M E N G E R O R M I S E S?

Interview of the *Daily Bell* with professor Antal Fekete

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Daily Bell: Hello, there, Dr. Fekete. The following questions are taken from some recent writings that you shared with us. Let's jump right in. You want to focus, among other things, on Richard Ebeling and the gold standard in this interview?

Antal Fekete: Yes.

Daily Bell: In a recent Daily Bell interview <http://www.thedailybell.com/exclusive-interviews/35030/Anthony-Wile-Richard-Ebeling-on-Austrian-Economics-Economic-Freedom-and-the-Trends-of-the-Future/>, Dr. Ebeling talks about his book *Political Economy, Public Policy, and Monetary Economics: Ludwig von Mises and the Austrian Tradition* (Routlege, 2010). He elaborates on the advantage of a monetary system based on a commodity like gold. Ebeling summarizes this advantage as follows: "The gold standard makes it more difficult for a government to arbitrarily change the quantity and therefore the value of money used within a country." What's your take, please?

Antal Fekete: While this is true, it is only a very small part of what the gold standard does or can do for a free and prosperous world economy. I take exception to the suggestion that a change in the quantity of money necessarily means a change to the value of money.

Daily Bell: What's the difference between Mises and Menger when it comes to gold?

Antal Fekete: The obvious difference is the apparent blindness of Mises to what Menger sees very clearly that money must be not just *a* commodity; it must be *the* most marketable commodity, the marginal utility of which is virtually constant. Mises categorically stated that constant marginal utility is contradictory in that it indicates infinite demand. Mises would be right only if interest as an obstruction to infinite demand would not play a part in all this. But it does. Mises ignored the nexus between gold and interest altogether. I believe Menger had this nexus very much in mind, although he died before he could elaborate on it.

Daily Bell: It is not well known but Menger was not a devotee of the Quantity Theory of Money (QTM). Can you explain Menger's view?

Antal Fekete: While Menger was not as emphatic in denying QTM as I am, you cannot find any support for QTM in his writings.

Daily Bell: You write that post-Mises Austrians shy away from Menger's theory of marketability in favor of the QTM. In doing so they deprive themselves of a most efficient analytical tool. What do you mean by this?

Antal Fekete: Any argument that appeals to or needs to be supported by QTM is wrong or incomplete. Perhaps it is sometimes helpful to use *ad hominem* arguments to make an idea appeal to the "galleries". However, there is a difference between a scientific argument and one that is meant only as a first approximation to truth.

I find it regrettable that post-Mises Austrians avoid using arguments involving the concept of marketability just because Mises did not use it and appealed to the concept most sparingly. I believe that most of their arguments using QTM could be reconstructed in terms of marketability once they define money in terms of the standard coin made of the most marketable metal. This is, of course, a paradigm shift that they have not been able to bring themselves to accepting.

Daily Bell: You write that, strictly speaking, QTM is not a theory. It is hardly more than a clever metaphor. Can you explain?

Antal Fekete: There are lots of cases when appeal to a clever metaphor can be helpful in popularizing a difficult concept. Take this, for example: "Archimedes discovered that objects submerged in water 'lose' weight". Strictly speaking this is not true, as we well know. Yet we repeat it constantly. No harm done. When I castigate QTM all I am saying is that such popularization must not be elevated to the level of scientific discourse. Mises said that his 1912 book on money and credit updated the vulgar form of QTM that was in the vogue before. He was a pioneer in taking it into account that an increase in the supply of money does not *immediately* raise prices, nor does it increase them in the same measure across the board. But this is only one of the shortcomings of QTM. Mises fails to mention that it could happen that *no* commodity price-increases take place at all in the wake of an increase of the money supply. Speculators grab the new money that has been created and run with it to the real estate market or to the money market. I can no longer say "no harm done". Very serious harm is being done if we ignore speculation with regard to QTM, for example, in appraising "open market operations" of centreal banks, or Keynes' concept of the "euthanasia of the rentier" through government-suppression of the rate of interest.

