THE GOLD PROBLEM REVISITED*

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The article *The Gold Problem* of Ludwig von Mises published 47 years ago in 1965, just six years before he died (the gold standard died with him in the same year) has some breathtaking thoughts, for example, “the gold standard alone can make the determination of money’s purchasing power independent of the ambitions and machinations of governments, of dictators, of political parties, and of pressure groups”, or: “the gold standard did not fail: governments deliberately sabotaged it, and still go on sabotaging it.” But for all our admiration we would be amiss if we did not point out certain errors in his article. These are all errors of omission, and correcting them would hopefully make the Mises article even more helpful to the discriminating reader.

Mises fails to answer his own question why gold is the best choice to serve as money. Indeed, why not another commodity, or a basket of commodities? The reason is that *the marginal utility of gold is unique in that it declines at a rate slower than that of any other substance on Earth*. Various assets have various marginal utilities which determine their value. All of them decline, albeit at various rates. In other words, economic actors accumulate any given asset increasingly reluctantly up to their satiation point that will be reached sooner or later. For gold the satiation point is further removed than for any other asset, so far indeed that for all practical purposes it is beyond reach. Therefore substituting another commodity (or basket of commodities) for gold would result in a unit of value with inferior marginal utility. A measuring tape made of rubber would be substituted for one made of metal.

In what follows I address the four points addressed by Mises in his original article.

1. The futility of inflationary policies

Mises ignores the fact that newly created money can be spent not only on goods and services, but also on financial assets. Price rises in the wake of credit expansion are not inevitable. This is the proverbial fly in the ointment of the inflationary argument. It is also a subtle one, so much so that the government as the would-be perpetrator of inflation often falls victim to it. It may think that it is promoting inflation while, in fact, it acts as the quartermaster for deflation.

By restricting the circulation of gold money or by other means, the government can make financial speculation more attractive. In doing so it wants to reduce the amount of money available for buying goods and services. This strategy of the government and its pseudo-economists consists precisely in channeling enough of the newly created money into speculative ventures so that the untoward consequences of price and wage rises will not occur, or they will occur much later, thus obscuring the causality relation.

The paramount example is bond speculation. Of course, under the gold standard there is no bond speculation because the variation in the bond price (or, equivalently, in the rate of interest) is minuscule making the opportunity to earn speculative profits negligible. *This is no longer true if risk-free profits are made available* as a bait to speculators through inappropriate monetary and fiscal measures.

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* This article is in response to Dr. Joseph Salerno’s remarks made in the interview with Anthony Wile of the *Daily Bell*, July 3, 2011. The article *The Gold Problem* by Mises is appended below.
This is exactly what happened in the early 1920’s when the policy of open market operations, so called, was first introduced – quite illegally, we might add. (The policy of open market operations was retroactively legalized in 1935 through an amendment, see the Federal Reserve Act of 1913, Article 14B, as amended.)

As the Fed was originally constituted, it was only enabled to be a passive player. Limited by its charter, it could enter (or decline to enter) business initiated by others. Significantly, it could not initiate business on its own. It could post its rediscount rate, but member banks had to step forward with their request to rediscount real bills from portfolio.

In and of itself rediscounting was not inflationary as a way to create new money. The new purchasing power so created was backed, dollar for dollar, by salable merchandise arising in production, and it was to be extinguished when the merchandise was sold to the ultimate consumer before the bill matured.

This was not the case, however, when the Fed assumed an active role and started purchasing (and selling) government bonds in the open market at its own initiative – in contravention of the original Federal Reserve Act of 1913. The monetary base is enlarged through the purchase of government bonds, providing member banks with an incentive to make loans – regardless whether or not new merchandise is simultaneously emerging in production. Making this distinction is important. New money derived from these loans embarks upon a search for prices that can be bid up.

