shows that the business cycle was actually not more unstable in the pre-Fed era in the 19th Century than it was after the pre-Fed era. So you can't even make the case anymore, according to Christina Romer's research, that the Fed has done anything to stabilize the business cycle compared to the bad system we had, the admittedly bad, flawed system we had before the Fed came into being.

Mr. HUIZENGA. Dr. Bivens, do you care to address Humphrey-Hawkins at all or any of the other points?

Mr. BIVENS. First, it was my understanding that Humphrey-Hawkins was actually no longer in effect. Am I wrong on that? Did it lapse in 2005 or 2006?

Mr. HUIZENGA. I wasn't here.

Mr. BIVENS. Okay. Sorry. So I am not, you know—I think the dual mandate should absolutely be part of what the Fed is tasked to do.

Mr. HUIZENGA. Okay.

Thank you, Mr. Chairman. I yield back my time.

Chairman PAUL. Thank you.

I now yield 5 minutes to Congresswoman Maloney from New York, who has joined us.

Mrs. MALONEY. Thank you so much, Mr. Chairman, for this hearing.

And I thank all the panelists for their thoughtful testimony that they delivered to our offices.

I would like to ask Dr. Vedder to comment on some of the facts that were raised in Dr. Bivens's testimony. In his testimony, he cited a study estimating that the $600 billion in Treasury asset purchases is likely to boost GDP by up to a full percentage point, which translates into roughly 1 million full-time jobs.

That same study also stated that the full effect of all large-scale asset purchases undertaken by the Federal Reserve probably supported nearly 3 million jobs and will have lowered measured unemployment by 1.5 percentage points through the end of 2012. Other economists and researchers have supported this with similar studies and results.

And so my question to Dr. Vedder is, isn't this solid research, solid evidence that sound monetary policy does help create jobs?

Mr. VEDDER. I haven't read the studies, to be honest, Congresswoman.

But I will say this: Since the recession began in late 2007, the Fed has followed the most expansionary monetary policy in, I think, its history in a situation like this. It has created a trillion dollars in excess reserves. It has done a whole variety of efforts and exertions to bail out companies and so forth in distress. And yet, we have fewer people working today than we did when this effort began. We have the worst employment record of any major downturn since the Great Depression.

And so I can't see any positive association between Federal Reserve monetary policy and job creation based on the reading of the evidence in a period when we have a 9 percent unemployment rate and we have, what, 15 million—"X" number of people out of work. It is kind of hard to get warm and fuzzy about the Fed's success rate with its monetary policy in recent times.

Mrs. MALONEY. May I ask unanimous consent to place this study in the record?

Chairman PAUL. Without objection, it is so ordered.

Mrs. MALONEY. And also to state that Christina Romer and others, other economists, including major economists, have testified that the economic shocks that our country has suffered are 3 times worse than the Great Depression. As the daughter of parents who suffered through the Great Depression, no matter how horrible this recession is or has been, it is nothing like what our country went through in the Great Depression.

So I would like to ask Dr. Bivens, Dr. Vedder mentioned that he believes that there should be constitutional constraints placed on the Federal Reserve's authority. Can you comment on that? And do you agree?

Mr. BIVENS. First, I would just like to reiterate your point. It is bad out there in the U.S. economy; the great recession is really bad. The shock to the private sector that happened with the burst in the housing bubble is absolutely enormous. Like you say, researchers in many places say it was bigger than what led to, actually, the Great Depression. And I think it was the aggressive response of policymakers across-the-board that kept it from being so.

In terms of constitutional limits on the Fed, I would like a lot more detail. If those limits would impede them from fighting future recessions as aggressively as they fought this one, I think that would be a very bad thing.

I think it is one thing to say this has been the most aggressive response ever and we still have 9 percent unemployment. It is kind of like, imagine a town that is building a levee wall in response to a flood. You can say, "It is the biggest levee we ever built, but the water keeps coming over it. We should stop. It is bigger than we have ever built." You have to build a wall as big as the shock.

Mrs. MALONEY. Okay. Thank you.

Last week, Chairman Bernanke gave a speech at the National Press Club. I ask unanimous consent to place that speech in the record.

Chairman PAUL. Without objection, it is so ordered.

Mrs. MALONEY. And he stated that, although economic growth will probably increase this year, unemployment is expected to remain above and inflation below the levels that policymakers have judged to foster maximum employment and price stability.

Since the Fed's rate has been near zero since December 2008, the Fed has been using alternative tools to provide additional monetary accommodation. Specifically, the Fed has been purchasing longer-term securities on the open market, or in common speech it has been called quantitative easing. And the goal of this has been to put downward pressure directly on longer-term interest rates.

Chairman Bernanke—and I want to ask the panelists if they could respond to whether or not they agree with his statement. He stated that, "A wide range of market indicators supports the view that the Federal Reserve's securities purchases have been effective at easing financial conditions."

I would like the panel to comment on whether they agree or disagree. I think it is an important question.

Mr. DILORENZO. They have to have had an effect in some industries, of course, because wherever the money goes to first. But, obviously, it has had very little effect on overall unemployment, since the unemployment rate remains stuck around 9 percent or more, depending on how it is measured.

So, yes, it has had some effect on some industries. That is why the stock market is up, some of the big corporations have done well. But unemployment is not being very successful.

Mrs. MALONEY. Could you also comment on what would have happened if we had not engaged in quantitative easing with the Fed's fund rate close to zero? What would have happened?

Mr. DILORENZO. Since you are, sort of, looking at me, it is not a coincidence, I don't think, that we have had somewhat of an explosion in government at all levels—the Fed printing money, government spending, government debt, and we are stuck at 9 percent unemployment or more. Because all of this diverts resources in the direction of government-directed spending in resource allocation away from the entrepreneurs and the business owners and the consumers, who know a lot better what to do with that money than government bureaucrats and politicians do.

And so I think we would be much worse off—as we said earlier before you came, Congresswoman, that we may be sowing the seeds of another bubble with all this quantitative easing.

Mrs. MALONEY. Dr. Bivens, would you comment briefly?

Mr. BIVENS. Yes, very briefly. If we had not done the quantitative easing, long-term interest rates would be higher, and we would have less business investment and consumer spending.

And I would just note, business investment has performed very well for the past 5 or 6 quarters, growing at about 15 percent at an annualized rate. So we would have less of that if we had not done the quantitative easing.

Mrs. MALONEY. My time has expired.

Chairman PAUL. Thank you.

I now yield 5 minutes to Congressman Jones from North Carolina.

Mr. JONES. Mr. Chairman, thank you again.

And I again want to start with an e-mail from my district and then get to a question.

This is Mr. Gordon Hansen from New Bern, North Carolina: "Thank you for requesting my opinion with regard to the Federal Reserve. My initial reaction to the Fed's policy to printing more money is, how is the Fed going to stop inflation? Since the beginning of this century, standard of living has decreased because fuel increased so rapidly, the middle-class wages could not keep up, and no one seems to notice or care."

This is America talking, quite frankly. And we have been elected by the people from all over this country to represent their feelings and their needs in Washington, D.C.

I have great respect for each and every one of you. You are very learned men, much more than I.

The frustration that I see back in my district and I feel is that, when I was born in 1943—and thank you for recognizing my birthday tomorrow—when I was born in 1943, this country was in war and coming out of war. This country impressed the world with its greatness after the war, of how we were in a position where we were creating things, we were manufacturing things.

And that gets me to the point that I am one of the few Republicans—I am opposed to any trade agreement at this time. I am not adamantly opposed to trade agreements, but when you are in a deep recession, which everybody has acknowledged, why are we passing the Korean trade agreement so we can create 70,000 jobs, I believe has been said. I am trying to verify that, by the way. I don't believe it.

But the point is, this country is a debtor nation. Now, we can pump it up, from the Feds to everybody else can put money out here. But, as everybody is saying, the people understand what is happening. They fully understand what is happening.

So my point is this. My State of North Carolina, from 1999 until 2009, lost 376,000 manufacturing jobs. What would have happened, in your opinion—I have a two-part question—what would have happened, in your opinion, if we had not passed NAFTA, CAFTA, and all of these trade agreements that supposedly were going to create more jobs for the American people?

I think greed is probably the most dangerous thing affecting America. Greed will destroy an individual, it will destroy a family, it will destroy a country. And my humble opinion is that greed has put America in this position, not only because of trade agreements.

But, in your learned minds, give me an example of nations that at one time were economically strong and yet, because of some decision such as free trade, that these nations—and maybe it is not exactly the same comparison—but these nations, in my opinion—at one time, Spain ruled the world. At one time, France ruled the world. At one time, Rome ruled the world. At one time, America was the dominant power. Now it is China. And we are slaves to China. We owe them over $900 billion.

From an economic standpoint, where do you see America? Are we at a point that America needs to understand that we cannot come back to be a strong power in the world? Are we at a point where, yes, we will have somewhat of a quality of lifestyle, but it is never going to go back, it is not even going to come close to going back to what it was?

I don't think you can continue to sell yourself out to other nations and expect to be strong economically or militarily.

Any response?

Mr. DiLorenzo. Sir, the countries you mentioned, the Spanish empire and so forth, they essentially bankrupted themselves with empire. And, in my view, we are a long way down that road with our military empire all around the world, too. And so I think that is a contributing factor.

And the only other thing I will say is, I am a free-market economist, but I opposed NAFTA at the time because when I first saw it, it was, like, a thousand pages of government regulations. And I didn't think it really constituted free trade at all, but government-managed trade. And I guess you would you have to do a careful study of how it has been managed over the past 15 years or so to really know its effects. But I wouldn't blame the problems on free trade, because I don't think NAFTA was a free-trade agreement, despite the words "free trade."

Mr. Jones. Thank you.

Mr. Vedder. I more or less agree with Professor DiLorenzo. I do believe in free trade as a concept. I think most economists do. This is one thing economists of all persuasions more or less agree with, but we do put a lot of provisions in these bills that get far afield from the issue of trade. And I think that is a source of concern.

As an economic historian, I would have to note that nations have rises and falls in the way people work and what they do. We had a rise in manufacturing in the 19th and early 20th centuries because of what us economists say, we had a comparative advantage in manufacturing. We have lost some of that comparative advantage today. Some of it has to do with government policies. Some of it has to do with other things that have nothing do with what the U.S. Government does.

I don't personally worry too much about the loss of manufacturing jobs per se. What I worry about is the loss of jobs in totality, the productivity of labor in its totality, and so forth. And that is, I think, a broader concern.

Mr. Bivens. You asked a very big question, so let me just try to be very brief.

I think it is absolutely true that if we want different results, if we want living standards to continue to grow at a reasonable rate in the United States for the broad workforce, we better start doing lots of things differently. And one of those things we should do differently is our international economic policy.

I am a little shocked to agree; I also did not like NAFTA. I think we need to think about exchange rates very differently. And so we better start doing things differently if we want to continue to grow.

Mr. Jones. Thank you, Mr. Chairman.

Chairman Paul. Thank you.

I will yield 5 minutes now to Mr. Green from Texas.

Mr. Green. Thank you, Mr. Chairman.

Let's talk for just a moment about causal connections as opposed to coincidence. Last summer, when the American Recovery and Reinvestment Act was at its zenith, when it was providing maximum benefit, we also at that time saw the turnaround in terms of a recovery in the economy.

Mr. Bivens, was that just coincidence or is there a causal connection?

Mr. BIVENS. I definitely believe there is a causal connection. Like you say, the Recovery Act was providing a sort of maximal boost to the U.S. economy at that point. There are a lot of estimates that said, without the support provided by the Recovery Act, we would have seen zero growth for about 3 or 4 quarters even after the official recession ended.

Mr. GREEN. Let's move now to the FDIC.

Mr. DiLorenzo, do you, sir, believe that the FDIC serves a meaningful purpose with its ability to wind down banks that are failing?

Mr. DILORENZO. With its ability to close down banks?