Daily Bell: You write that Ebeling's choice of a 100 percent gold standard is a major departure from Adam Smith's Gold Bills Doctrine, and from Menger's position as well. Can you explain?

Antal Fekete: I think that it is obvious that Ebeling dismisses Adam Smith's Gold Bills Doctrine, although he does not say this explicitly. As concerns Menger's position, he in his encyclopedic entry *Geld* dated 1909 explicitly states that the major part of the assets of a commercial bank, as well as that of the central bank, consists of gold bills maturing daily, and only a minor part consists of gold coins. This he considers not only an acceptable practice but, following Adam Smith, also inevitable as the volume of goods moving to the ultimate consumer financed by gold bills and commercial bank credit based on such gold bills is far from being constant. It shows seasonal variations as well as changes in what we may call, borrowing Keynes' felicitous phrase, the "propensity to consume". You cannot reconcile the variable demand for commercial credit with the idea of "100 percent gold standard".

Daily Bell: Explain the nature of the market for gold bills and also Real Bills.

Antal Fekete: I have recently made the innovation of dropping "real bill" in favor of "gold bill" at the suggestion of my student Paul Bouvet. For one thing, the term "gold bill" makes it clear that the bill must mature into gold coins. For another, the term real bill was introduced by detractors of Adam Smith, in particular, Lloyd Mints of the University of Chicago, the mentor of Milton Friedman. The adjective "real" is used by them pejoratively. Monetarists and other devotees of QTM do not believe that money has quality (whether real or not so real). They believe that the only attribute money can have is quantity. True followers of Menger know that various currencies also have marketability and can be ranked accordingly. Top marketability belongs to the standard gold coin. Second to it is the gold bill that circulates spontaneously through endorsing subject to discount. That makes it an earning asset (which the gold coin, in and of itself, is not). Moreover, the gold bill is the best earning asset a commercial bank can have.

Daily Bell: Why is there a prejudice among Misesians against Real Bills?

Antal Fekete: That is a mystery. One reason may be their iconoclastic reverence of Mises who dismissed real bills, although he acknowledged that they circulated in Lancashire among traders of wool products of higher degree (such as spinners, weavers, cloth merchants) in payment for semi-finished goods before the Bank of England opened its branch office in Manchester. Another reason may be the observation of Mises that the revenues of a commercial bank ought to be derived entirely from fees for services. In his view gold bills had no place in the portfolio of a commercial bank as backing for credit outstanding. This, in spite of Smith and Menger saying, approvingly, that commercial banking should be based on discounting real bills (and central banking on re-discounting them).

Daily Bell: You are partial, it seems, to the old gold standard that existed before World War I, even though Dr. Ebeling points out that it was just a "government-managed monetary system through a series of national central banks." Most anarcho-capitalists would agree with his assessment, not yours. You are more favorable to this sort of standard. Why?

Antal Fekete: I am not partial to the gold standard as it was practiced before 1914. I have criticized it severely; in particular I criticized the 1909 decision, first by France quickly followed by Germany, to make the note issue of their central banks legal tender. This seemingly invalidated the Gold Bills Doctrine as it pretended that gold bills could mature into paper. But it is preposterous to suggest that one kind of paper could "mature" into another kind of paper of *lesser* marketability. I am also very critical of the policy, observable long before 1909 already, to wean the public off gold coins in order to concentrate them in the coffers of the central bank. Not only was it the legal right of bearer to get gold coins in exchange for bank notes and bank deposits; it was also an integral part of the operation of the gold standard. The flow of gold coins back-and-forth between bank reserves and the general public was the means whereby the latter could assert its prerogative of regulating credit. In my book "gold standard" means, among others, that outstanding credit (as well as the rate of interest) is determined by the general public and not by the banks, or the central bank; not even by a well-meaning government. I maintain my position that before 1909 in the major trading counties the government was *not* "managing the monetary system". To insist that it *was* is a gross distortion of historical facts.