Using standard Quantitative Theory of Money (QTM) reasoning the Fed (and everybody else) assumed that the effect of open market purchases of government bonds was to be inflationary. Hooray, a subtle and potent new way of augmenting the money supply has been invented! The economy can now be micro-managed and fine-tuned through the intervention of the Fed, as the need may arise! There was great jubilation in the inflationist camp.

The jubilation was premature. The policy of open market operations as an instrument of inflation was an enormous blunder. It ignored bond speculation as a market force that had been dormant, but was at once woken up from its slumbers by the intervention of the Fed. QTM became inoperative: bond speculators easily overrode it. They knew exactly when the Fed had to go to the open market “to relieve nature’s urge” in passing new money (read: to purchase its next quota of government bonds). Speculators could make risk-free profits by pre-empting the Fed in buying the bonds first. The Fed had no choice: it had to buy the bonds from speculators at an enhanced price. The Fed thought it was in the driver’s seat. It was not. The “invisible hand” of the speculators was on the steering wheel, driving bond prices up or, what is the same to say, driving the rate of interest down.

The tool of open market operation as a spur of inflation backfired badly, if only for the reason that speculators were a much smarter lot than central bank agents confronting them in the bond pit. They were risking their own capital while losses made by central bank agents were covered from public funds. The game plan was upset — unbeknown to the planners themselves. What was supposed to be inflation ended up as deflation. Here are the details.

In an unhampered market risk-free profits that may occur from time-to-time are ephemeral and therefore inconsequential. Hawk-eyed speculators immediately take advantage of them with the result that any further opportunity to make risk-free profits is eliminated on the spot. This is no longer true if the opportunity to make risk-free profits is not an infrequent aberration but the consequence of a deliberate and well-advertised official policy — as it is in the case of the Fed’s open market operations.
If the Fed relies on open market purchases of government bonds in augmenting the monetary base on a regular, on-going basis, then speculators will anticipate it and act upon it. They will pre-empt the Fed. The result is the formation of an uptrend in bond prices or, what is the same to say, a falling interest-rate structure.

This policy, whole-heartedly supported by Keynesian/Friedmanite economics, is the most ill-conceived monetary policy ever concocted for the purpose of increasing the stock of money. Ostensibly it is inflationary, but in actual fact it is profoundly deflationary. It is responsible for putting the worm into the apple: it lends a decreasing bias to the interest-rate structure. The Fed may like that bias; the trouble is that the Fed thinks it can control it. In fact, it is controlled by the herd of bond speculators acting in unison.

The original Federal Reserve Act of 1913, for precisely these reasons, disallowed such a policy and imposed stiff and progressive penalties for non-compliance, whenever the balance sheet of a Federal Reserve bank showed that government bonds had been used to cover Federal Reserve note or deposit liabilities. At first the Fed used open market operations illegally in connivance with the U.S. Treasury that ‘has forgotten’ to collect the penalty. The conspiracy of the Fed and the Treasury created a fait accompli for Congress. It had to legalize the illegal practice retroactively in 1935.

The newly invented monetary policy of open market operations is responsible for much of the deflationary damage inflicted on the world economy during the Great Depression of the 1930’s. It started an avalanche of falling interest rates that soon went out of control. Falling interest rates destroy capital as they increase the burden of debt contracted earlier at higher rates. Perfectly sound businesses fail if their debt burden, through no fault of theirs, exceeds the profitability of deployed capital. From this point of view it does not matter whether the capital has come from borrowings, or whether it has been generated internally. Deployed capital is subject to erosion, in extremis to destruction, in response to a falling interest-rate structure.

The process of wiping out operational profits wholesale through escalating bond prices is most insidious. Entrepreneurs do not know what has hit them. From one day to the next they find themselves uncompetitive. Their competitors finance their business at lower rates. Their capital is in a shambles. They are forced to lay off employees. They go bankrupt in droves. Their competitors are no better off as they are the next victim. This type of wanton destruction of capital by the Fed was the main cause of deflation and the Great Depression in the 1930’s.

