# Destruction of Capital, Economic Resonance, Hyperdeflation

The Daily Bell is pleased to present this exclusive interview with Antal Fekete.

**Introduction:** *Professor Antal E. Fekete is an author, mathematician, monetary scientist and educator. Born in Budapest, Hungary in 1932, he graduated from the Eötvös Loránd University of Budapest in mathematics in 1955. He immigrated to Canada in 1957 and was appointed Assistant Professor at the Memorial University of Newfoundland in 1958. In 1993, after 35 years of service, he retired with the rank of Full Professor. In 1959 he was Instructor in Mathematics at Columbia University in New York. In 1963 he was Visiting Professor at Trinity College, Dublin, Ireland. In 1975 he was Fellow at Princeton University, Princeton, New Jersey. In 1983 he was resident scholar at the American Institute for Economic Research in Great Barrington, Massachusetts. While on a tour of duty in the Congressional Office of William E. Dannemeyer, Congressman from California, in Washington, D.C., professor Fekete was working on monetary and fiscal reform in the United States. The plan was taken to the Oval Office by a delegation of ten Republican Congressmen led by Mr. Dannemeyer and presented to President George Bush in October, 1989. In 1995 professor Fekete was resident fellow at the Foundation for Economic Education in Irvington-on-Hudson, New York. In 1996 he was Visiting Professor at the Francisco Marroquín University in Guatemala, teaching Austrian economics. He is the founder and Chairman of the New Austrian School of Economics in Hungary.* His website is www.professorfekete.com and www.antal.fekete.com . *Professor Fekete is a proponent of the gold standard and an outspoken critic of the monetary system based on irredeemable currency. His work falls into the school of free-market economic thought inspired by Carl Menger. He claims that his theory of interest is an extension of Menger's work, who championed the theory of direct exchange morphing into indirect exchange. In the same way Professor Fekete is championing the theory of direct conversion of income into wealth and wealth into income (read: gold hoarding and dishoarding) morphing into indirect conversion (read: selling and buying gold bonds). Professor Fekete is an advocate of Adam Smith's Real Bills Doctrine that he calls the Gold Bills Doctrine.*

*He was last interviewed on the Daily Bell on May 5, 2013.*

**Daily Bell Interview, October 27, 2013.**

**Daily Bell**: Hello again. Let's jump right in. The price of gold is still declining. Bring us up to date on the price action since we last spoke, please.

**Antal Fekete**: I take strong exception to your using the language of 'rising and falling gold price'. It puts things standing on their head. It paints a will-o'-the-wisp picture of reality. The rising of the gold price in reality is the irreversible long-term decline in the value of the dollar due to the U.S. defaulting on its gold obligation to foreign central banks and international financial institutions; the falling of the gold price in reality is a temporary strengthening of the dollar for whatever, mostly irrelevant, reasons. There is absolutely no symmetry between the two events. Moreover, this is as it ought to be, since the dollar is nothing but a dishonored promise to pay gold. When did you last see the dishonored promise of a banker permanently go to a premium? Whatever decline in the gold price you are talking about, it has not made a dent in the towering fact that the dollar has lost over 95 percent of its gold value as well as purchasing power since it was dishonored 42 years ago in 1971. The language of 'declining gold price' serves the interest of those whose hidden agenda is to blindfold the public in order to leave people in blissful ignorance about the terminal agony of the moribund dollar. It is disingenuous to suggest that the gold price is declining. A better way of expressing that fact is to say that a stay of execution for the dollar is in force.

**Daily Bell**: We hear that the Fed is actually considering increasing the amount of money being printed, presumably to break out of a liquidity trap. What's your take?

**Antal Fekete**: Liquidity trap is claptrap invented by Keynes. If the Fed is trying to fend off deflation, then it is using counter-productive means to achieve its ends. ZIRP (zero interest rate policy) has the effect of destroying capital. As the rate of interest is halved, the price the long-term bond is doubled. It now takes twice as much money to get out of debt. This is a loss that has to be charged to capital. The burden of debt has increased and the increase is the measure of destruction of capital. Printing money makes the problem worse, not better. You see, opening the tap fully will not necessarily increase the water-level in the tub. You also have to consider the status of the drain. If it is unplugged, as it is now, monetarily speaking, witness the ongoing destruction of capital, then the water-level in the tub may well be receding.

**Daily Bell:** You have been taken to task by your critics for suggesting that a falling interest-rate structure erodes, even destroys, capital. A bank carries its capital in the form of bonds. But bond values increase as interest rates decline. How do you explain this apparent contradiction? Has bank capital been destroyed, or has it been boosted?

**Antal Fekete:** Most certainly it has been destroyed by the falling interest-rate structure. To the extent the appreciating bonds are on the capital accounts of the bank, sound book-keeping principles demand that their market value be reported in the *liability* column, definitely not in the *asset* column, of the balance sheet. It should be crystal clear that the regime of falling interest rates erodes and ultimately destroys *intangible* capital. Conversely, the regime of rising interest rates erodes and ultimately destroys *tangible* capital such as plant and equipment of producing firms, as they are rendered submarginal. The thirty-three years old bull market in bonds has taken a terrible toll on bank capital. Virtually all banks have been rendered insolvent, with the rest to follow. Governments and central banks burn the midnight oil in trying to stonewall this fact, in vain. They pretend that insolvency is but a temporary liquidity problem. But this unprecedented banking crisis cannot be wished away so easily. Keynes is dead, and so is his idea that items can be shifted from the liability to the asset column of the balance sheet of the government at will. My critics are ignorant of double-entry book-keeping. But the real scandal is ignorance at the Fed, the Treasury and in academia. No one exposed ZIRP as a blueprint for the wholesale destruction of intangible, including bank capital.

