

Fed Holds Economy Hostage

By Scott Silva

Editor, *The Gold Speculator*

6-21-11

The Fed is holding the US economy hostage. And it's time for a prisoner snatch.

It was 32 years ago that President Reagan freed the hostages from Iran. He did within hours of his inauguration what Jimmy Carter had failed to do in 444 days--he freed 52 US embassy employees taken hostage and imprisoned by Iran's Islamic theocracy.

It is not that President Carter did not try to free the hostages held in the Tehran prison since November 4, 1979. One valiant rescue attempt ended in tragedy when two US rescue aircraft collided and burned in the Iranian desert. Jimmy Carter was just not effective at negotiation or, as it turned out, at leading covert military operations.

The US economy was failing during the Carter years. The 1970's were characterized by "stagflation", that debilitating mix of high inflation and slow growth. Double digit inflation, single digit growth and lack of leadership forced Carter out after a single term as president.

Many see similarities to the 1970's in the today's economic conditions. Oil prices are high, prices for food and other necessities are high, unemployment is high and the economy is limping along, barely growing. The misery index, coined in the 1970's, has returned as a measure of popular dissatisfaction with the nation's economic policies.

Studies of the causes of stagflation point to the confluence of economic shock and monetary expansion as the primary cause. In 1974 the economic shock was the OPEC oil embargo; in 2009 it was the financial meltdown. In both cases, the Fed printed more money. In fact, stagflation can arise from monetary policy alone. Barksy and Kilian show in their 2000 work, *A Monetary Explanation of the Great Stagflation of the 1970s*, "... the 1986 fall in oil price (which was not accompanied by major shifts in monetary policy stance or similarly drastic movements in other commodity prices), provides a natural experiment, the outcome of which casts doubts on the view that oil price shocks were important sources of inflation in the GDP deflator in the 1970s. In contrast, the monetary explanation...is capable of explaining both the recessionary and the inflationary aspect of stagflation."

Chairman Bernanke's Fed policies are similar to Fed policies in the 1970's. In both periods, the Fed responded to recession by expanding the money supply, although the scale of monetary expansion in the recent case is unprecedented. Under Fed Chairman Burns, monthly money growth, which had averaged 3.2 percent in the first quarter of 1971, jumped to 11 percent in the same period of 1972. The money supply grew 25 percent faster in 1972 compared to 1971. Money supply growth under Chairman Bernanke has been nothing short of remarkable.

The other significant event affecting the economy in the 1970's was Nixon's 1971 decision to abolish the gold standard. Since then, the US Dollar has declined in value with every new paper dollar. Debasement of the Dollar has made many eager to shift out of money bank deposits into

hard, commoditized assets precisely because dollars are losing value. Gold prices tripled in 1980-1981; gold has double in price since 2009.

President Reagan recognized the importance of sound money. In 1981, he established the Gold Commission to evaluate returning to the gold standard. Although the Commission's findings were not accepted at the time, variants of the basic structure have evolved that may be useful today. The advantages of a modern gold billion standard include long term price stability, lower inflation and effective fiscal control.

Former Fed Chairman Alan Greenspan and macro-economist Robert Barro have written in favor of a return to the gold standard. In *Gold and Economic Freedom*, Greenspan described supporters of fiat currencies as "welfare statist" intent on using monetary policies to finance deficit spending. He has argued that the fiat money system of his day had retained the favorable properties of the gold standard because central bankers had pursued monetary policy as if a gold standard were still in place. Barro puts forward the concept of a "monetary constitution" that would provide stability derived from monetary policy rather than politics, and suggests that the constitution could take the form of a gold standard or some other commodity-base standard equally as well and serve much better than a system based on fiat currency.

So how has the Fed imprisoned the US economy? The Fed has shackled growth by debasing the currency and destroying wealth of individuals and businesses. Ultra-easy monetary policies have driven up prices and fostered malinvestment, which has stalled economic recovery. In its response to the Great Recession, Congress expanded the role of the Federal Reserve, providing it, under the Dodd-Frank Act, sweeping powers over all financial institutions in the economy, and concentrating economic power in one individual, the Chairman of Federal Reserve. It is now within the Chairman's power to decide the fate of any financial institution, and to step in at his sole discretion to either seize or dismantle any financial institution deemed a "systemic threat" to the economy or the markets. At the same time, the private Federal Reserve is not accountable to anyone, not even to Congress. Congress can enforce no oversight of the Fed, whose internal operations remain secret. The Fed has never allowed its books to be audited.

The consequence of unchecked Federal Reserve power is economic slavery. The Fed is holding the economy hostage to its power-driven need to control every aspect of the economy, from interest rates and reserve deposits to mortgage down payments and debit card fees; and now, from dividend payouts and stock buybacks, to executive compensation and bonuses.

In no other period in the history of the United States has the economy been subject to such broad- reaching regulation and control. It is truly remarkable.

Despite the weight of oppressive and intrusive government policies, there is hope for individuals who recognize the path to freedom and prosperity. It is individual human action, based on the dignity of self-worth and self-interest that creates wealth. Wealth is not created by government or central economic planning.

Scaling back the Fed's over-reaching authority is not the only step needed to rescue the US economy. As you have read in these pages before, pro-growth tax reform and spending reforms

need to be implemented to achieve robust GDP growth and full employment. These are major departures from current Washington policies. Necessary changes may not come until 2012. We may see then, as we saw in 1981, on inauguration day a bold rescue, of our economy this time, by those with conviction and courage.

By the way, in 1981, as part of the Algiers Accord which ended the hostage crisis, the Iranians insisted on payment in gold rather than US dollars so the US transferred 50 tonnes of gold to Iran while simultaneously taking ownership of an equivalent quantity of Iranian gold that had been frozen at the New York Federal Reserve Bank.

To guard against unchecked debasement of the currency, the prudent investor can buy and own gold. While the US Dollar has declined in value, gold continues to be a store of value. Since 1979, gold prices have increased 670%

Gold is also a proven hedge against economic instability, seen now in Greece, Italy, Spain Portugal and Ireland, which threatens the Euro.

Investors from around the world benefit from timely market analysis on gold and silver and portfolio recommendations contained in *The Gold Speculator* investment newsletter, which is based on the principles of free markets, private property, sound money and Austrian School economics.



The question for you to consider is how are you going to protect yourself from the vagaries of the fiat money and growing inflation? We publish *The Gold Speculator* to help people make better decisions about their money. Our Model Conservative Portfolio gained 66.7% in 2010, and 55% for 1Q2011. Subscribe at our web site www.thegoldspeculatorllc.com with credit card or PayPal (\$300/yr) or by sending your check for \$290 (\$10 cash discount) The Gold Speculator, 614 Nashua St. #142 Milford, NH 03055