Daily Bell: You believe that Dr. Ebeling wishes to ban gold bills. Does he really suggest this – and if so, why?

Antal Fekete: To my knowledge Dr. Ebeling has never acknowledged the historical fact that gold bills came into existence spontaneously and were capable of monetary circulation without government interference. Please correct me if I am wrong. On the other hand, Dr. Ebeling obviously thinks that gold bills are inflationary and therefore detrimental to the public interest. I am just drawing the logical conclusion that he would ban them if he had the power to do so. My apologies if I read Dr. Ebeling's mind incorrectly. Please ask him why he thinks he knows better than the producers of goods of higher order did who accepted payment in gold bills and did not insist on getting paid in gold coins.

Daily Bell: You have kind words for "central banks in 1914," writing that they were "not the malevolent Moloch with unlimited power they are today." Here's more: "Most of them were operated as regular profit-making business without special privileges. They did not take the initiative to create credit in feeding the money market with arbitrary bond-purchases and they did not foist their credit upon society as they do today. According to the mandate laid down in their charter they were supposed to state the terms on which they were willing to do business (read: they posted their discount rate) and stood back, letting the commercial banks do the rest." The question that arises is whether a "charter" is not a kind of government force. If one is forced to use central banks, isn't this antithetical to the voluntary participation in the economy as suggested by Adam Smith's invisible hand?

Antal Fekete: A charter may or may not represent force by the government. Trading partners in the world before 1914 who drew and accepted gold bills on London in financing world trade were not using the services of the Bank of England. They were avoiding it. If commercial banks subsequently rediscounted these gold bills at the Bank of England, it was their choice, not the result of coercion.

Daily Bell: You believe that central bank problems arose after World War I. Can you elaborate?

Antal Fekete: As I already pointed out, central bank problems arose even before World War I, for example in 1909 when the notes of the Bank of France and the German Reichsbank were made legal tender in those countries for all debts, private and public.

Further very serious problems with central banks arose during World War I, especially in the United States. The Federal Reserve (F.R.) banks started putting their credit at the disposal of the Entente powers to finance their purchases of war material in violation of the F.R. Act of 1913, to say nothing of violating the Neutrality Act, practically the same day as war broke out in Europe in August, 1914. When later the U.S. joined the conflict, Liberty Bonds were accepted as valid basis for F.R. credit – illegally. Gold bills subsequently were crowded out from the portfolio of the F.R. banks.

After the war was over, all semblance of legality was abandoned in the U.S. “Open market operations” were introduced in 1922. This was in clear violation of the F.R. Act of 1913 which purposely excluded government bills, notes and bonds from the list of eligible paper. To put that gross violation of the law into context I mention the fact, stonewalled by mainstream economists and historians, that there was a bubble in 1921 in the market for U.S. government paper, as a result of which the capital of a lot of banks in the U.S. was wiped out. The wool was pulled before the eyes of the public and law-enforcement officials. The authors of the illegal policy were practicing “bailing-out”. They anticipated quantitative easing (Q.E.) that was to come in the next century.

Emboldened by the example of the U.S., central banks elsewhere started aping the policy of open market operations, for the stronger reason that gold bills were no longer available to balance the liabilities of commercial banks. Gold bills were summarily locked out of world trade by the victorious Entente powers. The blockade on Germany was lifted; the blocking of gold bills was imposed as a substitute. The idea was to control Germany's foreign trade. In doing so the Entente powers also shot themselves in the foot. They were unwittingly paving the way to the Great Depression that started a decade after signing the peace treaty. Gold bills furnished the "wage fund" before 1914 out of which producers of maturing consumer goods could be paid up to three months before these goods were ready to be sold for cash. In the absence of gold bills there was no wage fund and the workers had to be laid off in droves not only in Germany but also in the Entente countries.