Herein lies the incredible story of the failure of the policy of open market operations, missed by Mises and all other observers. The policy is counter-productive even from the point of view of the central bank and pseudo-economists acting as its cheer-leaders. It released the genie of risk-free bond speculation from the bottle believing that the genie could be brow-beaten back into the bottle. It couldn’t. Falling interest rates would run their devastating course.

The same story repeats itself today. Interest rates have been falling for over thirty years. Whatever it may say, the Fed is no longer in control. It is lunacy to believe that the avalanche started with dropping a single snowball in the early 1980’s can now be stopped dead in its track. Today the speculators are the only buyers left as China and other exporters to the US are bailing out of the US T-bond market. They will keep buying the bonds as long as they can reap risk-free profits. It is true that ‘quantitative easing’ cuts into that business, as the Fed is buying bonds directly from the Treasury, bypassing the open market (another illegal practice). How long can speculators be induced to bite the bait and buy the bonds?
Watch for the day when they will start selling bonds short. When they transfer their buying from the bond market to the commodity market, the game is up.

The policy of open market operations is a charade. When the producers and the savers are squeezed dry, it’s “après nous le deluge”. Ben Bernanke is the Quartermaster General of Great Depression II.

2. The futility of the policy of suppressing interest rates.

The rate of interest is a market phenomenon just like prices. In fact, the definition of the rate of interest must refer to the bond price: it is the rate at which the payment stream of interest will, upon maturity, amortize the bond’s price as quoted in the secondary market. The floor for the range in which the interest rate may move is determined by marginal time preference. (The ceiling, on the other hand, is determined by the marginal productivity of capital; we are not concerned with that concept in this article.) To understand this we must consider the arbitrage of the marginal bondholder between the bond market and the gold market. If the rate of interest falls below the rate of marginal time preference, then the marginal bondholder sells his overpriced bond and keeps the proceeds in gold coins. In this way he can force the bond price to come back to earth from outer space. Bank reserves are shrinking and the banks have to call in some of their credits and sell bonds from portfolio. By contrast, when the yield rises above the rate of marginal time preference, the marginal bondholder will repurchase his bond at a lower price. Time preference has no meaning outside of this context. It would remain just a pious wish — unless the marginal bondholder lends it teeth.

Mises (and before him Ricardo, who advocated the elimination of gold coins from circulation) was wrong when he stated that there was no difference between the gold coin and a promise to pay gold coin as long as the security and maturity of the promise cannot be doubted. The promise can perform all the monetary functions that the gold coin does. Well, it cannot, because there is one very important exception. When the marginal bondholder in protest against low interest rates sells his bond (a future good), he insists on getting gold (a present good). He will not take a promise to pay gold, because it is still a future good, and an inferior one to boot, as it pays no interest. Taking it would mean jumping from the frying pan into the fire. This shows that gold hoarding, far from being a deus ex machina, and far from being a curse of the gold standard, is an important market signal. It indicates that the rate of interest has been pushed below the rate of marginal time preference. The signal had better be heeded before it is too late. Gold hoarding cannot be understood except in the context of its counterpart, gold dishoarding. When the signal is heeded and the banks tighten up their loose credit policies, and the government reins in its expenditures, gold will be dishoarded, and the marginal bondholder will replace gold in his portfolio by repurchasing the bond. Bond/gold arbitrage is profitable in the service of regulating the rate of interest.

The reason for eliminating gold coin circulation first in Europe in 1914, and then in the United States in the 1930’s, was the determination of governments to make sure that they were in full control of the rate of interest, free of interference from the marginal bondholder. This policy was shipwrecked on the reef of gold (as it was still being hoarded after the closing of the Mint to gold).

All economists, including Mises himself, ignored the importance of gold hoarding and dishoarding as manifested by the arbitrage by the marginal bondholder, which explains the all-important contact between gold and interest — first observed by John Fullarton in 1844 (see his book: On the Regulation of Currencies.)
3. The futility of the policy of boosting wages.

