THE GOLDBUG, VARIATIONS III

The Dismal Monetary Science

by Antal E. Fekete,
Professor, Memorial University of Newfoundland

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Recitativo

Why not assure monetary virtue by trusting, not in the monetary wisdom of men, but in an objective standard? Why not emulate our great grandfathers and tie our currency to gold?

Very few economists think this would be a good idea.

Rondo

So few economists indeed, that it is a statistical oddity. It is all the more curious given the miserable record of the fiat dollar for the past 35 years while it has been trying to make do without a link to gold. What makes the loser the winner, and the winner the loser? My explanation is that the economists have been bribed. The bribe money can actually be tracked as the record is in the public domain. Please bear with me as it takes some time to relate this incredible story.

The Federal Reserve (FR) banks pay dividends at 6 percent per annum of subscribed capital to shareholders, the member banks. The Federal Reserve Act bars them to pay dividends at a higher rate, regardless how profitable the FR banks may be. And as you may have guessed, they are fabulously profitable. So what happens to the undivided surplus? The answer is this: *the Federal Reserve banks remit most of the undivided surplus to the U.S. Treasury under false pretenses.* In the income statement the remittance is called "franchise tax on the Federal Reserve notes outstanding". Now every federal tax must be authorized by legislation duly passed by the Congress and signed into law by the President. I urge you to ask your favorite professor of the dismal monetary science to identify the Act, and provide the date of its passing, which authorizes the franchise tax. But be prepared for a long wait while the professor is doing the search, because such an Act does not exist, has never been proposed or enacted. Incredible, isn't it?

You are a taxpayer. Would you pay a tax that has never been authorized by law, but someone at the IRS invented a catchy name and started collecting it? No, you wouldn't. You would fight the phantom tax in the courts, if need be, all the way to the Supreme Court. Now there are twelve FR banks in the United States. Every one of them has a legal department, well-staffed with well-paid legal counsels. Do you think that one of the twelve might have challenged the unauthorized tax and withheld payment to test the legality of its collection? Surprise, surprise. Not one of them ever has. Moreover, not one shareholder, not one member bank, has spoken out against the arrangement of paying an illegal tax. Why?

The professors of the dismal monetary science are at a loss to give you the answer. But I will. In the check-kiting scheme of the U.S. Treasury and the FR banks the latter are the junior partners.

The allocation of the loot is not on a 50-50 basis. The lion's share goes to the senior partner. The junior partners must be satisfied with the crumbs. But crumbs are plentiful to throw a jolly good party still. Why complain when the FR banks themselves can set the rate at which the 'tax' is assessed? They are free to subtract any and all expenditures on frills before they come to the bottom line, undivided surplus.

And spend on frills they do. One item listed as legitimate expenditure is money subsidizing economic research. It is a big item, covering not only in-house research, but also research grants paid to outsiders on contract at various universities and think-tanks. Now please estimate if you will the percentage of research funds that goes to economists analyzing the failure of the fiat dollar and studying the possibility of return to the gold standard as a remedy. You've got it: exactly zero percent.

From the point of view of the FR banks the more money they spend on subsidizing economic research the less tax they pay. So funds are gushing forth abundantly, and are granted generously to subsidize research in dismal monetary science, taking good care to shut out any dissonant noise about the gold standard.

Interlude

Lest my detractors charge that I have "the sour grapes complex" I mention an episode from my active days. In 1975 I spent a Sabbatical year as Visiting Fellow at Princeton University. By a strange quirk of fate Paul A. Volcker was also at Princeton University at the same time as Senior Fellow. Paul was cooling his heels between two jobs. After having served as Under-Secretary of the Treasury for Monetary Affairs, overseeing the devaluation of the dollar, he was awaiting a new assignment at the Fed. We didn't know it at the time, but soon it turned out to be his appointment as President of the Federal Reserve Bank of New York, the most lucrative job in the entire establishment, certainly more lucrative, if less prestigious, than that of the Chairman of the Federal Reserve Board, which was to be Volcker's next assignment a few years later. Paul ran a seminar for postgraduate students "on international monetary stuff" as he would call it. I was an irregular, occasionally dropping in to listen to Paul's lectures and the presentation of papers by students. I even contributed a paper myself, as I recall, on gold in the international monetary system. Paul and I also met outside of the classroom. Once he invited me to dinner at the Faculty Club of which he was a member.