Daily Bell: Comment on this point of yours: "The fly in the ointment was that the policy of open market operations made bond speculation risk-free."

Antal Fekete: This reflects on the incredible stupidity of the authors of the policy of open market operations. Policy-makers at the F.R. Board assumed that speculators were too dumb to take advantage of the unconditional offer to earn risk-free profits in the bond market. Up to that point speculators were not interested in bond trading at all because under the gold standard the variation in bond prices were not sufficiently high to justify bond trading for profit. The omission to take the effect of the illegal policy on speculation into account is just as inexcusable as the failure of economists to criticize it. Unlike speculation in agricultural goods, bond speculation is destabilizing. It triggers an avalanche of orders to buy bonds before the Fed does, as manifested by the collapsing interest-rate structure that in its turn leads to the erosion or destruction of capital.

Daily Bell: Another statement of yours: "Because of the illegal nature of open market operations a public discussion of the policy was never held, nor was an evaluation of the results ever conducted. Instead, the policy was retroactively legalized by Congress in 1935. In the meantime central banks abroad started aping the practice. Q.E. in the 21st century repeats the same orgy in the bond market on an even larger scale. Worse still, nowadays the timing and the exact size of the bond purchases is advertised far and wide in advance that makes it even easier for bond speculators to outbid one another. It can be confidently predicted that in due course Q.E. will lead to an even more devastating deflation and depression than the bond-purchasing policy of the Fed did in the 1930's." What will the nature of the deflation be – a collapse of the monetary system?

Antal Fekete: Much more than that. It will be a repetition of the deflation and depression of the 1930's, but on a much larger scale. Falling-domino-style bankruptcy of firms, devastating waves of unemployment, falling prices induced by falling interest rates are just some of the consequences.

Daily Bell: You have some comments about the "theory of interest" as well, as related by Dr. Ebeling. You write that the time preference theory of interest fails to reveal the nexus between gold and interest. Can you explain?

Antal Fekete: I maintain that one of the reasons that a sound theory of interest is still not available and remains the major unsolved problem of economics is that theorists – including time-preference theorists − have failed to take the nexus between gold and interest into account.

Daily Bell: You are partial to the productivity theory of interest, according to which the cause of interest is to be found in the productivity of capital. How have you resolved the conflict?

Antal Fekete: I am partial neither to the productivity theory of interest, not to the time preference theory of interest. On the contrary, I am advocating a *synthesis* between the two. I am merely pointing out that it is absurd to suggest, as Mises does, that rising interest rates do not increase the marginal productivity of capital, read: render a large amount of existing capital submarginal. In other words, rising interest rates put a lot of producers out of business indiscriminately.

The synthesis of the two competing interest theories starts from Menger's observation that there is no such thing as a monolithic price. Every price splits into a higher asked price and a lower bid price. Transactions take place anywhere in between these extremes. The right question to ask is not what the equilibrium price is. Rather, it is: what determines the asked price and what determines the bid price.

Similarly, there is no such thing as a monolithic rate of interest. The rate of interest splits into two: a ceiling and a floor. Lending and borrowing take place between these two extremes. The right question to ask is not what the equilibrium interest rate is. Rather, it is: what determines the ceiling and the floor of the range to which the rate of interest is constrained. It so happens that the former is determined the rate of marginal productivity of capital, and the latter is determined by the rate of marginal time preference. Let me suggest it to you that this recognition is a major breakthrough. It removes the stumbling block that hampered progress for centuries in solving the millennia-old problem of interest. And the credit for the breakthrough goes to Carl Menger who had the insight to challenge the prevailing orthodoxy about the supply/demand equilibrium theory of price.

Daily Bell: You write that interest is better understood if we look at the exchange of wealth and income instead of the exchange of present and future goods. What do you mean by this?

