First Fed Hearing Begins with Democratic Character Attack

The ranking Democrat on the House Domestic Monetary Policy and Technology Subcommittee began the first hearing on the Federal Reserve Bank in the new Congress with dramatic ad hominem attacks on Loyola University Maryland Economics Professor Thomas DiLorenzo. Rep. William Clay of Missouri accused DiLorenzo of having racist ties for being an adviser to the League of the South, a states'-rights organization, and then failed to address any substantive questions on economics to DiLorenzo with the dismissive remark: "I do know that I have no questions for you."

At the hearing, titled "Can Monetary Policy Really Create Jobs?," Clay commented to DiLorenzo,

> 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.

The subcommittee Chairman, Texas Republican Ron Paul, replied that Clay's remarks were probably the only politically effective attack on DiLorenzo's eloquent economic explanation before the committee. "I think that that's typical of people who can't compete on ideas, they have to try to discredit the individual," Paul told Reuters after the hearing.

"It has been difficult for my staff to locate any recent work of yours as an economist," Clay told DiLorenzo during the committee hearing, even though DiLorenzo has written three books on the history of banking, including *Hamilton's Curse*, on the First Bank of the United States. DiLorenzo is also a prolific writer for the Ludwig von Mises Institute, the most prominent think tank associated with the Austrian economics school.

Clay also attacked the Austrian school with the remark:

> 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 scientific rigor and its rejection of empirical data. You don't use the scientific method, and instead employ deductive reasoning. You apply preconceived generalizations to your work. You're kind of asking us to take your word for it. Without data, without providing falsifiable results, it's difficult for others to evaluate the merits of your work. And we must rely on your body of work itself.

It is true that the Austrian school favors the logic of deduction (deriving a conclusion from general or universal premises) over the logic of induction (i.e., the "scientific method") to analyze economic data because, in a complex economy it is virtually impossible to isolate a variable in the same way chemical compounds can be isolated in a scientific laboratory. But the Austrian school is the only economic school that predicted the housing bust almost unanimously years before the actual recession. The Ludwig von Mises Institute that Dr. DiLorenzo is affiliated with called the housing boom a bubble that's "too good to be true" and predicted the housing bust at least as early as 2003 and 2004, a time when no other economic school was talking about a bubble. Application of the "scientific method" to Austrian school analysis has simply proven the school to be far more accurate than any other school. And while the Austrian school may not have been "mainstream" several years ago, the amazing accuracy of its adherents before the housing bust has given it vastly expanded credibility and exposure.

When Clay claimed that DiLorenzo utilized "preconceived generalizations" in his testimony, he failed to address that these premises are based upon universally accepted laws of economics also accepted by other economic schools who do employ the scientific method. No economist would contend that lowered interest rates do not dramatically increase housing affordability, that more housing affordability increases demand for housing, and that increased demand for housing increases prices and provides an incentive to create more supply (i.e., more housing construction). Nor does any economist deny that increased interest rates provide the reverse incentive. "The cause of the boom was the Greenspan interest rate policies," DiLorenzo told the subcommittee of the housing boom in the last decade, stressing that

> The monetary expansion that the Fed creates, it sometimes produces price inflation, but that's 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.

DiLorenzo then went on to explain that the Federal Reserve's policies of pushing historically low interest rates in the 2000-2006 period made housing prices skyrocket by suddenly making houses far more affordable to buyers. Because banks have historically calculated housing affordability upon a monthly payment using the income of the borrower and interest rates, lowered interest rates suddenly made housing affordable to a larger segment of the population (and larger houses available to previously more modest purchasers). This shock of new affordability spiked demand and created a speculative market that skyrocketed prices and created a housing construction boom that was unsustainable in the long-term.

When the Federal Reserve was eventually forced to raise interest rates in 2006, the enormous speculative bubble burst and the massive economic investments the interest rate policy created in the financial markets and in the housing construction markets were liquidated. Widespread unemployment resulted from the frenzied sell-off. DiLorenzo further explained:

> The downside of the Fed's policy of lowering of interest rates, lower and lower, is that it deters savings. And savings and investment is really the key to having a sustainable economic growth and job creation. And the real damage occurs, then, during the boom of the business cycle where capital is misallocated. Too much of it goes into unsustainable areas, such as real estate in the latest bubble here.

DiLorenzo concluded that "the history of the Fed is that it has created boom and bust cycles ever since it was created back in 1914."

Photo: Thomas DiLorenzo