Mises did not subscribe to Adam Smith’s Real Bills Doctrine (RBD). Although he acknowledged the fact that real bills drawn on consumer goods in most urgent demand had circulated as a kind of ephemeral money through endorsing, as they did in Lancashire before the Bank of England opened its branch in Manchester, he did not find this matter worthy of further attention. He coined the word “circulation credit” that financed the movement of commodities from the producer to the consumer through the various phases of production, but he blotted out the important distinction between the discount rate and the rate of interest. He never used the term “self-liquidating credit” that would have revealed why circulation credit did indeed circulate spontaneously and without any coercion from the government — even in the hypothetical world without banks! It did circulate because the credit was liquidated through the release of the gold coin by the ultimate consumer in purchasing the merchandise on which the bill was constructed in 91 days or less. The banks’ role is subordinate.

Mises was unimpressed by the fact that bonds and mortgages could not circulate in the same way as bills. He set great store by the QTM. Yet he might have been disturbed by the fact that real bills, however temporarily, could serve either as money substitutes or as bank reserves on which sound money could be built. His negative attitude with regard to Adam Smith’s RBD is regrettable. Real bills are the next best thing to gold into which they mature in 91 days or less.

Demand for real bills is virtually unlimited. Not only will banks with surplus gold in their till scramble for them as the best earning asset they can have; individuals and institutions with large payments coming up (such as the cash purchase of a home, a factory, or the retirement of a bond issue) that have a need to assemble cash to meet the liability due shortly will also bid for them. They will not put their accumulating funds into stocks, bonds, or mortgages for reasons of insufficient liquidity. Any increase in offering will immediately depress their price. The liquidity of real bills as an earning asset is second to none. They are the preferred medium in which to assemble cash when the need arises.

But the greatest significance of real bills has to do with the labor market as they augment the demand for labor. The only author who recognized this fact was the German economist Heinrich Rittershausen (1898-1984), see his book Arbeitslosigkeit und Kapitalbildung, Jena, 1930.

A large part of outstanding real bills in circulation represented the wage fund of society. Out of this fund wages for labor producing merchandise that would not be available for sale for up to 91 days could be paid here and now. Thus real bills represented a real extension of demand for labor. Employers would simply go ahead and hire all the hands needed to produce merchandise in high consumer demand, without worrying who will advance the funds to pay wages before the merchandise could be sold. They assumed that the wage fund would always be there. The RBD explains why there was no ‘structural unemployment’ in the 19th century, in contrast with the 20th, before the wage fund was destroyed by the victorious Entente powers, never to be rebuilt. 19th century entrepreneurs did not have to assume the burden of financing the payment of wages. The bill market took care of that. Say’s Law was fully operational: there were employment opportunities as long as prospective employees wanted to eat, get clad, shod, and keep themselves warm in winter.
The point was driven home most forcefully when the wage fund was inadvertently destroyed. The victorious Entente Powers decided not to allow the rehabilitation of the bill market after the cessation of hostilities in 1918. This single decision sealed the fate of tens of millions of workers who were to be laid off in the 1930’s for lack of financing the wage bill. It was also the reason for creating the corrosive ‘welfare’ state that paid workers for not working and farmers for not farming. It also caused the demise of the gold standard by removing a vital organ, its clearing house: the bill market. Here are the details.

The victorious Entente Powers were afraid of German competition in the postwar world. They wanted to monitor, if not control, Germany’s exports and imports. As this would not be possible under the system of multilateral trade, that is, trade financed by real-bill circulation, they opted for a system of bilateral trade. Never mind that this meant a setback for their own producers and consumers as well. Never mind that much more gold was needed to run a system of bilateral trade than what would be required by a system of multilateral trade — extra gold they did not have. Never mind that this would make the 1925 return of Britain to the gold standard deflationary which guaranteed it failure. The neurotic fear of German competition took precedence over all other concerns. In fact, these concerns were never examined and the decision was made in high secrecy. Incidentally, this decision made Say’s Law inoperative. It was no longer true that employing labor ipso facto created demand for its own products. Real bill circulation is an absolute precondition for that.