Antal Fekete: The conventional time preference theory of interest is built around the question how to exchange a good available immediately for an identical good available in the future. Such exchanges are mostly imaginary. No one has ever exchanged one apple available today for three quarters of one apple available a year from now.

A more relevant problem is the exchange of wealth for income and income for wealth. Every adult has faced or is facing that problem when he wants to provide for the education of his children, or for the old age of his spouse and himself. The prototype of instruments making such exchanges possible is the gold bond. The seller of a bond is exchanging income for wealth; the buyer is exchanging wealth for income.

In jurisprudence such exchanges were considered unjust because he who surrendered income had to surrender more weight of gold than he who surrendered wealth, the difference being interest. Accordingly, such exchanges were banned by canon and civil law. However, the fact remains that the party surrendering wealth could achieve his goal without the mechanism of exchange, by dishoarding gold. The other party could only achieve his goal after a prolonged waiting period if he decided to hoard gold. In other words, the exchange of income for wealth and wealth for income is inherently asymmetric. The bargaining powers of the parties to the exchange are unequal. If this is unjust, then nature should be blamed, not usury. After the case for freeing the exchange from prohibition was championed by the scholastic fathers and, later, by Protestantism, the usury laws were abrogated. Interest taking and paying were absolved. Thereafter the rate of interest (having lost its risk-premium) showed a great decline. This was an extraordinarily important development. The rate of interest could be admitted and freely quoted. The trading of gold bonds became legal. Capital accumulation was encouraged and the blessings of capitalistic production were available to the widest segments of population. There can be no doubt that the correct way of formulating the problem of interest is in terms of exchanging wealth and income.

Daily Bell: You believe Dr. Ebeling has a narrow view of the gold standard. Please elaborate.

Antal Fekete: Dr. Ebeling mentions just one aspect of the gold standard in its favor: that of a constraint on governments to indulge in their inflationary proclivities. But as I mentioned already, although important, this is only an infinitesimally small part of the importance of the gold standard in human welfare. It says nothing about the part gold is playing in the formation of the rate of interest, the discount rate, in capital accumulation, in the problem of supplying the consumer with goods in urgent demand most efficiently, etc. The case for the gold standard ought to be presented in its widest scope.

Daily Bell: You write that post-Mises Austrian economists erred because they deviated from Menger. Please explain.

Antal Fekete: I have already mentioned several examples. Post-Mises Austrian economists have deviated from Menger in dismissing the Gold Bills Doctrine. I may add that their peculiar aversion to what they call "fractional reserve banking" is another example of deviation that follows from the first. Menger would never use such a derogatory term. Gold bills in his view were fully justified as reserves against the note and deposit liabilities of commercial banks. I have also mentioned that Menger would object to the slavish adherence of post-Mises Austrians to QTM which has caused endless mischief in monetary science. This is especially true in view of the fact that the Fed's Q.E. is counterproductive. The Fed is trying to trigger inflation on the theoretical basis of QTM, only to inflict deadly deflation to the world economy. Post-Mises Austrians almost unanimously predict that Q.E. will land the world in a hyperinflationary hell. A more careful analysis taking Menger's objections against QTM into account would show that Q.E. is leading to capital destruction, deflation and depression.

Daily Bell: Please elaborate on the confusion of lending versus clearing.

Antal Fekete: This refers to the post-Mises Austrians' dismissal of Adam Smith's Gold Bills Doctrine. They maintain that a producers of n-th order goods is making a loan to the producer of $(n - 1)$-st order goods when he delivers semi-finished products against payment with bills. This is a major misconception confusing lending and clearing that also comes from their deviation from Menger and his concept of marketability. No lending and borrowing is involved in extending commercial credit to the producer of lower-order goods. The goods handled by him are more marketable: he is closer to the gold coin disbursed by the ultimate consumer. Gold bills are not evidence of lending and indebtedness. They are evidence of clearing and cooperation.