Mr. GREEN. That are failing. When they are failing, the FDIC moves in, usually on a Friday, they wind down the bank, and then on Monday there is a new bank that opens, perhaps under the same name, or a new name, but they do reopen, and they move the assets. And they have the ability to do this with a premium that is paid by banks so as not to interrupt the economy.

Do you agree with this?

Mr. DILORENZO. I don't think we need a government institution to do that. That could be handled by the courts, I would think. But it is probably one of the least offensive things the FDIC—

Mr. GREEN. You would not have the FDIC, you would have the courts deal with the banks and the runs that would be created on banks? You would have multiple banks, as was the case when we were starting the great recession, that were challenged, and you would just simply let all of these banks go into bankruptcy? Do you not see that by doing this we would have runs, greater runs on banks that would create greater stress on the economy?

Mr. DILORENZO. I am not sure—before we had an FDIC, I am not sure you could make the case that the bank runs were worse throughout history.

Mr. GREEN. They were. Before we had the FDIC, we had the Great Depression.

Mr. DILORENZO. Yes, for a few short periods. But if you look at the long stretch of history, I don't think—you would have a much tougher time making that case.

Mr. GREEN. I would say to you that a few short periods that devastate the economy to the extent that the Great Depression did is something that would not go unnoticed.

Mr. Bivens, do you think the FDIC serves a meaningful purpose?

Mr. BIVENS. Absolutely, for the reasons you say. They make people secure in their deposits, and so you don't see the runs.

Mr. GREEN. Mr. Vedder, do you think the FDIC serves a meaningful purpose?

Mr. VEDDER. I wrote my doctoral dissertation on the FDIC. I think, generally, it has been one of the more successful government agencies. I do think it needs, however—

Mr. GREEN. Excuse me, since my time is limited. Thank you. Let me just follow up with this.

Mr. VEDDER. It needs—

Mr. GREEN. You will get an opportunity.

Let me follow up with this. Given that you think it serves a meaningful purpose—and I agree with you—let us then conclude something else. Do you think that we should be able to wind down these AIGs of the world when they can provide systemic risk to the economy? Or should they just be allowed to bring the economy down?

The AIGs of the world—you are familiar with AIG?

Mr. VEDDER. What do you mean by "wind them down?" Why don't we let them go into bankruptcy? What is wrong with bankruptcy?

Mr. GREEN. Why not let the banks go into bankruptcy? That is the point. You just said that the FDIC protects banks. If you are going to prevent banks from going into bankruptcy, why not try to salvage the economy and prevent the types of stress that can be caused by having these institutions that create systemic risk, by preventing them from just simply going into bankruptcy and creating all of these problems for us?

The point I am making is, Dodd-Frank deals with that. If you don't like Dodd-Frank, then you don't like a means by which we deal with "too-big-to-fail" institutions. Most people think that we need to do something about these institutions that were labeled "too-big-to-fail." Dodd-Frank addresses this. Dodd-Frank addresses other aspects.

You mentioned credit cards. Do you think there ought to be something called universal default? A lot of consumers are sitting in here. Are you familiar with that term, "universal default?"

Mr. VEDDER. I am familiar with the term, yes.

Mr. GREEN. Are you familiar with it? Do you think we ought to have universal default?

Mr. VEDDER. I haven't—I don't have a position on that.

Mr. GREEN. I do. I don't think consumers ought to be in a position such that, because they have problems in one place, credit card companies can simply decide, we are going to declare you in default with us because you had a problem someplace else, especially in this economy. Dodd-Frank deals with this.

Mr. VEDDER. Does it deal with Fannie Mae or Freddie Mac?

Mr. GREEN. Now, let me ask you one more. I have one more for you. I believe you are a gold standard person. Is that a fair statement, based upon your comments and your writings?

Mr. VEDDER. I think the gold standard—we did well when we were on the gold standard.

Mr. GREEN. And if we return to it, if we return to the gold standard, what would happen?

Mr. VEDDER. Pardon?

Mr. GREEN. What would happen if we returned to the gold standard?

Mr. VEDDER. It would be very—the return to the gold standard is not—if we did it and if the world did it, I think we would be a better place. I think we would be a better place. But I don't see it happening in the short term.

Mr. GREEN. Let's assume that you have made a prediction that we would be in a better place. Is that a fair statement?

Mr. VEDDER. Yes.

Mr. GREEN. Now, what did you say about people who make predictions earlier?

Mr. VEDDER. Economists are lousy predictors.

Mr. GREEN. What did you say about the people who make predictions?

Mr. VEDDER. So why are you sitting here listening to me, Congressman?

Mr. GREEN. I am listening to you because you are here as a person who merits some attention, given that you are before Congress.

Now, tell me, what did you say about people who make predictions?

Mr. VEDDER. What did I say?

Mr. GREEN. Yes, sir. You don't recall?

Mr. VEDDER. I said that some people, some economists make bad predictions, and some of them make good predictions.

Mr. GREEN. You had an "F" word that you used.

Mr. VEDDER. I did?

Mr. GREEN. Yes.

Mr. VEDDER. I don't remember.

Mr. GREEN. I do. You said they were foolish.

Mr. VEDDER. Foolish?

Mr. GREEN. Yes, sir.

Mr. VEDDER. Oh, okay.

Mr. GREEN. All right. Thank you for your prediction.

Mr. VEDDER. Okay.

Mr. GREEN. I yield back.

Chairman PAUL. I yield myself 5 minutes for closing remarks and anybody else who wants to have another question.

I do want to bring up the subject generally of QE2. There is a strong disagreement between those who object to it and Dr. Bivens, who thought that it really has helped a whole lot. And I don't think we will resolve that.

But, that was part of the program of injecting $4 trillion into the economy, with the argument that it has done very, very little at all and, some of us believe, maybe harm in the long run. But the $4 trillion, actually we can argue that it did help prevent a depression for some people, mainly Wall Street and the big bankers and some corporations. They were able to benefit. And who came out on the short end? The people who lost their jobs and lost their houses and lost their mortgages. So the whole thing didn't work if you were trying to help the poor people. I think you were destroying the poor people while it was nothing more than corporate welfare—$4 trillion, and we have very little to show for it.

But the question I want to address is, there is a little bit of talk—I don't think it is serious—about unwinding this. We bought up all the trash, all the worthless assets. And the taxpayers own this now, and it is on the books. We can't fully audit the Fed. We can't find out what they are doing. And now they are talking about, maybe we ought to unwind this. That is, we are going to sell that trash. Who is going to buy it? How do we do it? And when do we do it?

Chairman Bernanke says it is not time yet, but he is really cocky about this. He knows when it is, and he is going to do it, and he is going to do it smoothly. And what did he say about problems coming? His anticipation, his whole idea that when a crisis comes and when there is a recession, I can take care of it, I know how to inject money in just unlimited amounts. And I tell you what, he did, unlimited amounts, the largest ever. And the jury may be still out on how bad a failure it is going to be, but the time will come.

But the question is, what are we going to do about unwinding? Are they really serious? And what would that do to employment? If they did it now—they are not going to dare do it now, with unemployment rates, real unemployment rates up to 22 percent, because it would do that horrible thing of raising interest rates. So that is not going to happen.

What they are going to do is continue to look at the CPI. That is where Bernanke is going to get his signal. When the CPI goes up and we have price inflation, that is when we have to unwind.

And he is so overconfident about this. You talk about predictions and braggadocio, "I can take care of it." Like, he didn't know it was coming, he would take care of it if it came, and now he says, "I know exactly when to turn it off." I just think that is such dangerous talk.

By looking at the CPI, what does he do? He takes the CPI, he excludes food and energy, and says, gee, CPI isn't going up, and he has price stability. There is no more price stability in this country when you look at what happens to the bond prices and the housing prices and commodity prices. There is nothing. What is this stuff about unwinding?

I would like a comment from each one of you on what is going to happen, or if it happens, and what are the abilities of truly unwinding this and really saving us from a calamity?

First, Dr. DiLorenzo.

Mr. DiLorenzo. Congressman, what you just said reminds me of what Friedrich Hayek won the Nobel Prize for in 1974. It is summarized in a book of his called, "The Fatal Conceit." And it is essentially a critique of this whole idea that one man or one group or one committee could, sort of, essentially plan an economy, whether it is by manipulating interest rates or the price level or whatever else. And I see no reason why we Americans are better at central planning today than the Russians were in the 20th Century.

That is basically the mindset that you are talking about when you are talking about Chairman Bernanke claiming to be able to manipulate the economy in these ways. I don't see any way out. If he had a smooth exit strategy, I assume he would be taking it right now. And so I see nothing but bad things that could possibly happen from winding down, as you say.

Chairman Paul. Dr. Vedder?

Mr. Vedder. To me, the supreme irony of all of what you just said and what Professor DiLorenzo said is, why was the Fed created in the first place? I think if you read the history of the period, after the panic of 1907—the panic of 1907, there was no central bank. And so, what happened were a bunch of private bankers, led by J.P. Morgan, sort of organized an ad hoc committee to sort of save banks and prevent them from failing. And by the way, it achieved some success in doing that.

But afterwards, people said we can't have a single individual serve as sort of the guru to save our economy, like J.P. Morgan. We have to create a central bank and decentralize it into 12 banks and all, to keep the power diffuse.

And we moved away from that diffusion of power back to the centralization of power. Now it is Bernanke. At least J.P. Morgan had some skin in the game. He had some money in the game. When the banks failed, he failed. What does Bernanke have in the game? He gets his salary anyway and then goes off to work for Goldman Sachs.

So I think that is it. And I have no idea how it is going to be unwound. Because it is an historically unprecedented situation, I can't predict. But I am uneasy. And that is why markets are uneasy. And that is why prices—that is why we have the problems we have. That is why bond prices are starting to go up. That is why Moody's is starting to say, should we give AAA bond rating to the U.S. Government securities? Things like that. People are getting uneasy.

Chairman PAUL. Maybe Dr. Bivens will be more optimistic.

Mr. BIVENS. Slightly, yes. It is not a trivial challenge about how this is all going to be unwound. But I will say just two things quickly.

One, it is going to actually feel like a luxurious decision if we can start unwinding this and the unemployment rate is much lower. And so, to my mind, the proper focus now is on providing maximal support to job growth in the economy, not worrying so much about how this is unwound.

And two, I have to say, I am sure there will be mistakes made as we do it. I am sure there will be some targets missed. But he has actually—Ben Bernanke and the rest of the Fed has laid out a strategy for how this will be unwound. They have talked about the instruments they are going to use, the levers. Is it going to work perfectly? Are they going to hit forecasts to the decimal point? Absolutely not. But, to my mind, the fact that they are focused much more on support and job growth in the near term says very good things about what they are doing.

Chairman PAUL. Thank you.

Mr. Clay, I yield to you for another 5 minutes. Or Mr. Green.

Mr. CLAY. Mr. Chairman, I will yield to Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman. And I thank the ranking member, as well.

I would close by reminding us that we have seen, I am sure many of you, the movie, "Back to the Future." Based upon what I have heard today, there are some who would take us "forward to the past"—back to the past, or forward to the past, when we didn't have a Fed, when we didn't have FDIC, when we did not have VA, when we did not have many of the institutions that have helped people move into the middle class. Home ownership, 30-year mortgages—these things have made a difference in the lives of the American people.

And I would caution us, before we make decisions to eliminate institutions that have served us well, perhaps we should consider the unintended consequences of such a massive decision. And I think we ought to proceed with a great degree of caution when we say things like, we can live without the Fed, without the FDIC. I am indicating VA; no one said it. But when you are on this track, it appears to me that you may be talking about the VA, as well.

Many of these institutions have served a good many middle-class people well, and we ought to move with caution.

I thank you for the time, and I yield back.

Chairman PAUL. The hearing is adjourned.

[Whereupon, at 12:15 p.m., the hearing was adjourned.]