This was the end of real-bill financed world trade, the great success story of the 19th century. The bill market was destroyed. We still suffer the consequences. In effect, world trade has been reduced to barter between countries. Worst of all, along with the destruction of the bill market society’s wage fund was also destroyed. There was no one around to advance wages payable to laborers whose products could not be sold for cash up to 91 days while going through the phases of production and distribution. Vast sections of the world’s productive plants were condemned to idleness for reasons of a disappearing wage fund. As I have mentioned, the only economist in the world who saw what was coming was Rittershausen. Economists still owe him recognition for his great insight. The world is still condemning the gold standard as the major cause of the Great Depression of the 1930’s and the horrible unemployment in its wake, when the real cause was the destruction of the wage fund, a misguided unilateral decision of the victors in World War I made under the veil of secrecy—a veil that has never been lifted.

It is most unfortunate for economic science that Mises failed to give support to Rittershausen’s charges. Not only were governments guilty of putting improper and counterproductive measures into effect to boost wage rates thus fostering unemployment as explained in the article of Mises. More importantly, they were directly responsible for the world-wide leap-tide of unemployment through the destruction of the bill market and its wage fund.

Once again the world is facing the same dangers as it did four score of years ago. Yet one can see only complacent governments in a self-congratulating mood over their ‘success’ in ‘fending off’ the Great Financial Crisis. But the writing is on the wall: if governments fail to rehabilitate the gold standard and its clearing house, the bill market, thus restoring the wage fund, then a much more devastating leap-tide of unemployment will soon engulf the world.

4. The futility of the policy of gold valorization.

The world has been witnessing the pathetic attempts of governments and central banks “to keep the gold price in check” since the 1971 fraudulent default of the US government on its
international gold obligations. To be sure, a default is always followed by a depreciation of the dishonored paper, so the ultimate futility of the policy of gold valorization has always been a foregone conclusion. But what we have is far more than this self-defeating effort to keep gold out forever from the monetary system. What we have is a veritable brain-washing of the whole world about the role of gold in the economy, and blaming gold for results that only keeping gold in the system could have prevented.

It is alleged that gold has disqualified itself from playing the role as the monetary anchor and source of credit in the economy. “Gold has become far too volatile for that”. This is puerile because it ignores the fact that the so-called volatility of gold is just the mirror image of the volatility of the irredeemable dollar in which the price of gold is quoted.

It is also ignored that the debt crisis is a direct consequence of exiling gold from the monetary system. Gold is the only ultimate extinguisher of debt. It cannot be replaced by the dollar or any other irredeemable currency. Under the dollar system debt simply cannot be extinguished. Total debt can only grow, never shrink. All the bad debt and “toxic sludge” stays in the system and is merely kicked upstairs into the balance sheet of the US Treasury which is what actually takes place. There it remains, representing a great threat to the world economy and its stability. Like radioactive material, when its quantity exceeds critical mass, a chain-reaction starts triggering nuclear explosion. The world needs gold in order to prevent the nuclear explosion of debt.

Central banks have been falling over themselves to sell gold from the asset column of their balance sheets, replacing it with ‘earning’ and ‘appreciating’ assets such as US Treasury bonds. The foolishness of this becomes clear when we contemplate that the so-called ‘earning’ is more than wiped out by the faster depreciation of the US dollar, and the so-called ‘appreciation’ of the US Treasury bonds (due to the falling interest-rate structure) inexorably turns into depreciation as the bonds approach maturity. The upshot is that the balance sheets of central banks are hit twice:

- First, the value of their bond portfolio and dollar earnings is decimated by monetary depreciation (commonly referred to as ‘inflation’);
- Second, there is an additional capital loss due to the disappearance of the premium on the face value of the bond (reflecting the falling interest rate structure) at maturity.

It goes without saying that pari passu with capital losses suffered by central banks on their assets, their note issue is subject to further depreciation due to the inflation of the money supply in excess of production of goods and services.