Daily Bell: You also have a criticism of the Misesian business cycle. You write, "post-Mises Austrian economists make a mistake in ignoring the distinction between interest and discount in business cycle theory." What do you mean by this?

Antal Fekete: We have mentioned that post-Mises Austrian economists dismiss the distinction between the rate of interest and the discount rate as spurious. As a consequence they have missed the chance to come up with a more realistic version of the theory of business cycles.

Daily Bell: Please try to fully summarize your problem with the business cycle explanation of Mises and Hayek. Why don't you believe it is accurate?

Antal Fekete: The business cycle theory of Mises and Hayek has been taken over by the post-Mises Austrian school without any change. I have criticized this theory as it assigns a rather low I.Q. to businessmen who allegedly fall victim again and again to the teaser interest rates made available to them by the government and banking system. Misled by false signals they make unsound investments which, in due course, come unstuck. Recovery takes a rather long time.

I am offering an improved version of the business cycle theory that makes no such assumption about the intellectual capacity of businessmen. According to it there is an interplay between the rate of interest rate and the discount rate. Less scrupulous and profit-hungry people borrow short in the bill market and lend long in the bond market. They think they can get away with this scheme called illicit interest arbitrage and pocket the difference between the higher rate of interest and the lower discount rate with impunity.

But illicit interest arbitrage causes the spread between the two rates to narrow. In particular, the discount rate rises and the interest rate falls. When the critical point is reached, there is panic in the money market. People who have set up straddles with short leg in the bill market and long leg in the bond market get squeezed. They find that they can’t move their short leg forward without a loss. The ripple-effect makes poorly financed firms to go bankrupt. Boom is followed by bust. The damage is done. Recovery consists in restoring the safe spread between the rate of interest and the discount rate.

Daily Bell: You believe a so-called 100 percent gold standard is a non-starter. Why?

Antal Fekete: As I suggested a moment ago, such a monetary system would be too rigid. The demand for circulating media varies with the seasons. It culminates when the crop is moved to storage. At that time a squeeze develops that may make the system collapse. Gold coins must be supplemented with gold bills maturing in 91 days to avoid it.

Daily Bell: Let's turn to bonds. You believe a main tenet of Keynesianism is that the "government has the power to manipulate interest rates as it pleases, in order to keep unemployment in check." But this ignores "the constraints of finance, including the elementary fact that *ex nihilo nihil fit* (nothing comes from nothing).” Can you explain, please?

Antal Fekete: Marketable gold bonds are relatively new in the economy. They go back to the lifting of prohibition on interest in the 19th century. Keynes believed that manipulating interest rates is costless. By now we know he was wrong. The destabilization of interest rates is a great destructive force in the economy. Interest rates can move up or they can move down. Either way, it causes capital destruction.

Daily Bell: You also write, "The great quandary in the history of science is how one charlatan could mesmerize an entire profession with his quackery into somnambulance." Please elaborate.

Antal Fekete: Keynes was a charlatan. A charming one according to Hayek, to be sure. That may be so. Indeed, he charmed the entire profession of economists like the Pied Piper of Hameln charmed the children of the village with his music, leading them to their destruction. Keynes' original idea of the "euthanasia of the rentier class" is a great error, showing that he did not know what he was talking about. With his left hand he would punish the parasitic coupon-clipping class by reducing its interest income to zero. But he was completely oblivious to the fact that at the same time with his right hand he would endow them with capital gains galore. The market price of their bonds would increase *pari passu* with the decline in interest rates.

Daily Bell: Keynes's fundamental contradiction is that "you cannot suppress interest rates and bond prices at the same time!" This strikes us as an important point. Please elaborate.

Antal Fekete: The idea that you can create something out of nothing is highly contagious. That's the secret of Keynes success. But as we know there is a cost to everything in this earthly life. Even a free lunch has its cost. If you want to benefit mankind with a zero interest-rate structure, you wipe out its capital which is putatively invested in bonds on the liability side of the balance sheet. And if you want to benefit mankind by endowing infinite capital gains on its bond holdings, then willy-nilly you reduce the interest-rate structure to zero, thereby destroying their capacity to earn an income in the future. There is no way to reduce bond prices and the rate of interest to zero simultaneously!