A P P E N D I X

February 9, 2011

United States House of Representatives
Subcommittee on Domestic Monetary Policy
"Can Monetary Policy Really Create Jobs?"
Hearing Date: February 9, 2011

Chairman Ron Paul
Statement for the Record

For the past three decades, the Federal Reserve has been tasked with a dual mandate: keeping prices stable and maximizing employment. Influenced by Keynesian economics and the supposed tradeoff between inflation and unemployment, the dual mandate relies on the idea that a handful of experts can successfully steer the American economy and create economic growth. This has forced upon us an interventionist monetary policy that believes that creation of money out of thin air is the cure for all that ails us.

This policy relies not only on the fatal conceit of believing in the wisdom of supposed experts, but also on numerical chicanery. Rather than understanding inflation in the classical sense as a monetary phenomenon-- an increase in the money supply- it has been redefined as an increase in the Consumer Price Index (CPI). The CPI is calculated based upon a weighted basket of goods which is constantly fluctuating, allowing for manipulation of the index to keep inflation expectations low. Employment figures are much the same, relying on survey data, seasonal adjustments, and birth/death models, while the major focus remains on the unemployment rate. Of course, the unemployment rate can fall as discouraged workers drop out of the labor market altogether, leading to the phenomenon of a falling unemployment rate with no job growth.

In terms of keeping stable prices, the Fed has failed miserably. According to the government's own CPI calculators, it takes $2.65 today to purchase what cost one dollar in 1980. And since its creation in 1913, the Federal Reserve has presided over a 98% decline in the dollar's purchasing power. Recent news stories have offered numerous anecdotes of prices rising far faster than would be expected if official inflation figures were accurate. With commodities, oil, or food prices, speculation is that the Federal Reserve's quantitative easing is leading to hot money flooding world markets. The average American family sees the price of milk, eggs, and meat increasing, while packaged household goods decrease in size rather than price. People around the world are reacting against the specter of sharp price increases. While the focus of this hearing does not deal with inflation or even specifically with the dual mandate, this subcommittee undoubtedly will hold further hearings on these topics in the future.

Today's hearing focuses on jobs, and the inability of the Federal Reserve's monetary policy to create jobs or to achieve maximum employment. The stagflation of the 1970s should have taught us this lesson already The Federal Reserve's loose monetary policy, rather than leading to a tradeoff between jobs and inflation, instead led to both high inflation and high unemployment. Hopefully we will learn the lesson this time around.

Of course loose fiscal policy has failed to create jobs too. Consider that we had a $700 billion TARP program, nearly $1 trillion in stimulus spending, a government takeover of General Motors, and hundreds of billions of dollars of guarantees to Fannie Mae, Freddie Mac, HUD, FDIC, etc. On top of those programs the Federal Reserve has provided over $4 trillion worth of assistance over the past few years through its credit facilities, purchases of mortgage-backed securities, and now its second round of quantitative easing. Yet even after all these trillions of dollars of spending and bailouts, total nonfarm payroll employment is still seven million jobs lower than it was before this crisis began. Since employment levels bottomed out last year, the government reports that roughly one million jobs have been created. This means that each job created has cost upwards of five million dollars. We probably would have been better off just printing out these trillions of dollars and throwing them out the window of a helicopter.

In this same period of time that we lost seven million jobs, the total U.S. population has increased by nine million people. We would expect that roughly four million of these people should have been employed, so we are really dealing with eleven million fewer employed people than would otherwise be expected. Let us put this figure in perspective. Eleven million people represents almost the population of Ohio, a figure greater than the population of 43 of the 50 states. Eleven million people is twice as many people as are currently employed in construction, 45% more people than are currently employed in financial activities, and almost as many people as are currently employed in manufacturing.

Unfortunately, numbers like these are often ignored or overlooked. Everyone pays attention to the unemployment rate, which has just recently declined. Part of this is due to discouraged workers who have given up looking for work and have taken themselves out of the labor force, but the employment numbers are rigged in such a way as to make it look as though the employment situation is improving.

Another curious anomaly in employment data relates to seasonal adjustments. Seasonal variations are understandable-- for instance workers hired for the Christmas season and laid off immediately afterward. But such statistical adjustments are easy to manipulate. When unemployment figures were released in February of 2010, non-seasonally adjusted figures showed an additional 1.4 million unemployed workers from December 2009 to January 2010, while the seasonally adjusted numbers showed 69,000 fewer unemployed. The most recent figures released in February of 2011 showed an additional 3.1 million unemployed workers from December 2010 to January 2011, yet the seasonal adjustment shows 367,000 fewer unemployed. Spinning a 22% increase in the number of unemployed workers into a statistical decrease should be met with a healthy dose of skepticism.

It should not be surprising that monetary policy is ineffective at creating jobs. For one thing, there are numerous other factors that affect employment, including taxes, labor laws, and other regulations that contribute to labor market rigidity and institutional unemployment. But it is the effects of monetary policy itself that cause the boom and bust of the business cycle that leads to swings in the unemployment rate.

By lowering interest rates through its loose monetary policy, the Fed spurs investment in long-term projects that would not be profitable at market-determined interest rates. The signal to businesses is that consumers are increasing savings and deferring consumption in order to consume more capital-intensive more in the future. If the Fed-mandated interest rate is in fact lower than the market interest rate, the reality is that consumer preferences between consumption and savings have not changed, but businesses act as though they have. The result of lower interest rates is an economic boom which manifests itself as a bubble.

Everything seems to go well for awhile until businesses realize that they cannot sell their newly-built houses, their inventories of iron ore, or their new cars. Low interest rates have spurred production, but because the low interest rates resulted from Fed intervention and not through changes in consumption patterns, the result is overcapacity. Resources have been "malinvested," directed into sectors of the economy which are not truly in demand from consumers. These resources must be liquidated, and this is the corresponding bursting of the bubble. Until these resources are redirected, often with great economic pain for all involved, true economic recovery cannot begin.

Labor is one of these resources that can be malinvested. As inflation rises due to the Fed's monetary intervention, real wage rates decrease, increasing the demand for labor and leading to lower unemployment. Sectors into which this new money flows see hiring increases, as we recently saw in financial services, mortgage lending, and construction during the housing boom. When the bust comes, however, these workers end up being laid off. They find it difficult to find employment in other industries due to an inability to sell their houses and move, or to retrain for a new skilled labor position, or for any number of other reasons. However the result of that initial meddling in monetary policy is an eventual increase in the unemployment rate.

We find ourselves now in the midst of the worst economic crisis in decades. Unemployment remains persistently high, and the United States cannot afford increased meddling by the Federal Reserve. Over $4 trillion in bailout facilities and outright debt monetization, combined with interest rates near zero for over two years, have not and will not contribute to increased employment. I shudder to think of what the Fed might do if the unemployment rate were to continue to increase.

By falsely diagnosing the cause of the crisis, the Fed's solution is fatally flawed. What is needed is liquidation of debt and of malinvested resources. Pumping money into the same sectors that have just crashed merely prolongs the crisis and ensures that the day of financial reckoning that eventually will come will be far more severe than otherwise. Until we learn the lesson that jobs are produced through real savings and investment and not through the creation of new money, we are doomed to repeat this boom and bust cycle.

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For Immediate Release | Contact: Jeff Emerson, Marisol Garibay 202-226-0471

February 9, 2011

Bachus: Entrepreneurs And Workers Of America Will Lead Us To Economic Recovery, Not Government

WASHINGTON: Financial Services Committee Chairman Spencer Bachus prepared statement for the Domestic Monetary Policy Subcommittee hearing entitled "Can Monetary Policy Really Create Jobs?" follows:

"I commend Chairman Paul for choosing this topic for the first hearing of this subcommittee.

"The nation's unemployment rate has been consistently at or above 9 percent for the longest period of time since World War II. Last week, the chairman of the Federal Reserve predicted we will have unacceptably high unemployment for several more years.

"There are reasons for this dearth of employment. Yes, we had a major economic catastrophe. But throughout our history, American businesses and American workers have proven themselves strong and resilient. In just our recent past, the economy was able to shrug off the S&L crisis and the bursting of the dot-com bubble relatively quickly. So what's different this time? Unlike now, we didn't have out-of-control spending and trillion dollar deficits as far as the eye can see. We did not have a Congress and a White House issuing an ever increasing and endless flurry of confusing statutory and regulatory mandates. We were not confronted by a Federal Reserve printing money at an alarming rate nor regulators and the White House arbitrarily deciding which private businesses would survive and which would perish. We didn't have, with the exception of the Hoover and FDR administrations, the Executive Branch attempting to micromanage the private sector with a barrage of new regulations, commands or directives.

"All this has created higher costs and a level of uncertainty that is causing American businesses to hunker down rather than hire.

"Restoring confidence and certainty is essential for restoring our long-term growth, and I and many others are concerned that the Federal Reserve's so-called QE2 action introduces more uncertainty which could lead to higher inflation and generate artificial asset bubbles that cause further economic harm.

"It will be the entrepreneurs and workers of America who will lead us to economic recovery, not government stimulus or micromanagement. However, the private sector will do so only if we refrain from burying them in a blizzard of burdensome and overreaching regulatory constraints.

"The Financial Services Committee and House Republicans are committed to sweeping away unnecessary, repetitive or intrusive government-imposed obstacles to recovery and hiring. We will look to remove the confusing impediments the Dodd-Frank Act places in the way of a freely operating and safe financial services industry. And, through the focus of Dr. Paul's subcommittee, we will look towards a more consistent Fed monetary policy -- as discussed at last week's hearing by Dr. John Taylor -- without in any way compromising the central bank's independence."

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OPENING STATEMENT OF REP. BILL HUIZENGA

HOUSE FINANCIAL SERVICES COMMITTEE

SUBCOMMITTEE ON DOMESTIC MONETARY POLICY AND TECHNOLOGY

HEARING ENTITLED "CAN MONETARY POLICY REALLY CREATE JOBS?"

FEBRUARY 9, 2011

Good morning and thank you Chairman Paul and Ranking Member Clay for holding this important hearing today.

By trade, I am a small business owner involved in both the real estate and construction. I now represent a district currently suffering an unemployment rate well above the national average and one in which this hearing's topic holds special significance. Earlier this month, the Bureau of Labor Statistics reported that the national unemployment rate fell from 9.4 percent to 9.0 percent. That equates to roughly 14 million Americans without a job. While this is a staggering number, in my home state of Michigan, the unemployment rate is an astonishing 11.7 percent and in some areas of the Second District, it is nearly double the national average.

This past fall, the American public made their voices heard loud and clear. The most vital issue facing this Congress is jobs, jobs, jobs, and I thank you Chairman Paul for demonstrating that it is this subcommittee's number one priority by making it the subject of your first hearing.

The Federal Reserve Board of Governors is congressionally mandated to enact monetary policy with the goal of maximizing employment. However, after witnessing the Obama administration's attempts over the previous two years to increase employment through failed *fiscal* policies, I am pleased that we are now spending some time exploring the role of monetary policy in the area of job growth.

As I previously mentioned, I am a small business owner at heart. Such businesses are the backbone of the U.S. economy and provide more than two-thirds of American jobs. I understand the universal principles of successful businesses, and it is important that we recognize the appropriate role for government in the process. Simply put, the private sector, not the public sector, creates prosperity. It is clear to all small business owners that responsible fiscal policy including reduced government spending and the implementation of friendly tax and regulatory environments go a long way in creating an atmosphere for success.

In recent years, the FED has taken unprecedented action to provide liquidity to the financial markets; yet month after month, unemployment remains at historic levels. Most recently, due to the fact that the federal funds rate sits near zero percent, the FED decided to purchase an additional $600 billion of Treasury securities commonly referred to as "quantitative easing" or "QE2." This strategy was undertaken despite the fact that the first round of quantitative easing (QE1) – the FED purchase of $1.2 trillion in Treasury and Agency securities in March 2009 – has not proven to be an effective method of creating jobs.

Today we will examine as a whole what effect the Federal Reserve's open market operations have on long and short term unemployment rates. In addition, I look forward to carefully inspecting what potential role FED policies played in such artificial asset bubbles as that of the housing market between 2001 and 2008.

