

OPINION

Ron Paul, the Fed and the Need for a Stable Dollar

By David Malpass

On Wednesday the Federal Reserve shared its thoughts on the course of interest rates—but not on the implications for the value of the dollar. The two can't be disconnected. The Fed's rationale on interest rates determines the stability of the dollar, which is the economic bedrock for price stability, capital inflows, growth and jobs.

Obfuscation on the dollar works fine for Wall Street, which reaps billions in profits from the Fed's unstable dollar policy. It trades currencies and volatility, and makes a bundle protecting investors from the Fed by selling complex derivatives, interest-rate swaps, even triple-leveraged gold and currency funds pitched on television.

After the Fed's statement, markets bid gold above \$1,700 per ounce, the latest insult to the Founders' clear intent for the dollar's value to be strong and stable relative to gold and silver over the life of our republic.

Dollar weakness doesn't work at all for economic well-being. The corollary to the Fed's policy of manipulating interest rates downward at the expense of savers is declining median incomes. It's no coincidence that inflation-adjusted median incomes rose in the sound-money booms of the Reagan and Clinton administrations and fell in the weak-dollar busts during the Carter, Bush and Obama years. When the currency weakens, the prices of staples rise faster than wages, hurting all but the rich who buy protection.

The economy and median incomes would do much better if the Fed said simply that it would set interest rates as best it could in order to keep the dollar's value strong and stable in coming decades, with the goal of attracting capital, maintaining price stability and encouraging full employment.

Yet the Fed is adamant that somehow business confidence will benefit by the Fed sharing its guesses on equilibrium interest rates—which after all are far from a science—but not its vital thinking on the future value of the dollar.

The Fed's status in Washington is unique and practically unassailable. It alone is a colossal self-funder operating outside the congressional appropriations process. Even the CIA and Navy Seals don't enjoy the Fed's unlimited spending power, checked only by its handpicked board and senior leadership.

Americans know this is a big problem but can't stop it. Texas Congressman Ron Paul has created an intensely popular presidential campaign around the need for stable money and limitations on the size (the Fed employs 22,000 people) and power of the Fed.

Yet legislation is moving in the opposite direction. Dodd-Frank's open-ended mandate has added another layer to the Fed's power, instructing it to control bank risk (good luck), protect the financial welfare of consumers, and even advise on mortgage bailouts.

Wednesday's meeting result could have been worse. The Fed might have announced more purchases of U.S. Treasuries and mortgage securities. It already owns nearly \$2 trillion worth and has no limit on its expenditures, which fall completely outside the federal budget. Bond traders have been pleading with the Fed to announce further purchases so they can buy first and score big profits.

Stopping Fed asset purchases would help growth by allowing market distortions to subside. Its clear there's been no benefit from the Fed's unprecedented balance-sheet expansion, up

250% since 2008: no increase in private-sector credit (flat since 2009) and no impetus to the economy, which has been particularly weak in the quarters following Fed asset purchases.

Near-zero interest rates penalize savers and channel artificially cheap capital to government, big corporations and foreign countries. One of the most fundamental principles of economics is that holding prices artificially low causes shortages. When something of value is free, it runs out fast and only the well-connected get any. Interest rates are the price for credit and shouldn't be controlled at zero. It causes cheap credit for those with special access but shortages for those without—primarily new and small businesses and those seeking private-sector mortgages.

The economy's exit from Fed dominance of bond markets wouldn't be traumatic. The Fed has been fully sterilizing its asset purchases, meaning all the cash it has used to buy bonds is still contained at the Fed, not multiplied in the private sector. The Fed accomplishes this through bank regulation and by borrowing from banks at above-market interest rates—\$1.5 trillion as of Jan. 18.

The Fed can reverse this process, letting its bond portfolio mature and the private sector smoothly reabsorb the debt by drawing down the excess reserves it has on deposit at the Fed. Other bond holders may see price pressure as the Fed finally sells its portfolio, but principal losses on bonds

are small compared to fluctuations in equity markets. If the Fed adopts the pro-growth stance of letting markets allocate capital and the dollar stabilize, equity market gains will heavily outweigh bond market losses, lowering the cost of capital in the private sector.

The Fed's responsibility is to create confidence in price stability and the dollar, thus providing the best monetary policy environment for full employment. Most central banks operate on this principle. Instead, the Fed has systematically undermined economic confidence by promising to maintain zero interest rates for privileged borrowers. That policy will have to stop if the U.S. is to again achieve impressive growth.

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