Daily Bell: You write: "Open market operations were introduced illegally by the Fed in 1922, the year after the bubble in the market for U.S. Treasury paper burst, pricked by spiking interest rates in the wake of the inflationary binge, aided and abetted by the post World War I Fed. A carbon-copy of that scenario is being played out before our very eyes." How so?

Antal Fekete: Policy-makers of the 1922 Fed were laboring under the same delusion as Keynes. They thought they could create money out of the thin air and use it to purchase bonds, driving interest rates down in the process in order to restore the impaired capital of the banking system. The cost: the collapse of the world economy less than a decade later. History repeats itself because, as Benjamin Franklin pointed out, experience runs an expensive school but fools will learn in no other. Policy-makers at the Fed in the twenty-first century have given a new name to the policy of open market operations calling it "quantitative easing". But it is just the same old idea of monetizing government bonds.

They thought that with "capital gains" so created they could replenish the impaired capital of the banking system. The cost will be the same when the bill is presented in due course: the collapse of the world economy.

Daily Bell: You write: "The sweetheart-deal between the Treasury and the Fed conferred mutual benefits upon the conspirators. The Federal Reserve banks got theirs in the form of legalized check-kiting at the expense of the public." Please elaborate.

Antal Fekete: The illegal open market operation of the Federal Reserve is a check-kiting scheme, pure and simple. It is based on the conspiracy of the Fed and the Treasury. The Fed issues checks without backing (namely the F.R. notes) which the Treasury accepts in payment for its bonds. Then it is the turn of the Treasury to issues checks without backing (namely bonds) which the Fed uses as collateral to create more F.R. notes. Of course, this is a scheme to create something out of nothing is at the expense of the general public. The conspirators create hundreds of billions, but it is not out of nothing. They tap into the bank account of *every* depositor of *every* bank in the world and pilfer a small amount hoping that the depositors won't notice.

Daily Bell: You believe that the policy of open market operations of the Fed causes deflation rather than inflation as intended. How is this possible?

Antal Fekete: The Fed is unmindful of the fact that they cannot suppress the rate of interest and the price of bonds at the same time. Reduction in the rate of interest causes bond prices to rise that shows up as erosion (ultimately destruction) of capital across the board. The capital of every firm is putatively carried in the form of a bond listed in the liability column of the balance sheet. As the interest rate falls, the deficit in capital account grows. This is capital erosion. It is a form of deflation. If the deficit is ignored, that is, if new capital is not injected as it should without delay then, sooner or later, the critical point will be reached. Most firms could no longer stay afloat. They sink. This is called the "sudden death syndrome". Since this is happening simultaneously across the board, the economy plunges into depression.

Daily Bell: You believe there is a causal relationship between a falling interest rate structure and the erosion (destruction) of capital. What would that be?

Antal Fekete: In answering the previous question I detailed the process of capital erosion as the cost of monetizing government debt. Symptoms of deflation appear. The Fed wants to combat deflation. To that end it fosters inflation. But in effect it fosters more deflation, again disguised as capital erosion. The vicious circle is on. The Fed acts contrary to purpose.

Daily Bell: Elaborate on this statement of yours, if you will: "Keynes charged that businessmen behave irrationally and can go overboard in their pessimistic appraisal of business prospects. He insisted that the cure is serial cutting of the rate of interest by the central bank." You don't believe this is accurate. Why?

Antal Fekete: Businessmen are not stupid. They know their trade. When they are uniformly pessimistic, their pessimism is usually well-grounded. They know on which side their bread is buttered. They resist the temptation to chase illusory profits. Serial cutting of interest rates will not spur their urge to invest. On the contrary, it will only make them even more pessimistic. They will not make new investments as long as the prospect is for ever lower interest rates. If the serial cutting of interest rates lasts forever, then they will *never* invest again. It is as simple as that.