As a Member of the 112th Congress and a member of this important subcommittee charged with overseeing operations at the Federal Reserve, I take my responsibility for strict oversight of taxpayer dollars with the utmost seriousness. I look forward to today's robust discussion on the short-term effectiveness of monetary policy on job growth, the appropriateness of the FED's dual mandate, and potentially negative long-term consequences from the FED's most recent unparalleled intervention in the markets.

Mr. Chairman, thank you again for holding this important hearing, and I look forward to hearing from our witnesses.

Monetary policy as macroeconomic stabilizer

during the Great Recession

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Financial Services Committee, U.S. House of Representatives
February 9, 2011

Monetary policy as an economic stabilizer during the Great Recession

What we now call the Great Recession was a long time in coming. The economic expansion of 2001 to 2007 was dependent to a historically unprecedented degree on a huge increase in private sector debt. This debt was, largely, used to buy homes, which saw historically large price increases. These price increases were borrowed against by homeowners who then used this equity to support consumption – consumer spending as a share of the overall economy rose to its highest level on record during the housing boom of the 2000s.

The bursting of the home-price bubble had straight-forward effects on the economy – residential investment (the act of building homes) inflated to 6% of overall GDP at the peak of the boom then quickly shrank back down below its 3% of GDP average as home-builders realized that they had overbuilt and faced an enormous inventory of unsold homes. This contraction of residential investment reduced overall demand for goods and services in the economy by roughly $420 billion. A similar (though less extreme) dynamic in commercial real estate reduced economy-wide demand by another $140 billion. Further, as households saw their net worth decimated by falling home-prices and realized that they would now have to start saving out of current income to meet long-run wealth targets like providing a comfortable retirement or sending kids to college, consumer spending collapsed. The 30% fall in home prices erased roughly $7 trillion of wealth from American households. The best research indicates that each $1 fall in housing wealth leads (conservatively) to a $0.06 fall in consumer spending through a "wealth effect" on consumption; translating into a $420 billion annual decline in consumer spending.

This $960 billion negative shock to annual demand for goods and services ($420+$140+$420) *is* the Great Recession. **Figure 1** below shows the path of home prices, residential investment as a share of the economy and mortgage equity withdrawals (just one way that households could increase spending through greater housing wealth) during and after the bubble.

Figure 1 here

How monetary policy fights recessions, in theory

There are three policy levers that can be used to stabilize an economy that has suffered such a shock to aggregate demand: exchange-rate policy, fiscal policy, and monetary policy. This hearing is about the last, so I'll focus my attention here. As with fiscal and exchange-rate policies, the goal for monetary policymakers is to stabilize economic activity after a negative shock to aggregate demand by providing a countervailing *positive* spur to demand with the levers they have available to them. The primary lever the Federal Reserve (or Fed, henceforth) has available to them is control over short-term interest rates.

By lowering these "policy" interest rates (generally the Federal Funds Rate, the rate at which banks can lend each reserves at the Fed), the hope is that interest rates up and down the term- and risk-structure will fall through arbitrage. Then, as interest rates on longer-term and riskier debt fall, it becomes cheaper for firms to borrow to finance new expansions to their capital stock and for households to borrow to purchase new homes or durable consumption goods or to pay outstanding credit card balances - freeing up purchasing power for other kinds of consumer spending. Further, lower interest rates may provide a one-time boost to asset prices – directly to bonds as the Fed begins buying bonds to increase their price and hence lower the interest rates paid on them, and indirectly as lower interest rates on bonds, for example, may increase demand for other types of assets like equities. The boost to asset prices can ease firms' borrowing constraints and allow them to finance new investments that they would otherwise be constrained from doing and can also provide a boost to household wealth that may spur new spending.

In recent decades, it has become the overwhelming consensus in the economics profession that the Federal Reserve is best-placed to fire the first shot in the fight against recessions. The "inside lag" of monetary policy – ie, the lag between when a developing problem is recognized and policymakers act – is much shorter for monetary policy than either of the other stabilization tools. The Fed is, by constitution, as cognizant of upcoming developments in the economy as any other institution and the relative smallness of the decision-making body makes rapid discussion, debate and action possible.

How the Fed policy acted as a shock absorber against the fallout from the bursting housing bubble

This rapid decision-making and action began as the Great Recession approached – the Fed began lowering interest rates in August 2007 and began providing support to failing financial institutions early in 2008 – well before the blowup associated with the fall of Lehman Brothers.

Barely halfway through the Great Recession, however, the Fed had run out of the conventional ammunition it generally uses to stabilize the economy – policy rates were sitting at less than 1% by October 2008. It has been observed often enough to be a cliché, but having an economy mired in a deep recession with policy interest rates sitting just above zero is a very dangerous place to be – the U.S. economy during the Great Depression and Japan in its lost decade of the 1990s are two of the only historical episodes where this has happened. The danger is that zero constitutes a firm lower-bound on interest rates – as nobody would ever accept a negative return on their wealth-holdings (it would essentially be like *paying* the bank to store your money) – yet the economy might "need" short-term rates below zero for a time to generate the spending necessary to keep unemployment from rising.

Luckily, the Fed found ways to provide support through the economy through other means than just its short-term interest rates. First, it began providing extraordinary support for the liquidity of financial institutions through its "alphabet soup" of lending programs. These programs clearly worked to reduce credit-spreads on private-sector debt, largely calming the financial market chaos of late 2008 – see **Figure 2** below for the reduction in credit spreads for automobile asset-backed securities following the beginning of the Term Asset –Backed Securities Loan Facility, or TALF.

Figure 2 here

Second, the Fed undertook two rounds of "quantitative easing" – attempting to lower long-term interest rates directly through the purchase of long-term assets. The first round of quantitative easing was focused on mortgage-backed securities (MBS) - largely through purchases of agency bonds (the debt of

Fannie Mae and Freddie Mac). This first found of quantitative easing had the desired effect and established clearly that when it wanted to, the Fed could indeed lower long-term interest rates – as shown in **Figure 3**.

Figure 3 here

The second-round of quantitative easing was announced in November of 2010 and focused on the debt of the U.S. government instead of MBS. Again, strong anticipation of this move, based on transparent communications from the Federal Open Market Committee (FOMC), led to clear downward movements in the interest rates of not only U.S. government debt, but other interest rates as well. Some on this committee may have noticed that 30-year rates on fixed home mortgages fell to almost 4% a couple of months ago – that was clearly a symptom of this second round of quantitative easing (or as it was popularly dubbed, QE2). **Figure 4** shows that again returns on a range of securities fell with the announcement of QE2.

Figure 4 here

Just to give a sense of the potential of this quantitative easing for spurring purchasing power in the U.S. economy, analysts at JPMorgan Chase have estimated that if all mortgage holders guaranteed by the federal government (through Fannie Mae and Freddie Mac) had been able to refinance when 30-year rates dropped to nearly 4%, this could have added an economic stimulus of more than $50 billion per year to the economy. Further, since this stimulus would be effectively permanent (the lower mortgage payments would be faced for the life of each holder's mortgage after refinance), the extra economic output it would have likely spurred would have been very large.

Have the Fed's actions propped up output and employment?

There is no doubt at all that the Great Recession would have been worse, perhaps much worse, had the Fed kept interest rates at the 5.26 percent that characterized July 2007 – the last month before it was clear that a global financial crisis was in the making. There was, as far as I know, *not a single economist* arguing between July 2007 and June 2009 (the official end of the recession) that the Fed should *not* have lowered its conventional policy rate as the recession approached.

There is a school of thought (to which I'm sympathetic) that argues that while the Fed has great power to rein in an overheating economy through interest rate increases it actually has far less power to spur spending in an economy that is deflating – the vivid metaphor often used to explain this asymmetry is "pushing on a string". And there are reasons to think the Fed's conventional tools were especially ill-suited to the fallout of the most current recession. For example, increased housing activity is a key tradition channel through which interest rate cuts spur economic activity. Given the massive overbuilding and plummeting home prices resulting from the burst housing bubble, it was always very unlikely that increased activity in the housing sector – regardless of what the Fed was doing – was going to be a primary channel for pulling the U.S. economy out of recession.

However, noting this asymmetry in the Fed's power does not argue that interest rate loosening cannot work at all or is somehow the *wrong* thing to do. As households, for example, look to pay down debt in the wake of lost housing wealth, low interest rates can provide immediate space for them to do by lowering auto, credit card, and even some mortgage loans (and often can afford the possibility of re-finance).

And in the past, monetary loosening has clearly been a key ingredient in spurring rapid economic recovery, even from severe recessions. Romer (1992), for example, finds that expansionary monetary policy was a key ingredient in helping the U.S. economy escape from the Great Depression in the 1930s. Posen (2009) similarly argues that the strong performance of the Japanese economy between 2002 and 2008 was a result of loosening monetary policy as well. **Figure 5** below shows the performance of economic growth in the year following a change in the federal funds rate. The precise statistical link between these variables is tough to pin down outside of careful econometrics because the Fed changes these rates precisely in reaction to changing economic conditions. Yet, the figure shows that large increases in the federal funds rate over a year tends to lead to slower growth in the subsequent year and vice-versa.

Figure 5 here

More recently in U.S. history, an examination of the very sharp (though thankfully very brief) recession of 1981-1982 also provides clear evidence of the efficacy of expansionary monetary policy. The unemployment rate in December 1982 actually peaked at 10.8% - higher than at any point in the Great Recession.[1] Yet 12 months later payroll employment was back to its pre-recession level. What contributed to this extraordinarily rapid recovery in jobs and unemployment? The simplest answer is very rapid output growth – GDP grew in the 2 years following the trough in 1982 at an annual average rate of 6.7% - in the 6 quarters since the trough of the most recent recession growth rates have averaged well under half this pace.

This rapid output growth , in turn, was driven by an extraordinary degree of monetary easing – the policy rate controlled by the Fed fell nearly 10 percentage points between the business cycle peak of 1981 and the recession's trough of November 1982. The Fed continued cutting rates for the next 6 months following this trough – and by November 1983 payroll employment had completely recovered its pre-recession level. Figure 6 below shows the path of the federal funds rate and economic growth between 1981 and 1984 – the reduction in the federal funds rate at the end of 1982 is clearly associated with a return to growth, while the slight uptick in these rates in 1984 sees these growth rates moderating.

Figure 6 here

[1] Of course, the labor force in 1982 was younger and less-educated so should have, all else equal, had higher unemployment rates in general. Baker and Schmitt (2009) have pointed out that age-adjusting the U.S. workforce to match the 1982 age distribution results in higher unemployment rates being reached during the most recent recession.

It's true that there was also a large fiscal stimulus injected into the economy in those years, but this stimulus was particularly ill-suited for spurring output growth, as most of it took the form of tax-cuts aimed a group (high-income individuals and businesses) that were likely to have lower propensities to consume out of current income than others. In short, it is clear that the very rapid monetary easing was largely responsible for "morning in America".

While there was less scope for this degree of *conventional* easing in the latest recession (because interest rates were lower going into it), the unconventional actions of the Fed have been able to provide a spur to spending even over and above what was provided by the move of federal funds rates to zero. Gagnon et al. (2010) argue that the unconventional actions of the Fed lowered interest rates across the term and risk-structure. Chung et al. (2011) then undertake a simulation exercise based on the historical relationships between these interest rates and components of GDP. They find that the $600 billion in Treasury purchases recently undertaken by the Fed is likely to boost GDP by up to a full percentage point, which translates into roughly 1 million full-time equivalent jobs supported by these actions. It should again be noted that this is just the effect of the most recent Fed asset purchase – not the full range of effects spurred by their conventional easing in the early parts of the recession and the first round of quantitative easing – Chung et al. (2011) estimate that the full effect of all large-scale asset purchases undertaken by the Fed probably supported nearly 3 million jobs and will have lowered measured unemployment by 1.5 percentage points through the end of 2012.

Has the Fed done enough?