Through a system of bribes, blackmail and intimidation research on questions relating to gold money has been discouraged by the Research Departments of the twelve Federal Reserve banks to the point that it is now practically non-existent. The situation is not significantly better outside of the U.S. The world continues to live in a fool's paradise. It believes the size of government debt does not matter because it can always be rolled over. “One pocket owes it to another”. Nor would, according to these doctrines, inflation or deflation be caused. Competent and honorable gentlemen at the helm can safely navigate our monetary ship through the strait of the Scylla of hyper-inflation and the Charybdis of deflation. They have a powerful tool at their disposal: the printing press, and with its judicious application they can fine-tune the quantity of money in circulation as well as they can micro-manage the rate of interest for the benefit of all.

However, the elimination of research on the monetary role of gold is striking back. These ‘competent’ and ‘honorable’ gentlemen at the helm are perfect ignoramuses when it comes to gold basis, that is, the difference between the nearest future and the spot price of gold. They have no notion of the continuous and inexorable erosion of the gold basis for the
past 40 years from its top reading in 1972 all the way to zero now. Worse still is the fact that they don't understand the significance of the irresistible march of the gold futures markets into the death valley of permanent backwardation.

When the basis goes irreversibly negative and permanent backwardation sets in, gold is not available at any price. At that point the U.S. Treasury bonds cease to be redeemable in gold at any rate of exchange. This may not bother the Keynesian and Friedmanite butchers at the Fed and the Treasury unduly, but it will certainly upset all those who accept them as collateral for the currency, among others, all the producers of real goods and services. Their refusal to accept irredeemable promises in payment for real goods and real services will trigger an irresistible slide into barter as far as essential commodities are concerned. The world is insidiously slipping back into direct exchange for want of money acceptable in indirect exchange. However, you cannot feed the world’s present population on the basis of a barter economy. Poverty, pestilence, famine threatens society, not to mention the breakdown of law and order. All this, and more, because government leaders have suppressed not only monetary gold itself, but also any meaningful research on its role in the global economy.

Permanent gold backwardation, if nothing else will, must finally bring about a sovereign debt crisis in America as it metastasizes across the Atlantic. It will herald the arrival of the moment of truth. It will reveal without the shadow of a doubt that the U.S. Treasury bond is irredeemable; that it promises to pay nothing but more of itself; that the Fed backing Federal Reserve notes with Treasury paper while the Treasury paper is payable in Federal Reserve notes is just a legalized check-kiting scheme. The dollar would have gone the way of the Assignat and the Reichsmark a long time ago but for the fact that it could still be exchanged for gold (however little). To most people this fact suggests that the dollar will always command some gold (albeit a variable amount). These people are ignorant of the vanishing of the gold basis that is about to turn negative for the first time in all history.

Ben Bernanke, the Chairman of the Federal Reserve Board in his testimony at a Congressional hearing introduced a new phrase into the economic vocabulary on July 11, 2011. The new phrase is: “tail risk”. He defined it as “really, really bad outcomes” in the economy, as if they were completely outside of human control – just as floods, earthquakes, volcanic eruptions, tsunamis are.

In reality ‘tail risk’ is nothing but a bunch of wholly unnecessary risks that Bernanke & Co. take with human lives. This is a gang of parasitic, corrupt, contemptuous, conceited, and yes, ignorant policy makers guiding the destinies of the U.S. and the world at the helm of the Fed and the U.S. Treasury, imitated by sycophants in comparable positions in other countries. They hijacked the Constitution, turning its monetary clauses, which unequivocally define money in terms of silver and gold, upside down. They usurp the power the Constitution has reserved for the people themselves, namely, the power to create money by delivering silver and gold to the Mint for coining. They are now preparing to finish the hatchet-job. They are only interested in saving their own hide and that of their accomplices inhabiting the executive suites of multinational banks; in their own self-aggrandizement; in perpetuating their power; and in spreading their superstitious faith in irredeemable currency – a monetary system that has failed ignominiously every time foolish leaders in history have experimented with it.