Daily Bell: You write: "America is putting the world at great risk. Gold is going into hiding fast. When the dollar will reach the point that it cannot fetch gold any more, the game of musical chairs is up. World trade breaks down. Barter is the order of the day. But our complex economy cannot survive on barter. It takes multilateral trade, not barter, to build computers and jetliners." Please explain this statement further. What can be done to stop this process?

Antal Fekete: It is not widely recognized but should be that the flight of gold into hiding will deprive the world of multilateral trade; it will result in bilateral trade which is essentially barter. Why? Because other highly marketable goods will imitate gold and will also take fight. But a complex economy such as ours is bound to break down if it is reduced to barter. This is what happened when gold went into hiding before 476 A.D. that was followed by the collapse of the Western Roman Empire.

America made a stupid blunder in letting China take the monetary leadership concerning gold. In order to avoid the fate of the Western Roman Empire the first thing America should do is to make a clean breast of it. Admit that exiling gold from the international monetary system was a mistake and it was wrong to confiscate the gold of Americans in 1933, and of non-Americans in 1971. Promise to restore the monetary clauses of the Constitution. Only then can America try to reverse the flight of gold from West to East.

Daily Bell: You write: "America should provide monetary leadership to the world. It should open the U.S. Mint to the free and unlimited coinage of gold and silver. Incidentally, this would make money conform to the Constitution once more. This would call monetary gold and silver out of hiding and coax gold back from East to West. It would put an end to the growth of the Debt Tower. It would eliminate so much waste and inefficiency from the system. It would end youth unemployment, arguably the greatest blight caused by the regime of irredeemable currency. There was no youth unemployment under the gold standard, was there? It would open up a new Golden Age of peace and prosperity." How can this be accomplished realistically? What would need to happen in terms of the political process?

Antal Fekete: The doctrinaire policy-makers in America are unlikely to do what must be done. But any jurisdiction (say Switzerland, Germany, Austria, the United Kingdom, France, or China) may open its Mint to the free and unlimited coinage of gold (and silver). We must understand that the gold and silver coins currently minted are merely souvenir coins produced for profit. They don't count. They are conversation pieces on the march to the cookie-jar. They are marching into hoards in a world which has destabilized values, which has forcibly destroyed the currency as a means of savings, of preserving value and of accumulating capital.

But if there was a Mint somewhere out there, open to gold, then the problem would be largely solved. The gold mines would flock to the Mint bringing unrefined gold for coining. The Mint would issue gold bills against metal received payable in 91 days in standard gold coins. The gold mines would auction off their gold bills to the highest bidder, that is, to the party willing to discount the face value of the bill by the least amount. The spontaneous circulation of gold bills would be rebooted. Multilateral trade would flourish once again.

All this can be done without raising taxes. The cost of minting standard gold coins would be absorbed by the cost of refining. The gold outflow would stop at once. There would be a gold inflow, bringing prosperity with it. Unemployment would be a thing of the past. The more gold, the lower would be the discount rate. Unlike the fall of the rate of interest, the fall of the discount rate would be most beneficial. It would eliminate unemployment, for example. The unemployed would turn into entrepreneurs selling consumer goods to those working for wages and salaries. Practically they need zero capital if the discount rate is sufficiently low. They could sell merchandise by the curbside. The world would make a clean start with gold bill financing of trade. The future would be bright and businessmen would be most optimistic about it, with good reason.

Daily Bell: Professor Fekete, thanks for sharing your most recent papers with us. We have enjoyed this interview with you and hope our readers find it beneficial.

Antal Fekete: Thank you for the opportunity to explain my view to the readers of Daily Bell. And thank you for posting my paper "Why Gold Standard?" along with the interview.

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