All this said, I don't have to remind anybody on this panel that the U.S. economy is far from healed – unemployment was 9.0% as of January 2011 (and will almost surely reach over 9.5% again before the labor-market recovery is complete) and if most private and public-sector forecasts are to believed, will only fall slowly over the next couple of years – reaching a level comparable to its immediate pre-recession peak in 2015.

This begs the question – did the Fed do enough?

My short-answer to this is not yet, but it is on the right track. For one, the jobs-crisis is far from over and the economy far from stabilized. Until unemployment returns to tolerably low levels and the economy is much closer to producing at its potential level, the Fed should remain very aggressive in its policy stance: keeping policy-rates low, following through with the full round of QE2 and preferably engaging in more asset purchases after the initial $600 billion is exhausted. However, absent support from the other levers of macroeconomic stabilization – fiscal and exchange-rate policies, the Fed is limited in how much it can contribute to recovery. If, for example, Congress acted to provide a new, significant round of effective fiscal support to the economy, the Fed could act to enhance the effectiveness of this support as well as keeping it from adding to the national debt held by the public by simply buying the new debt issues and holding them on its balance sheet.

This action should ameliorate the concerns of those worried that more fiscal support to the economy would lead to high debt burdens for the U.S. government in the future – if the Fed owns the newly-created debt that that provides fiscal support, interest on this debt would be paid to the Fed and recycled back to the U.S. Treasury. This is not a strategy that can be continued when the economy is near full-employment – it would surely lead to inflation. But there is no danger of that happening today, with vast numbers of unused resources available to match new production to new money creation.

Again, the Fed has clearly acted with more urgency than any of our other macroeconomic policymaking institutions to the Great Recession and continues to treat the jobs-crisis as the number one priority in setting its policy; this is to its great credit. It should continue with this aggressive pro-growth stance until a full economic recovery is reached. However, unless more support is forthcoming from *other* levers of macroeconomic stabilization, its ability to do much more than continue its current stance is limited.

In short, the Fed (a) saw the economic downturn coming before any other major macroeconomic policymaking body, (b) acted more aggressively than any other, and (c) continues to attack the problem of sluggish recovery in both output and employment with greater urgency than any other team of economic policymakers. If our fiscal and exchange-rate policies were as aggressive as our monetary policy in historical terms, we could well have an unemployment rate 2-3 percentage points lower today and hundreds of billions of dollars of additional economic output.

Criticisms of the expansionary monetary policy I: did low interest rates cause the bubble?

Given the absolutely central role played by the housing price bubble in generating the Great Recession and given as well that some critics of the current aggressively pro-growth stance taken by the Fed have tried to blame accommodative monetary policy on the *creation* of this bubble, it seems worthwhile to examine the case for and against the role of too-low interest rates in inflating home-prices in the 2000s.

The argument that low interest rates are a prime suspect in creating the bubble rests simply on the fact that as the bubble inflated in the early 2000s, these interest rates were kept unusually low by historical standards. As low interest rates should (all else equal) encourage borrowing, and mortgage debt is by far the single largest category of household borrowing, the case continues that easy credit engineered by the Fed pumped up the demand for homes and inflated the bubble. The corollary to this argument is often presented that it is obvious that the Fed should have considerably tightened monetary policy very quickly after the 2001 recession ended.

There are a number of reasons to reject this diagnosis and the proposed cure.

First, interest rates *should* have been low in the early 2000s – employment growth following the 2001 recession was, by far, the weakest of any recovery since the Great Depression. Between 1948 and 1990, it took an average of 13 months from the end of a recession to fully regain all employment losses. Yet it took 38 months following the 2001 recession (see **Figure 7** below). In fact, employment growth did not even turn consistently *positive* until August 2003, 21 months after the official end of the recession. The notion that interest rates should have been sharply increased even while jobs were still being shed in the economy is hard to credit.

Figure 7 here

This can be seen more formally by invoking a standard "Taylor Rule" of prescriptive Fed behavior. The Taylor rule argues that policy rates should be changed based on a weighted average of expected inflation and productive slack in the economy. As expected inflation rises, the Taylor rule argues for rates to rise in response to cool the economy; when productive slack (or, the measured "output gap") rises, rates should be lowered to spur spending to tighten this slack. Applying a Taylor rule that weights inflationary expectations every bit as heavily as concerns over the economy underperforming potential actually would have led to a path of policy interest rates *very much like* what was actually pursued by the Fed in the early 2000s, as shown below in **Figure 8**.

Figure 8 here

Second, the timing of rising home-prices and low interest rates is much less clear than proponents of the "it was too-low interest rates" theory of bubble-inflation generally admit. Home prices began rising in the late 1990s – as *interest rates were being increased*. The pace of price-growth did rise in the early 2000s as interest rates were lowered, but, then the pace of growth remained torrid between 2004 and 2006 – as interest rates were being sharply *increased*. In short, the sharp rise in prices began in a period of rising rates and persisted nearly undiminished during a period of rising rates; this makes it hard to sustain the argument that low rates were the key driver of the housing price bubble. **Figure 9** shows this by displaying the change in the federal funds rate and annual home-price appreciation for periods of rising and falling rates.

Figure 9 here

Third, the bubble in equity markets in the 1990s in the U.S. accelerated just after a sharp increase in policy interest rates beginning near the end of 1993. The bubble got larger and larger even as rates stayed generally steady throughout the late 1990s (see **Figure 10** below).[2] Very few (I could find none) argued in real-time that the Fed had *caused* the equity-price bubble (some argued that they should have raised interest rates to smother it, but that's a different question) – leading one to conclude at least that excessively low interest rates are not a necessary condition for asset-price bubbles.

Figure 10 here

Fifth, we can use the fact that the housing bubble of the 2000s was not unique to the U.S. economy to see if there is a durable connection between rising home prices and interest rates. France, Denmark, and the UK (among others) all saw home-price appreciation faster than the U.S. from 2001 to 2006. Yet these nations also saw monetary policy that was tighter than in the U.S. relative to what should have been expected from a Taylor rule based on their national inflation and output-gap indicators. In short,

[2] There was a dip in policy rates in 1998, largely in reaction to crises in East Asia and the Russian bond defaults. This dip was quickly reversed, however.

these countries more closely followed the diagnosis of interest rate tightening (relative to current economic conditions) yet still saw larger increases in home-price growth during the 2000s (see **Figure 11**).

Figure 11 here

Criticisms of expansionary monetary policy II: It will cause inflation and that's bad

Lastly, there is commonly-voiced concern that the Fed's current aggressive actions to spur growth and jobs in the economy will instead give rise to rapid inflation. It is true that large-scale money creation would indeed translate mostly into higher prices and not higher output in an economy characterized by no productive slack (with no productive slack, output could not, by definition, be increased in the short-term). This is why the short-hand definition for inflation is often stated as "too much money chasing too few goods".

However, the key phrases in the formulations above are "no productive slack" and "too few goods". There is significant productive slack in the U.S. economy right now, as evidenced by very high rates of unemployment of labor and non-utilization of productive capacity. Given this, it seems hard to frame the problem of "too few goods" being chased by "too much" money – if there is excess demand for ("too much money chasing") new goods and services, *we should make more of these goods and services* to solve concerns over inflation.

The simplest way to assuage fears of incipient inflation is just to look at the price-data. We should be clear here what data we're looking at and why. Inflation is, by definition, a *generalized* rise in prices. The prices of individual goods or services rise and fall all of the time. Cherry-picking a single good (or select basket of goods) to "prove" that prices overall are falling or rising makes no sense – it is, by definition, not a measure of inflation.

Additionally, it is the overwhelming consensus in empirical macroeconomics that measures of "core" inflation are the proper ones to examine when gauging the impact of monetary policy on price growth. The simplest forms of these "core" measures exclude the costs of food and energy. As food and energy prices are volatile and change often and are often dramatically affected by idiosyncratic supply-side influences (bad weather, closing of shipping lanes, refinery fires), they are a very bad measure of the inflation *momentum* building up in an economy.

When firms set those prices that are less volatile than food or energy (wages in the case of workers), they take the overall state of inflationary expectations into account. For example, if a worker desires real (ie, inflation-adjusted) wage stability, if she expects overall inflation to run at 2 percent for the forthcoming year, she'll need to ask for a 2% raise to insure this real (inflation-adjusted) wage stability. And when a grocer wants his sales to finance the same living standard he purchased for himself last year, he needs to raise his prices by 2% if he expects overall prices in the economy to rise this much. If rapid money creation does occur during times of little productive slack, this could well lead to increases in prices across-the-board and hence to rising expectations of inflation, which become self-fulfilling.

Scare-stories (sometimes true) about central banks unleashing inflation upon their economies are about this inflationary momentum, not about discrete jumps in single-prices.

Further, because it is not just food and energy prices that are volatile and non-informative about the embedded state of inflationary expectations, there are a number of measures of "core" inflation. Import prices can rise or fall sharply based on movements in the value of the dollar. In some countries, changes in national sales taxes (or value-added taxes) can lead to large one-time jumps in the price-level without causing permanently higher inflationary expectations. In short, good measures of "core" inflation seek to exclude those prices that do not convey much useful information about the real inflationary momentum in the economy.

Luckily, *all* measures of core inflation are telling the same story – the last couple of years have seen rapid disinflationary pressures in the U.S. economy (see **Figure 12** for a range of commonly-used core measures of inflation). In short, the data from the recent past argues that worrying about rampant price-growth is profoundly misguided.

Figure 12 here

Further, forward-looking measures of inflationary expectations used by forecasters and market participants are telling largely the same story. The spread between real and nominal 10-year Treasury securities is one commonly-used proxy for inflationary expectations – this spread has shown no upward trend in the past couple of years (see **Figure 13** below).

Figure 13 here

Importantly, the data showing disinflation and very low rates of expected inflation in coming years are not a surprise – they are in fact exactly what conventional macroeconomic theory would lead one to expect. High unemployment rates and large output gaps (again, measures of productive slack) are historically correlated with low rates of inflation. The reason is simple; as the economy cools and consumers and businesses stop spending, firms see output piling up unsold and hence lose the ability to raise prices and workers lose the ability to demand large wage-increases when they see many of their peers out of work.

Figure 14 below shows the relationship between unemployment and inflation in the U.S. over the 2000s – with the last 4 quarters highlighted . This short-run relationship between prices and unemployment replicates a common pattern within business cycles – periods of high unemployment rarely see growing price pressure. The one recent historical counter to this trend, the "stagflation" of the 1970s (high unemployment accompanied by high inflation) can be largely explained developments on the supply-side of the economy – an oil price-shock combined with very rapidly decelerating trend productivity growth in the economy.

Figure 14 here

We can reassure ourselves that there is little evidence of a similar fall in productivity that could lead to upward price-pressures on the horizon. Another key predictor of inflation is a rise in unit labor costs – the labor cost of each additional unit of output. This cost rises as labor compensation rises, but falls as productivity increases (as each worker can now produce more output). **Figure 15** below shows a plot of inflation versus unit labor costs for the U.S. economy since 1959, with the most recent quarters highlighted. As can be seen, a price-push from the supply-side looks very unlikely.

Figure 15 here

Lastly, it should be noted that the current rates of inflation are undesirably low for the U.S. economy. For example, the price deflator for core personal consumption expenditures rose by less than 1% over the past year – the first time in the history of this indicator that it has fallen under 1%. Disinflation is bad because as inflation falls, real interest rates tend to rise – and given that the economy needs more spending from households and businesses right now, rising interest rates will not help this.

Further, the debt-driven nature of the Great Recession would make higher inflation rates desirable right now. Both households and businesses are operating underneath a very large overhang of debt accumulated during the last 15 years. Over time, debt fixed in nominal terms (like mortgage debts) actually becomes less and less burdensome relative to other prices and wages in the economy so long as there is positive inflation. For example, if your mortgage payment is $1,000 per month and inflation runs at 4% per year, by the 30th year your mortgage payment has actually shrunk by just under 70% relative to all other prices and wages in the economy. If, instead, inflation only rises by 1%, then the mortgage payment will only have only shrunk by 25% by the 30th year (and deflation, falling prices, would actually cause one's mortgage burden to *rise*). Given the very high debt burden currently afflicting American households and business (see **Figure 16** below for household debt measures), inflation rates of under 1% will allow them to dig out of this debt overhang very slowly indeed.