Concerning gold, Paul didn't beat around the bush. He said that there was no objection against gold being the constitutional monarch. But gold must behave and abide by the decisions of Parliament. If gold started asserting itself, if it misbehaved, then it would be ousted and sent into exile. That's what had happened in 1971. Gold would not be tolerated as an absolute monarch.

I did not argue with Paul's anthropomorphism. I could have pointed out that it was not a question of gold being the sovereign but the people holding it, as they should according to the Constitution of the United States.

Paul never had any qualms about the loyalty of other countries following the leadership of the dollar, as vassals follow the feudal lord. Foreign central banks knew full well that their currencies are in the same boat as the dollar. If they scuttle the boat, then they all perish. It was a matter of hanging together lest they hang separately (with thanks to Benjamin Franklin for the felicitous phrase).

Paul of course knew that I was a professional mathematician. He asked me if I would be interested in setting up a differential equation to describe the relationship between the foreign exchange rate and the spread between the rates of interest prevailing in the two countries. I guess if I had said “yes”, then I could have made a career as a contributor of dismal monetary science, with a fat research grant from the FR bank of New York. But I said “no” adding that, in my opinion, there was no such a thing. Differential equations describe the relationship of causality. They are quite useless if what you want to grasp is the relationship of teleology. And the relationship between foreign exchange rates and interest-rate spreads was a problem of teleology, not one of causality. You can’t treat individuals who have free will as if they were inanimate particles in a physical experiment. That’s the trouble with macroeconomics as opposed to microeconomics. It assumes that economic aggregates have their own lives, and in their hands individuals are lifeless, inert matter that, like playdough, could be given any desired shape.

That’s how my brush with dismal monetary science ended, needless to say, to the great detriment of my remuneration. Yet I had no regrets. I had not left my native Hungary when Soviet troops overran it in 1956 because I wanted to exchange one sycophancy for another.

Rondo

It should be clear that the funds dished out by the research departments of the FR banks are bribe money subsidizing dismal monetary science exclusively, having precious little to do with the search for and dissemination of truth but designed to entrench and aggrandize incumbent power. Small wonder that so few economists dare to express views that the regime of irredeemable currency is a disaster of the first magnitude, leading to an economic catastrophe worse than that following the experiment with fiat money in France at the end of the 18th century, admirably documented by Andrew Dickson White. Very few economists would express their view in public that tying the dollar to gold is the answer.

Consider once more how profitable the check-kiting scheme between the Treasury and the FR banks is. The latter can buy off an entire profession from the crumbs and trickle-down profits, and still have money left to award to economists from other countries willing to parrot the Keynesian demand-side theory of money.

This goes to show the utter insidiousness of the regime of irredeemable currency. Not only does it allow vampirism plaguing the savers and producers of society through check-kiting while throwing the gates wide open to vote-buying by politicians, it also corrupts the mind and frustrates any impartial discussion of the underlying scientific principles. Irredeemable currency is cancer on the body economic, body politic, and body academic as well.

Recitativo

The argument against the gold standard is one of pragmatism, not one of principle. The gold standard would have all the disadvantages of any system of rigidly fixed foreign exchange rates.

Rondo

Thus according to Krugman pragmatism trumps the Constitution, which mandates a metallic monetary system. Worse still, advocates of the dismal monetary science also think that it is pragmatic not to press for a Constitutional amendment. Why take a chance? People will not notice, still less bother, if their Constitution is trampled in the mud.

The Founding Fathers did not establish a central bank for the United States. They established the U.S. Mint, and opened it to silver and gold. In doing so they elevated the principle of free coinage to the level of basic human rights. The power to create or to extinguish money was reserved for the people themselves by the Constitution. It was not delegated to the representatives of the people, nor to so-called experts hired by them. If people thought that there was too little money in circulation, or that interest rates were too high, then they could do something about it. They could take old jewelry and plate, or cause new silver and gold from the mines to flow, to the Mint to be converted into the coins of the realm. Conversely, if the people thought that there was too much money in circulation, or that interest rates were too low, then they could do something about that, too. They could melt down the coins and convert the monetary metals into jewelry and plate, or have them exported along with new gold and silver from the mines.