Mises was a great warrior fighting these usurpers and monetary hijackers with the sharpest weapon there is: human reason. We must follow his lead, even if sometimes it means that we have to introduce new ideas that go beyond Mises’ published opus.
The day of reckoning for monetary insanity is on hand. The Constitution is there for the protection of all. If we fail to reclaim and uphold it, if we meekly succumb to the monetary hijackers’, blackmailers’ and usurpers’ demands, then we shall have only ourselves to blame for the consequences.

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ANNOUNCEMENT
New Austrian School of Economics
Munich, Germany
From September 3 - 9, 2012
Title of the course:

CRITIQUE OF MAINSTREAM AUSTRIAN ECONOMICS
Marginalism; Marketability; The Real Bills Doctrine vs. the Quantity Theory of Money; Interest versus Discount; The True Role of the Gold Standard

Part One: Marginalism
1. Marginal utility and unit price
2. Marginal productivity of capital
3. Marginal productivity of labor
4. Marginal productivity of debt
5. The marginal object and the marginal subject
6. From price to spread: arbitrage
7. Menger’s concept of marketability

Part Two: The Theory of Value
8. Can value be measured?
9. Is constant marginal utility of gold contradictory?
10. Is paper money a present good or a future good?
11. The Gold Standard (unadulterated and Rothbard’s so-called 100 percent gold standard)
12. Menger and the Quantity Theory of Money
13. The wisdom of Adam Smith
14. Spontaneity of real bill circulation
Part Three: Interest versus Discount

15. Where gold certificates cannot deputize for gold coins
16. Market process and the determination of the rate of interest
17. The meaning of zero interest and zero discount
18. Gold and Interest
19. Marginal time preference and marginal productivity of capital
20. The discount rate and the marginal productivity of social circulating capital

This course is a seven-day, twenty-lecture session. Its topics are not recycled but new material. Its completion will earn one credit of the four needed towards a Bachelor of Monetary Science (BMSc) degree handed out by Prof. Fekete. It is meant for those, including beginners, who are interested in the theory of money, credit, and banking, with special emphasis on the current financial and economic crisis. Previous courses are not a prerequisite. For further information or in order to register for the course you can get in contact with the organizers Ludwig Karl and Wilhelm Rabenstein via mail (nasoe@kt-solutions.de) or phone (+49 – 170 – 380 39 48, before calling please consider a possible time lag). You might also want to take a look at the New Austrian School of Economics on Facebook: https://www.facebook.com/newasoe and https://www.facebook.com/events/191504464305951/
THE GOLD PROBLEM*

*Ludwig von Mises*

Why have a monetary system based on gold? Because, as conditions are today and for the foreseeable future, the gold standard alone can make the determination of money’s purchasing power independent of the ambitions and machinations of governments, of dictators, of political parties, and of pressure groups. The eminence and usefulness of the gold standard consists in the fact that it makes increases in the supply of money depend on the profitability of mining gold, thus preventing large-scale inflationary ventures on the part of governments.

The gold standard did not fail. Governments deliberately sabotaged it, and still go on sabotaging it. Governments believe that it is the gold standard’s fault that their inflationary schemes not only fail to produce the expected benefits, but unavoidably bring about conditions that are considered as much worse than the alleged or real evils that they were intended to eliminate. The gold standard, pseudo-economists tell the government, is the stumbling block frustrating its policy to make everybody happy and prosperous. Let us examine the futility of some of the pet policies of governments.

1. The futility of inflationary policies

The government increases the quantity of money in circulation. Then a greater amount of money ‘chases’ the same amount of goods and services. The government merely made prices of goods and services soar. If the government wants to raise the income of some people, say that of government employees, then it has to confiscate by taxation part of some other people’s income and redistribute it to the favored groups. Then taxpayers are forced to restrict their spending while the recipients of higher salaries can increase theirs. In this arrangement there is no change in the purchasing power of the monetary unit.