Figure 16 here

Conclusion

What we now call the Great Recession can be described simply in the terms of macroeconomics – it was a huge negative shock to economy-wide demand for goods and services caused by the bursting of the housing bubble. Since this shock, the Federal Reserve has, as would be recommended by the vast majority of professional macroeconomists, attempted to lean against this negative shock to demand and spur spending with its policy levers. It has done this through conventional (lowering the short-term policy interest rates it controls) and unconventional (direct purchases of longer-term securities) means.

Its actions have clearly helped. They have also clearly *not* been accompanied with the same degree of urgency on the part of policymakers in charge of the other levers of macroeconomic stabilization policy (fiscal and exchange-rate policy). Because of this, we remain today at intolerably high levels of unemployment. However, blaming the Fed for this is quite odd – they have been by far the policymaking institution that has responded most forcefully and in the timeliest manner to the crisis.

Arguments that the Fed actions have been in the *wrong direction* are even odder. Here a (strained) analogy might help. Say that the economy in the midst of the housing bubble burst is akin to a man who has fallen out of a third-story window. The actions by Fed in response can be thought of as throwing a mattress underneath him to break the fall; the mattress will surely help but may not be thick enough to prevent all damage from the fall. Criticizing the Fed for flirting with inflation with its actions during the current crisis would be like arguing that the mattress thrown under our falling man is *too* thick and *too* plush: if slept on for a long time our falling man may eventually develop an achy back.

Going into the recession, the overwhelming consensus among professional macroeconomists was that the Fed could be an effective part of stabilization policy and through forceful actions could make recessions shallower and shorter. Absolutely nothing that has happened in the past three years has shaken that belief.

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Figure 1

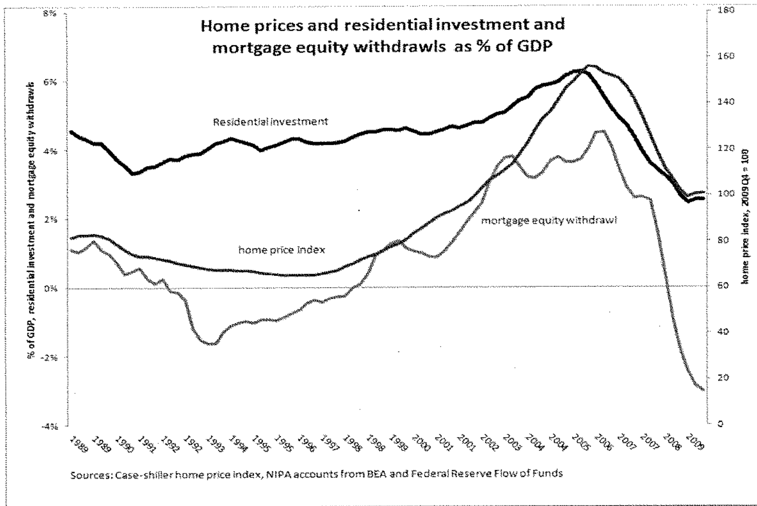
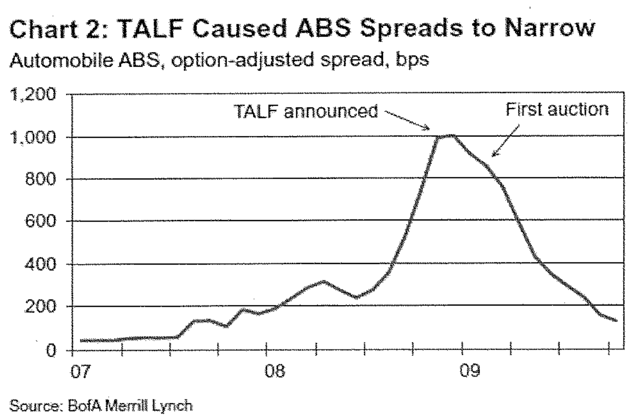


Figure 2



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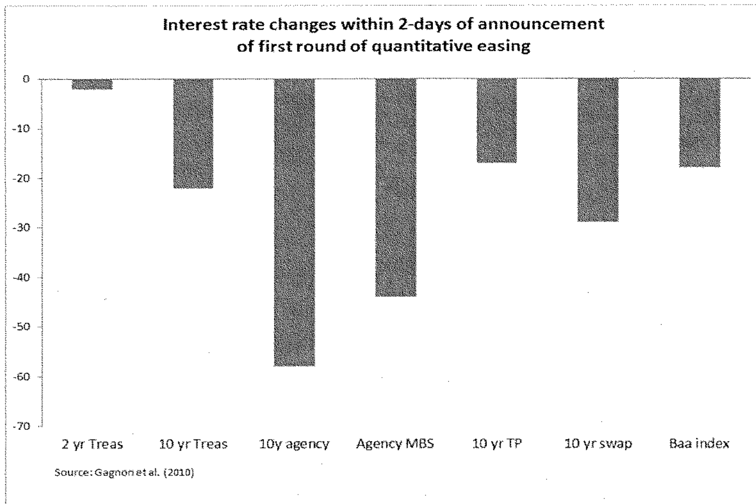


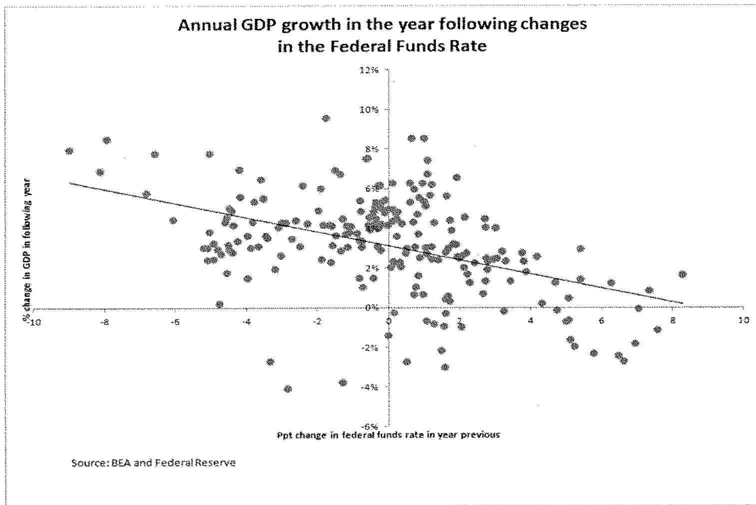
Figure 4

Table 2: Responses of U.S. Interest Rates to News about the Second Round of Asset Purchases

Date	10-Year Treasury Yield	10-Year TIPS Yield	30-Year MBS Yield	10-Year BBB Corporate Bond Yield
Aug. 10, 2010	-7	-9	-2	-1
Aug. 11 to Nov. 2, 2010	-11	-47	-9	-23
Nov. 3, 2010	3	2	-2	2

Note: The table displays basis point changes from close of business on the day before the announcement to close of business on the day of the announcement, with the exception of Aug.11 to Nov. 2, 2010, which shows the interperiod change. Changes in the 10-year nominal Treasury yield are computed using a smoothed yield curve estimated by staff from off-the-run Treasury coupon securities. Changes in the yield on 10-year Treasury inflation-protected securities (TIPS) are computed by staff using a smoothed inflation-indexed yield curve. Changes in the yield on 30-year mortgage-backed securities (MBS) are computed using Bloomberg data on securities issued by Fannie Mae. Changes in the yield on 10-year BBB corporate bonds are computed using a smoothed yield curve estimated by staff using Merrill Lynch data.

Figure 5



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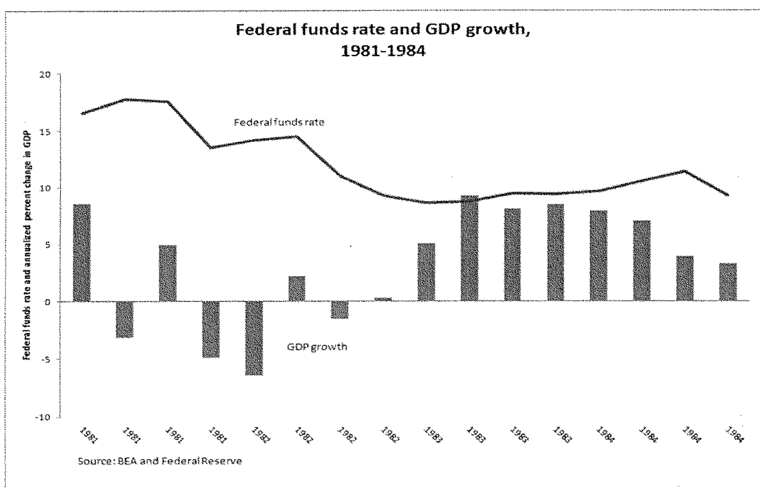

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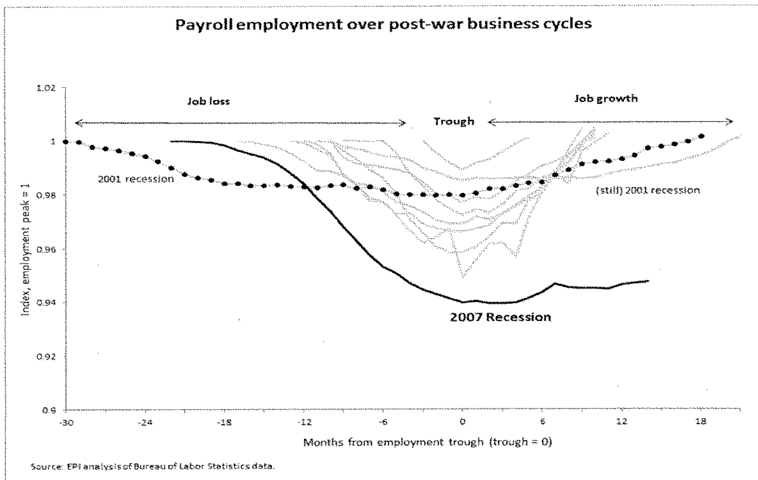

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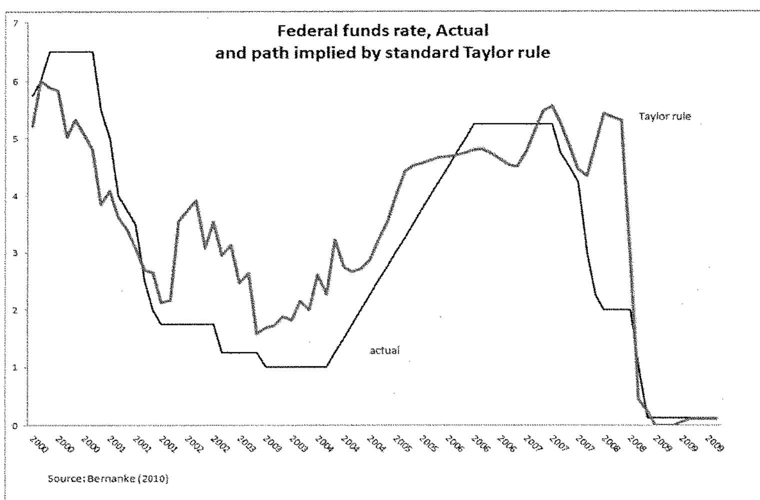