It is true that the international gold standard confines the foreign exchange rate between two countries adhering to it to a narrow range between the gold export and import points. This is not a drawback of the gold standard; it is one of its main excellence. It is responsible for the promotion of division of labor between countries. Each country will produce the goods and services for which it is best fitted, and import other goods and services which can be produced more efficiently abroad. The regime of floating exchange rates (that should be properly called the regime of *sinking* exchange rates) destroys international division of labor and promotes autarky.

But it destroys division of labor domestically as well. Previously the exporter could concentrate his talent and energies on production, knowing that as long as he is the best, no foreign competitor could harm his business. This is no longer true under floating. Foreign competitors could nail his business on the foreign exchanges. The central banks, as advocated by dismal monetary science, could manipulate foreign exchange rates to his detriment. It goes by the name “beggar thy neighbor”. To be successful as an exporter it is no longer sufficient to excel in production. The exporter also has to be a skillful speculator in foreign exchange. This is what has killed many a small business during the past 35 years. The principals could not cope with volatility in the foreign exchange market. Big business, on the other hand, decided that it was less risky to export jobs than goods, and this is exactly what they did. An unprecedented dismantling of production facilities on American soil was the result, because the price of the imported ingredients rose faster than export earnings, thanks to the deliberate dollar debasement.

Floating exchange rates were a giant step backwards in division of labor, discouraging talent from going into productive enterprise. Talent now goes into financial speculation, as witnessed by the snow-balling derivatives market where the commitment of speculators is estimated at more than two hundred *trillion* dollars, or more than the market capitalization of the entire globe.

One of the more imbecile ideas of dismal monetary science is that devaluation of the currency helps the country to export more and import less, thus rectifying the trade imbalance. It is absolutely amazing that economists do not find it repulsive to parrot this trash, apparently on order from the grant departments of the FR banks (in whose interest the policy of currency debasement clearly is). In 1968 the exchange rate with Japan was around 320 yens to the dollar and there was a huge trade deficit run by the U.S. To rectify it a dollar-debasement policy was put into effect promising that it would cure the deficit and turn it into a surplus. That is not what happened. In the next ten years the value of the dollar was pushed all the way down from 320 to 80, or one quarter of the initial, while the trade deficit instead of turning into a surplus ballooned tenfold. The question arises how much more beating does the dollar have to take before a dent is made in the trade deficit?

The explanation for the perverse reaction of the patient to Keynesian therapy as advocated by dismal monetary science is actually quite simple. Naturally, it was never permitted to be publicized by the award-officers at the FR banks. Currency devaluation makes your terms of trade with the rest of the world deteriorate. This means that you can import less for every dollar of export earnings as a result of devaluation.

Virtually all export items have imported ingredients, so devaluation makes them more expensive to produce, not less. While it may let you sell your existing inventory at bargain-basement prices to foreigners, this is fool's paradise. The boost in exports is strictly temporary. It is all at the expense of future production which is put in jeopardy by the higher cost of imported ingredients, as the experience of the American industry for the past 35 years has amply demonstrated.

Currency devaluation is not unlike self-mutilation. You don't cut off one of your arms while trying to compete with foreigners in the world market. Yet this is exactly what America has done to itself. The country's de-industrialization is the direct result of the deliberate debasement of the dollar for the past 35 years. Keynesian demand-side monetary theory suggests, and Krugman agrees, that devaluing the currency has a benefit to offer to the export industry. It is the benefit of the grave. Power is being turned off at factories and plants that once were busy, humming and producing, while providing well-paid industrial jobs for Americans. The once prosperous and productive industrial heartland of America has been turned into a graveyard, thanks to the floating (sinking) dollar.

The trade deficit of the United States is at an all-time high and still increasing. No economist has the courage to say it, but it is caused by the policy of deliberate dollar debasement, now in its 35th year. You have to pursue the argument of dismal monetary science *ad absurdum* to understand it. If a little bit of devaluation is supposed to be good for the country, then a big devaluation should be even better and, reducing the exchange rate to zero, Nirvana itself. Then the country could give away its goods and services to foreigners free of charge. That, finally, will really perk up exports.

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