THE ANTI-GOLD GOSPEL ACCORDING TO FRIEDEN

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Jeff Frieden is professor at Harvard focusing his research on the politics of international monetary and financial relations. He has been quoted as saying that, if once more on a gold standard,

> the United States would be unable to respond quickly and effectively to sudden economic shocks. Recessions would be deeper and longer, and the economy would be biased towards deflationary spirals. Witness the fact that the United States, which remained on the gold standard till 1933, had a much longer and deeper recession than Britain which had gone off gold in 1931.

If the above quotation by Barron Young Smith (see appendix to my previous paper) is accurate, then the Harvard professor writes his monetary economics while standing on his head. He is ascribing a bad condition to a hypothetical gold standard, but the same condition presently obtains in an undiluted form as a direct consequence of the regime of the irredeemable dollar. The U.S. economy is presently biased towards a huge deflationary spiral in consequence of a long cycle of falling interest rates that started from the level of over twenty percent per annum in the early 1980's, and still has not run its course. As is well-known, falling interest rates must ultimately culminate in falling prices. If we haven't seen much evidence of actually falling prices yet, it is because policymakers have made the unforgivable mistake of using the irredeemable dollar as a tool to dismantle America's industrial fortress. In other words, falling prices are present in disguise through the proxy of the wholesale shutdown of production and the elimination of entire industries. We already have the ultimate effects of a deflationary spiral, usually transmitted through falling prices, but in this instance brought about directly through falling interest rates.

Other proxies of a falling price level are also present. Most important is the loss of pricing power. Some firms have so far survived the hecatomb inflicted upon American industry by policymakers, for example, in the auto industry. But auto-makers have definitely lost pricing power. It is possible that, lately, they have been selling cars at a loss. This loss has been made up by the lucrative business of car-financing, at least prior to the subprime crisis. It is highly unlikely that auto-makers can long continue their subprime car financing business. Not at zero percent interest.

In the meantime American exports fall, in spite of the ongoing debasement of the dollar, with the exception of exporting highly-paid industrial jobs to low-wage countries. But much worse is to come. The real scourge on the economy of the falling interest rate structure has not yet shown up: wholesale bankruptcies of midsize businesses in the United States. I have been writing on this subject for some eight years, but failed to alarm public opinion.

Declining interest rates bestow huge unearned profits upon bond speculators. These profits do not come out of nowhere. They are being siphoned off from the capital accounts of the producers. We are looking at vampirism by the financial sector sucking the blood of the producing sector. It has been made possible by the regime of the irredeemable dollar as it destabilized interest rates. Under the gold standard with stable interest rates there is neither bond speculation nor vampirism. Under the gold standard the producing sector is the dog and the financial sector is the tail. The regime of the irredeemable dollar has turned things upside down: now the financial sector is the dog and the producing sector is the tail which, moreover, is in danger of being cut off altogether. The most appalling part of this vampirism is that producers are not aware that they are being victimized. Their capital is siphoned off stealthily and unobtrusively. Producing firms are paying out phantom profits to shareholders, further weakening their capital.

To understand this process fully we must make an excursion into accounting. Persistently falling interest rates decimate capital values as the present value of debt keeps increasing. The resulting capital loss should be recorded in the balance sheet and made up in the form of charges against future earnings. But nobody does it, as everybody prefers to listen to the sweet siren song: *"falling interest rates are good for you!"* In fact, the Fed's policy of serial interest rate cuts is an insane policy cutting the ground under the producers further and providing a tailwind to bond speculation. It confuses a *low* interest rate structure with a *falling* one. While the former is beneficial to business, the latter is lethal as it is the root cause of depressions. Professor Frieden's blaming the gold standard as being deflationary is entirely misplaced.

Open market operations of the Fed — introduced as an illegal practice* in the 20's and legalized retroactively in the 30's — is thoroughly destructive as it makes bond speculation risk-free. Bond speculators stalk and forestall the Fed as it is making its regular trips to the bond market to purchase its quota of bonds. The Fed is helpless: it must purchase the bonds in order to increase the money supply. This illegal regime of risk-free profits to bond speculators was scandalously cheered on by mainstream economist, who declared that "taxation for revenues is now obsolete". From now on, they rejoiced, taxation can be used to manipulate the taxpayers and the economy.

Professor Frieden's suggestion that Britain escaped two years of recession in 1931 because it went off gold that much earlier is not valid. In Britain there was no confiscation of gold in 1931. (That particular leaf from the book of the U.S. was borrowed by the British later.) One consequence of the confiscation of gold in 1933 was the falling interest-rate structure, the root cause of the Great Depression. In the eyes of the most conservative investors gold was the only competition for bonds. As this competition was forcibly removed, demand for bonds increased. This made bond prices rise and interest rates fall. Without gold confiscation interest rates would not have kept falling in the 1930's and the Great Depression would have been avoided. Deflation in the U.S. was self-inflicted through the instrument of the gold ban.

> The gold standard, if introduced, would increase government regulation of the economy. With no Fed, inexpert Congress will bear the onus of alleviating economic suffering. With deeper, longer recessions, Congressmen will inevitably succumb to pressure for more spending and regulation of the economy — as they did during the Great Depression.