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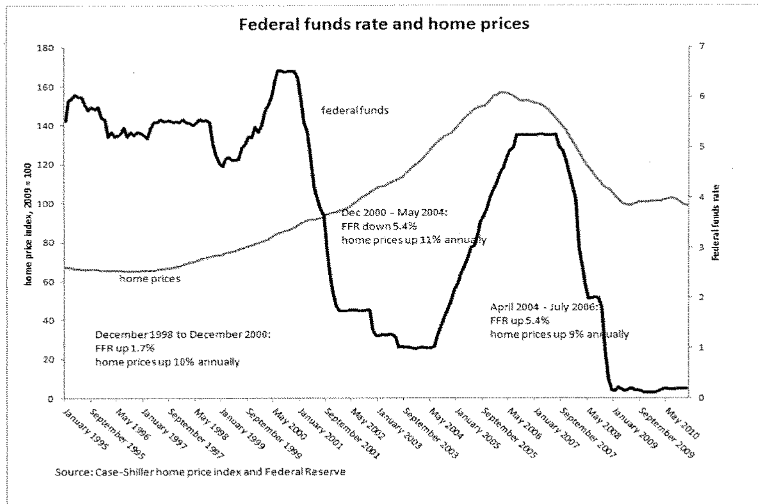

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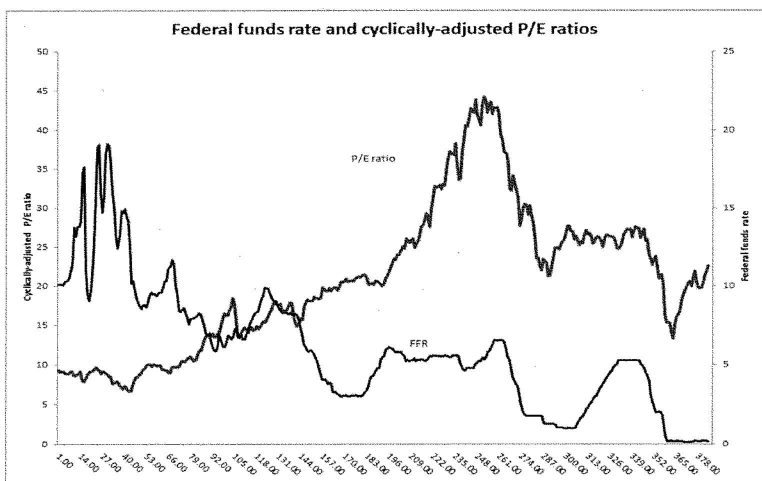

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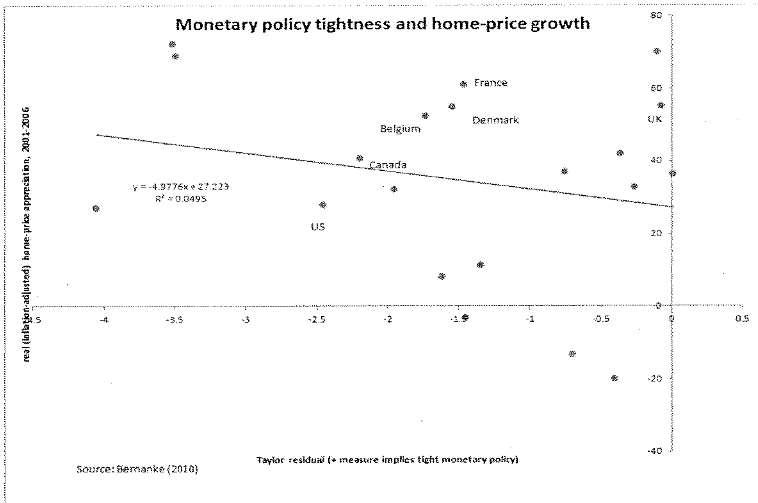


Figure 12

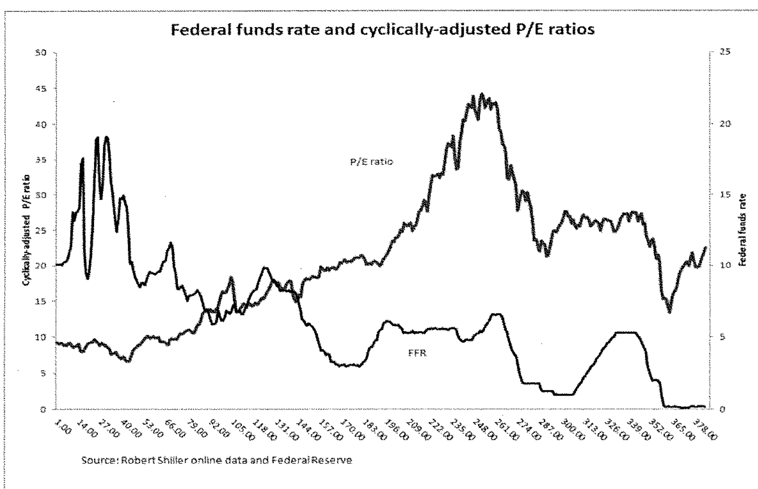


Figure 13

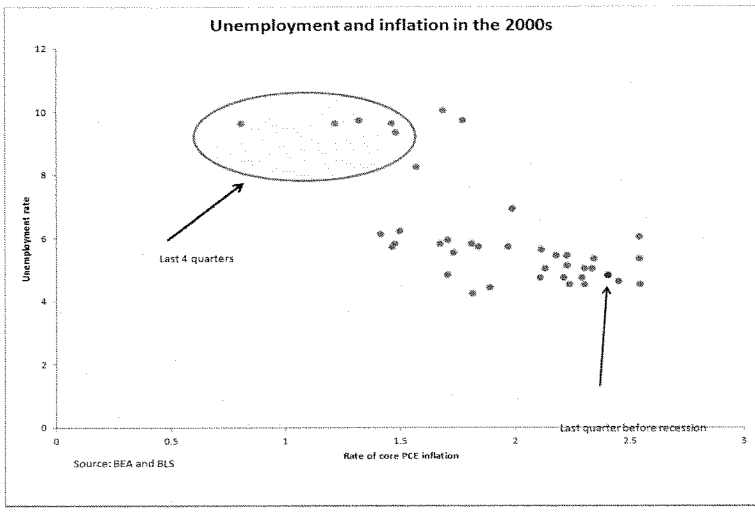
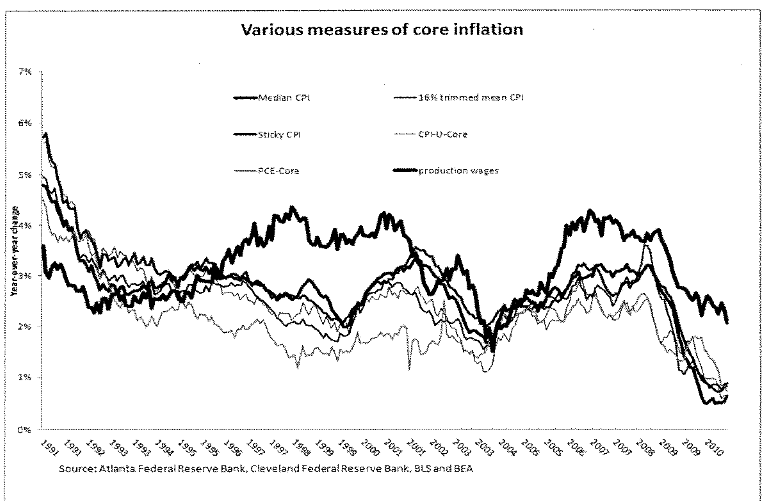


Figure 14



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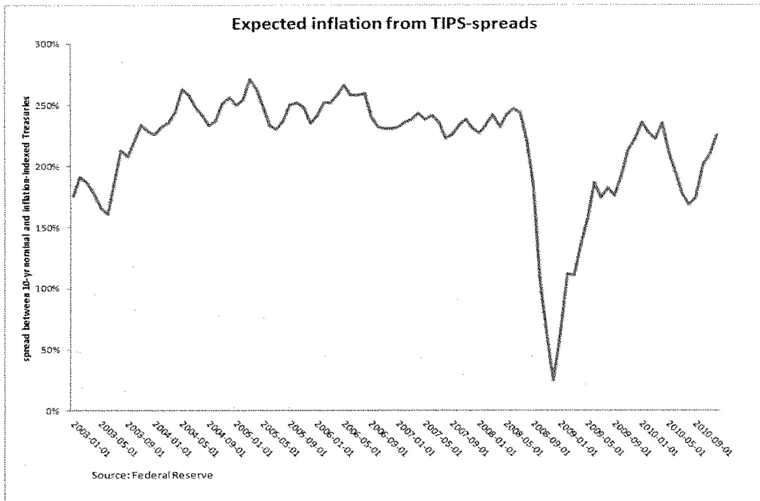


Figure 16

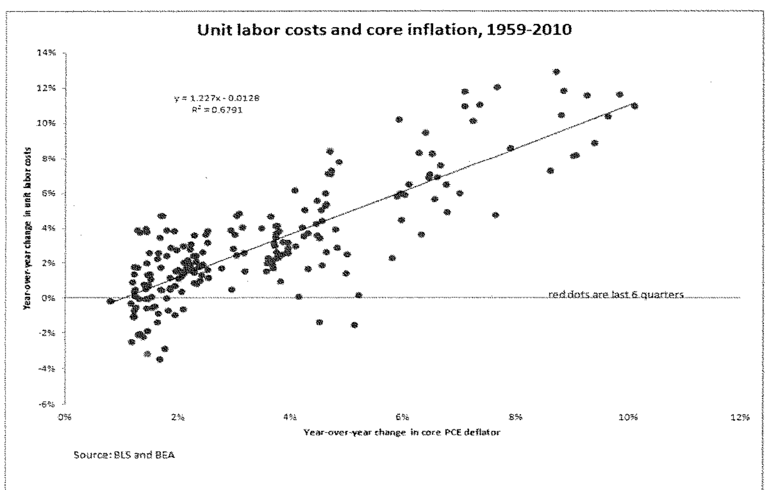
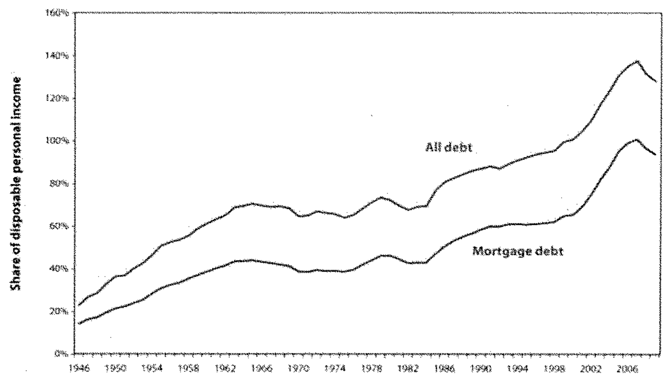


Figure 16

Household debt soars in recent decades



Source: EPI analysis of U.S. Federal Reserve Board, Flow of Funds Accounts of the United States.

Testimony of Dr. Thomas DiLorenzo

Professor of Economics, Loyola University Maryland

Committee on Financial Services, Subcommittee on Domestic Monetary Policy and Technology

Wednesday, February 9, 2011

2128 Rayburn House Office Building

Mr. Chairman and members of the committee, I thank you for the opportunity to address the issue of today's hearing: "Can Monetary Policy Really Create Jobs?" Since I am an academic economist, you will not be surprised to learn that I believe that the correct answer to this question is: "yes and no." Monetary policy under the direction of the Federal Reserve has a history of creating *and destroying* jobs. The reason for this is that the Fed, like all other central banks, has always been a generator of boom-and-bust cycles in the economy. Why this is so is explained in three classic treatises in economics: *Theory of Money and Credit* by Ludwig von Mises, and two treatises by Nobel laureate economist F.A. Hayek: *Monetary Theory and the Trade Cycle* and *Prices and Production.* Hayek was awarded the Nobel Prize in Economic Science in 1974 for this work. I will summarize the essence of this theory of the business cycle as plainly as I can.

When the Fed expands the money supply excessively it not only is prone to creating price inflation, but it also sows the seeds of recession or depression by artificially lowering interest rates, which can ignite a false or unsustainable "boom" period. Lower interest rates induce people to consume more and *save less*. But *increased* savings and the subsequent business investment that it finances is what fuels economic growth and job creation.