But if the government provides the money for the payment of higher salaries to the favored group by simply printing it, then the new money in the hands of these beneficiaries constitutes additional demand for goods and services. The unavoidable result is a tendency of prices to rise. Taxpayers can find shelter against capricious inflationary adventures of the government at their expense in gold ownership.

2. The futility of the policy of suppressing the rate of interest

Interest is the difference in the valuation of present and future goods. It is the discount in the valuation of future goods as against that of present goods. Interest cannot be ‘abolished’ as long as people prefer an apple available today to an apple available only in a year or in ten years. It is therefore obvious that the height of the market rate of interest does not depend on the whims, fancies and the pecuniary interests of the personnel operating the government apparatus of coercion and compulsion. But the government can push the Fed and the banks subject to it to pursue a policy of ‘easy money’. Underbidding the rate of interest as established in the market, they offer additional credit created out of nothing. Businessmen are
misled. The intervention of the banks creates the impression of a more generous supply of capital goods. Projects are undertaken which a sober calculation would label as malinvestment. Boom is created that cannot be sustained for lack of a sufficient quantity of capital goods (that can only be created by additional savings). When the malinvestment becomes visible, the boom leads to debacle and misery. Gold is blamed as the bearer of bad news, and is dealt with accordingly.

3. The futility of the policy of boosting wages
The height of wage rates is determined by the consumers’ appraisal of the value of the worker’s labor added to the value of merchandise in the process of production. If an entrepreneur tried to pay a hired hand less than the amount deemed right by the consumers, then this man will be hired away by competing entrepreneurs. On the other hand no entrepreneur can pay more than that amount because consumers in buying the product will not compensate him for the resulting losses. He then will be ejected from the ranks of businessmen.

Governments believe that they can overrule the verdict of the consumers. They establish minimum wages. They grant legal immunity to unions committing violence against people (yellow scabs: the strike-breakers) and property (plant and equipment) in pursuit of higher wages. But governments and unions are helpless against economic law. Violence can prevent the employer from hiring help at potential market rates, but they cannot force him to employ all those who are anxious to get jobs. The result is unemployment.

The only valid way to provide higher wages, and jobs for all those who are eager to earn them, is to increase the per capita quota of capital invested in production facilities. This result can only be brought about by additional savings and capital accumulation — never by government decrees, union violence, intimidation, inflation. Once again, gold is blamed as the bearer of bad news, and is dealt with accordingly.

4. The futility of the policy of gold valorization
The way gold delivers bad news is through going into hiding under the gold standard or, in case the gold standard has been overthrown, through an increase in the gold price. The government reacts by trying to cap the appreciation in the value of gold by hook or crook. This government activity is known as the “policy of gold valorization”: assigning a lower value to gold than the market does, according to the preconceptions of government bureaucrats.

In history there have been innumerable experiments on the part of governments to valorize various goods in various places at various times, but none proved to be a greater failure or embarrassment than the attempt to valorize gold. Banning ownership and trade in gold has been a favorite method tried by the government of France under John Law’s system and, later, during the French Revolution — not to mention other attempts in other countries,
sometimes even invoking the death penalty. These measures explicitly deny the individual’s right to seek protection for himself and for his family, including young children, against famine or financial ruin caused by capricious and misguided government policies such as price and foreign exchange controls.

There is only one method available to avoid confrontation between the government and its citizens over the gold problem, namely, radical abandonment of the policy of deficit spending, the system of minimum wages, and the policy of easy money.

If you have enjoyed reading this material, you might be interested in reading my submission to the Wolfson Economics Prize 2012 Contest under the title: How to Ensure the Stability of the New European Currencies? that can be found on my website: www.professorfekete.com

The entire session of the New Austrian School of Economics in Munich Bavaria, Germany, from September 3 to 9, 2012, will be devoted to the theme: Critique of Mainstream Austrian Economics. For further information, contact: nasoe@kt-solutions.de