If the above quotation by Barron Young Smith is accurate, then Professor Frieden is putting on a poorly fitting garb and mask as a defender of the free market. But his hidden agenda cannot be masked: he wants to preempt at all costs a free and uninhibited discussion of the proposition to abolish the Fed. If he succeeds, a great opportunity will have been lost. The Fed has become conceited and obtuse. Its open market operations are kept above criticism by both the Keynesians and Friedmanites. Yet open market operations are not only deflationary but counter-productive as well. The new money pumped into the economy to prevent prices from falling flows to the bond market and makes interest rates fall. Prices fall as a consequence, contrary to purpose.

> The gold standard, if introduced, would increase our reliance on foreign credit and ship yet more jobs overseas. Ron Paul says "our economy and our very independence as a nation is increasingly in the hands of foreign governments such as that of China and Saudi Arabia." But adopting the gold standard would actually exacerbate the problem, not alleviate it.

Assuming that this quotation is accurate, Professor Frieden is guilty of scarce-mongering. Our reliance on foreign credit cannot be further increased as this source of credit is more than exhausted, courtesy of the irredeemable dollar and its "spend now, pay later" ethos. It was the regime of the irredeemable dollar has landed the U.S. economy in a corner where the very independence of the nation is increasingly in the hands of foreign governments. It would have never happened under the gold standard. The only escape route from the corner is through the gold standard, provided the U.S. opens the Mint to gold and silver *before* the Chinese and the Russians open theirs.

Shipping jobs overseas is not a characteristic of the gold standard. It is a characteristic of the regime of irredeemable currency as it destroys capital so that industry can no longer compete with foreign labor. The lion's share the outstanding marketable debt of the U.S. government is now in the hands of foreign governments such as that of China and Japan, mentioning but the two greatest concentrations. Such a development could have never taken place under the gold standard, and no self-respecting government should have ever allowed this to happen.

> Insofar as it helps anybody, the gold standard would favor Wall Street bankers over entrepreneurs, businesses, and workers. Ron Paul likes to rail against Wall Street complaining that our money is being "inflated at the behest of big government and big banks" who "cause your income and savings to lose their value".

If this quotation is accurate, then Professor Frieden betrays his fundamental ignorance about the nature of the gold standard which is the most even-handed monetary system that has ever existed, making all playing fields level. Under the gold standard people are the boss and the banks are the servant. The latter can be disciplined by the former withdrawing bank reserves in the form of gold. People have lost this power when the gold standard was forcibly overthrown by the government, which was also irritated by the control over the public purse that people could exercise through gold withdrawals. Under the regime of the irredeemable dollar the banks are the boss and they plunge people into debt-servitude. Control over the public purse by the people has also been removed, giving rise to endless budget deficits.

It is preposterous to suggest that the gold standard would favor bankers over entrepreneurs, businesses, and wage earners. If it ever looked that way in the past, it was because of a double standard in contract law, and not because of the gold standard *per se*. The banks were granted immunity from forcible liquidation in case they failed to perform on their contracts. The government declared a bank holiday if a number of banks became insolvent and could not pay gold on their sight liabilities. To add insult to injury, the defaulting banks' paper was promoted to the status of legal tender in place of gold. So much for the perverse incentive system favoring banks bent on credit expansion. While the banks enjoyed immunity, the force of contract law was always applied in full force against other entrepreneurs, businesses, and wage earners, and home-makers.

I would welcome an open discussion on the merits of the gold standard and on the proposal that the Fed should be abolished. I sincerely hope that Professor Frieden will take up my challenge and, during this election year when both the efficacy of the gold standard and the Fed's incompetence were made an elections issue, will give me the pleasure of participating in a continued debate.

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* The Federal Reserve Act of 1913 did not authorize it. It did not list government bonds, notes and bills among the eligible papers that could be held against the note and deposit liabilities of the Federal Reserve banks. In fact, the Fed was subjected to a stiff and progressive penalty tax to the extent its liabilities could be balanced only by counting its portfolio of government paper. If the U.S. Treasury has "forgotten" to collect the penalty tax, well, that's just what Treasury Secretaries would do when T-bonds do not find ready buyers in the open market.

References

A.E. Fekete, The Anti-Gold Gospel According to Kaletsky, www.professorfekete.com

A.E. Fekete, The Anti-Gold Gospel According to Smith, Appendix: What Would Happen If We Adopted the Gold Standard? by Barron Young Smith, www.professorfekete.com

A.E. Fekete, Fiat Currency, the Destroyer of Capital, www.professorfekete.com

GOLD STANDARD UNIVERSITY LIVE

Session Three has just concluded in Dallas, Texas. The subject of the 13-lecture course was *Adam Smith's Real Bills Doctrine and Its Relevance Today.* (Monetary Economics 102). The titles of the follow-up conferences were: 1. *The Economics of Gold Mining* and 2. *Gold Profits in Troubled Times: Putting the Basis to Good Use.* Course material will soon be available in print and in DVD format to all interested parties.

Session Four is planned to take place in Szombathely, Hungary (at the Martineum Academy where the first two sessions were held). The subject of the 13-lecture course is *The Bond Market and the Market Process Determining the Rate of Interest* (Monetary Economics 201). Tentative date: June 27-30. For more information please contact GSUL@t-online.hu . Further announcements will be made at the website www.professorfekete.com .