Lowered interest rates and wider availability of credit caused by the Fed's expansionary monetary policy causes businesses to invest more in (mostly long-term) capital projects (primarily real estate in the latest boom-and-bust cycle), and there *is* an accompanying expansion of employment in those industries. But since the lower interest rates are caused by the Fed's expansion of the money supply and not an increase in savings by the public (i.e., by the free market), businesses that have invested in long-term capital projects eventually discover that there is not enough consumer demand to justify their investments. (The reduced savings in the past means consumer demand is weaker in the future). This is when the "bust" occurs.

The economic damage done by the boom-and-bust policies of the Fed occur in the boom period when resources are misallocated in the ways described here. The "bust" period is actually a necessary cure for the economic miscalculations that have occurred, as businesses liquidate their unsound investments and begin to make decisions on realistic, market-based interest rates. Prices and wages must return to reality as well.

Government policies that bail out businesses that have made these bad investment decisions will only delay or prohibit economic recovery while encouraging more of such behavior in the future (the "moral hazard problem"). This is how short recessions can be turned into seemingly endless ones. Worse yet is for the Fed to create even more monetary inflation, rather than allowing the necessary economic adjustments to take place, which will eventually set off another boom-and bust cycle.

As applied to today's economic situation, it is obvious that the artificially low interest rates caused by the policies of the Greenspan Fed created an unsustainable boom in the housing market. Thousands of new jobs were in fact created – and then destroyed –giving an updated meaning to Joseph Schumpeter's phrase "creative destruction." Many Americans who obtained jobs and pursued careers in housing construction and related industries realized that those jobs and careers were not sustainable after all; they were fooled by the Fed's low interest rate policies. Thus, the Fed was not only responsible for causing the massive unemployment that we endure today, but also a great amount of what economists call "mismatch" unemployment. The skills that people in these industries developed were no longer in demand; they lost their jobs; and now they must retool and re-educate themselves.

The Fed has been generating boom-and-bust cycles from its inception in January of 1914. Total bank deposits more than doubled from 1914 to 1920 (partly because the Fed financed part of the American involvement in World War I) and created a false boom that turned to a bust with the Depression of 1920. GDP fell by 24% from 1920-1921, and the number of unemployed more than doubled, from 2.1 million to 4.9 million (See Richard Vedder and Lowell Galloway, *Out of Work: Unemployment and Government in Twentieth-Century America*). This was a more severe economic decline than was the first year of the Great Depression.

In *America's Great Depression* economist Murray N. Rothbard demonstrated that, once again, it was the excessively expansionary monetary policy of the Fed – and of other central banks – that caused yet another boom-and-bust cycle that spawned the Great Depression. It was not the Fed's subsequent restrictive monetary policy of 1929-1932 that was the problem, as Milton Friedman and others have argued, but its previous *expansion*. The Fed was therefore guilty of contributing greatly to the massive unemployment of the Great Depression.

In summary, the Fed's monetary policies tend to create temporary and unsustainable increases in employment while being the very engine of recession and depression that creates a much greater degree of job destruction and unemployment.

TESTIMONY OF RICHARD K. VEDDER, DISTINGUISHED PROFESSOR OF ECONOMICS, OHIO UNIVERSITY
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY AND TECHNOLOGY
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
2128 RAYBURN HOUSE OFFICE BUILDING
FEBRUARY 9, 2011

Dr. Paul and committee members, thank you. The first decade of this century had the lowest rate of economic growth of any decade since the Great Depression. Employment growth was the lowest in six decades. Inflation-adjusted equity prices fell sharply. In large part, this reflects faulty government policies. On the fiscal side, federal spending soared, increasingly financed by borrowing. The ratio of national debt to output is at a historic high for a relatively peaceful period. On the monetary side, we had the worst financial crisis since the Depression, with many iconic financial institutions closing their doors or surviving only because of federal bailouts. And, despite huge federal exertions on both the fiscal and monetary side, we have the weakest recovery going on now in the lifetimes of most persons in this room. Moreover, the huge run-up in the ratio of federal debt to output will be a significant drag on the economy for many years, and may well lead the Fed to monetize debt, unleashing a wave of inflation that can only undermine our economy.

Let me add some more factual detail. Between December 2007 and December 2010 –three full years-- employment fell by over seven million in the United States, despite a first $160-180 billion stimulus package in early 2008, a supersized second one of nearly $800 billion in early 2009 and the subsequent addition of four trillion dollars in debt through massive deficit spending. On the monetary side, the monetary base more than doubled as the Federal Reserve gave banks literally a trillion dollars in excess reserves. The Fed pushed real interest rates into the negative territory in an attempt to provide monetary stimulus. Yet job formation was persistently negative, and we had the worst downturn in post-war history. Far from providing stimulus, the combined easy money monetary policy and wildly expansionist fiscal policy scared the heck out of business persons and investors who were further scared by all the President's bashing of capitalists, the government takeover of iconic private corporations like General Motors, the passage of an unpopular, costly, and exceedingly inefficient health care bill, the restrictions imposed by Dodd-Frank, and so on. Businesses literally accumulated two trillion dollars in cash, and the price of gold rose by about 80 percent from Election Day 2008 as investors increasingly worried about inflation.

Turning to the 2008 financial crisis, while private irrational exuberance no doubt occurred, the crisis largely resulted from three types of government failure. First, the Federal Reserve for years prior to the crisis pursued an easy-money policy that reduced interest rates below levels justified by human behavior and market conditions. This led to an unsustainable and artificial inflation in housing prices. Second, the Feds encouraged imprudent lending practices through such things as the Community Reinvestment Act and HUD policies going back to the 1990s designed to promote home ownership. Third, Fannie Mae and Freddie Mac, government sponsored corporations, promoted totally inappropriate lending practices that contributed to the housing bubble and foreclosure mess. Congress blocked attempts to rein in these companies, no doubt because of the campaign contributions they generated.

You might say that the wildly expansionary policies of the Federal Reserve have not harmed the economy; we averted a meltdown of the financial system, the economy is beginning to recover, and the much talked about inflation threat has not occurred. But I think that is too optimistic. The recovery is by many measures the weakest since the Depression amidst the most aggressive fiscal and monetary policy stimulus of any in American economic history save that surrounding World War II. Inflation has been averted in large part because a frightened consuming and investing public has been hoarding cash rather than spending. The election results of 2010 have forced some moderation or led to anticipated moderation in the policies frightening consumers and investors, so economic activity is increasing a bit. At some point, banks will start to lend some of their huge excess reserves, increasing the money stock and unleashing inflationary forces. Fed Chairman Bernanke says "don't worry; I will not let that happen," but the markets are not overwhelmingly trusting of this former academic, with good reason. The king size federal deficit is increasingly raising interest costs on the debt, and the Fed will feel pressures to monetize that debt and try to keep interest rates low to minimize debt service costs. All of this will increase inflationary fears that can only be restrained by the Fed selling bonds and doing other things to reduce excess reserves and the monetary base, something that seems exceedingly unlikely as we approach a presidential election year. It is revealing that the dollar has generally fallen against an equally challenged currency, the Euro, itself under attack because of the fiscal and monetary excesses of European governments. The price of gold was $740 an ounce on Election Day in 2008 and is now over 80 percent higher. Scared people run to gold. How long will it be that before ratings on U.S. government bonds will be reduced?

I am an economic historian, and both economics and historical experience demonstrate that federal incursions into economic activity are counterproductive; some textbooks talk about the Policy Ineffectiveness Theorem. Aggressive deficit spending and Federal Reserve monetary expansion led to stagflation in the 1970s. Japan went on a huge binge of stimulus spending in the 1990s and economic growth virtually ground to a halt. The excesses of the European welfare state and its funding are causing crises all over the European Union, from Ireland to Greece. The Obama Administration engaged in stimulus plans accompanied by rising, not falling unemployment. Bail outs and "too big to fail" policies have created a huge moral hazard problem. The Federal Reserve has engaged in huge purchases of government long term bonds and mortgages to keep long term interest rates low, but long term interest rates are *not* falling as concerns about potential inflation justifiably have risen. By many indicators, this is the weakest postwar recovery. The Fed and the government have monetary and fiscal time bombs threatening both short term recovery and long term financial and economic vitality.

Lowell Gallaway and I have reviewed the 20th century from the standpoint of explaining variations in unemployment in our book *Out of Work: Unemployment and Government in Twentieth-Century America*. Variations in unemployment rates can be explained by changes in the productivity-adjusted real wages received by labor. Other things equal, rises in productivity or prices tend to have the impact of lowering unemployment, as does falling money wages. This implies inflationary monetary policies will increase employment and lower unemployment –the Phillips Curve phenomenon. But consistent inflation changes expectations, and reduces the willingness of workers to supply their services at any given price, typically leading to increases in unemployment. Unemployment during the highly inflationary 1970s, for example, was higher on average than in the less inflationary 1950 and 1960s. Government attempts to manipulate wages and prices have employment effects. Wage enhancing policies like minimum wage laws or pro-union legislation typically raise unemployment rates, for example. Monetary policy that increases an expectation of price stability is usually associated with relatively robust employment conditions, as we observed in the 1920s, 1950s, most of the 1960s, and, to a somewhat lesser extent, in the period from about 1985 to 2000. Monetary and fiscal activities that promote productivity advances likewise increase employment opportunities and tend to reduce unemployment. Nearly every major spike in unemployment in the 20th century is associated with some government actions that led to temporary wage-price-productivity dis-coordination: the depression of 1920-22 was an outgrowth of explosive monetary expansion followed by deceleration and reversal of that growth in the World War I era. The 1929-41 Great Depression reflected a downturn prompted by a consumption bubble arising in large part from excessive monetary growth, and then various strategies designed to raise wages, ranging from moral suasion under President Hoover to laws such as the National Industrial Recovery Act and the Wagner Act under President Roosevelt. The downturns of the mid-1970s and 1981-82 are related first to the ineffectiveness of monetary and fiscal expansion in the midst of rising inflationary explanations, and then to the effects that the reversal of monetary expansion had temporarily on real wages and thus labor markets.

As an economic historian, I am alternatively amused and saddened by a richly ironic fact. The Federal Reserve Act was in large part a consequence of concerns growing out of the 1907 banking crisis. In that crisis, bank runs in New York City imperiled major institutions at a time when many country banks kept enormous reserves in New York. An ad hoc group of private bank officials, dominated by J.P. Morgan, put together a fund that was used to head off runs on some key institutions, moderating the banking crisis. The feeling grew that it is not appropriate to have a single man, even one like J.P. Morgan, have so much discretionary power over the banking system and the economy. Yet today, a single man, Ben Bernanke, backed by a small number of others, makes huge decisions about responding to the current crisis. Ben Bernanke is the new J.P. Morgan, but at least Morgan's behavior was constrained by the fact that he, personally, had a good deal of wealth at stake as a consequence of his actions, whereas Bernanke gets paid the same whether he succeeds or fails.

What to do? Our nation achieved economic supremacy from 1871 to 1914, a period of a gold standard, near price stability and no central bank. Consumer prices in 1914 were within 10 percent of what they were in 1871. We can learn from that experience. To restore monetary stability, ideally we would ultimately consider retreating from fractional reserve banking where even moderate declines in confidence potentially lead to devastating consequences. But more immediately, we need to limit monetary growth, and given human weaknesses, probably the best way to do that ultimately is by having a gold standard or some variant that removes or dramatically reduces the discretion of central bankers. On the fiscal side, politicians unfettered by rules behave like unsupervised alcoholics in liquor stores. Thus we need some sort of constitutional constraints on governmental fiscal actions. Practically, changes of this magnitude take time. In the short run, however, you can start holding the Fed's feet to the fire; perhaps, for starters, you should establish price stability as the single monetary mandate for the Fed, repeal the Humphrey-Hawkins Act, and privatize or abolish Fannie Mae and Freddie Mac. Private markets handled mortgages and other lending for generations successfully without federal intervention, and they can do it again. Thank you.