Incidentally, the banking crisis in the U.S. 80 years ago was also caused by the destruction of capital due to declining interest rates, but you mustn't say this in polite company.

**Daily Bell**: Do you still believe there's no way out of this cycle but "extinction" and then barter?

**Antal Fekete**: It is not a cycle, it is a disaster brought upon us by the incompetence and ineptitude of our Keynesian and Friedmanite money doctors. It leads to permanent gold backwardation (read: headlong rush of gold into hiding) that will in the fullness of time convert our incomparable multilateral trading system into miserable barter, and our highly productive world economy into a subsistence economy.

**Daily Bell**: What would you do if you were head of the Fed?

**Antal Fekete**: When Mises was once asked what he would do if he were the President of the United States he said he would resign forthwith. I answer your question by saying that I would issue a strongly-worded statement that I don't want my name to be associated with a wrong-headed, utterly corrupt and unconstitutional experiment with irredeemable currency, foisting it upon the rest of the world. It is dishonorable. It is immoral. It marks the darkest hour in the history of this nation. Then I would resign.

**Daily Bell**: What is Janet Yellen going to do when she becomes Fed head? Will there inevitably be another crash?

**Antal Fekete**: She is well-heeled to kick the can further down the road, as they say. This road leads to a series of crashes, the blowing and pricking of bubbles. We are already in a depression, masked by unlimited money creation which is pouring oil on the fire of deflation. If 50+ percent youth unemployment does not indicate depression, then I don't know what depression is. Bond purchases by the Fed lead to halving interest rates and halving them again and again. This is tantamount to destruction of capital as we mentioned a moment ago. Lower interest rates mean higher bond prices, which measure the increase of the burden of debt, the proverbial straw that breaks the back of the camel. Not only is the debt increasing exponentially in absolute terms; the burden of debt is increasing as well on the top of that.

**Daily Bell**: Are the central bankers managing to re-stimulate? We believe that they will cause another stock market boom and bust. Your thoughts?

**Antal Fekete**: Central bankers manage to stimulate prosperity and the economy into oblivion. Capital destroyed by the falling interest rate structure cannot be resurrected by an exercise in "exit strategies" or in "tapering". Besides, easy money (quantitative or otherwise) is addictive. Once being hooked on it, the economy cannot be weaned off the drug. There is a threshold of abuse beyond which the economy is doomed.

**Daily Bell**: The current "recovery" will not be extensive no matter how high the market runs because a money-led expansion cannot affect the underlying distortions of the economy. Only a full-fledged purging can do that, letting bankrupt firms fold up, etc. Comment?

**Antal Fekete**: You have put it beautifully.

**Daily Bell**: Let's return to your previous interview with some follow-up questions. Why does gold's marginal utility decline at a rate lower than that of any other commodity, as you observed last time?

**Antal Fekete**: It is the result of a long ongoing historical process that has started even before writing was invented. As Menger described it in his *Origin of Money*, people came to be using the most marketable good for exchange purposes, in order to reduce losses to irreducible minimum. Like it or hate it, the most marketable good was (and is) gold. Marketability is measured by the spread between the asked and bid price as ever greater quantities are thrown on the market. For the most marketable good the spread declines more slowly than it does for any other. Now Menger had a problem. He was about to define what "price" was supposed to mean, and got tangled up in a circular argument that used price in the process of defining price. He resolved the problem brilliantly by introducing the concept of marginal utility. Thereby he could avoid using the word "price" in the definition of price. By this stratagem he could break out of the logical vicious circle. To say that the marginal utility of gold declines more slowly than that of any other good is just another way of saying that the most marketable good within the observation of man is gold. It has to do with the fact that the ratio of existing stocks to annual flows of new production is far greater for gold than for any other good (with the possible exception of silver).

**Daily Bell**: You pointed out that gold does not obey the Law of Supply and Demand. "For example, a higher price of gold need not call out a greater supply; often it causes the supply to shrink further." So when Rothbard stated that higher gold valuation was bound to pull metal into the market, he was wrong?

**Antal Fekete**: Not necessarily. Perhaps Rothbard was thinking of a crisis-situation such as the one that presented itself on August 15, 1971. On that day President Nixon was facing the world-wide flight of gold into hiding on an unprecedented scale. He could have solved the problem by doubling the official gold price from $35 to $70 per oz. This would have stopped the hemorrhage and would have coaxed a lot of gold out of hiding. On that day Paul A. Samuelson, the paramount apostle spreading the Keynesian gospel in an amusing but long-forgotten incident jumped the gun. He published an op-ed article in the *Washington Post* in which he stated that President Nixon decided to devalue the dollar in terms of gold by 50 percent! This amazing *faux pas* left Samuelson red-faced when Nixon went on world-wide TV announcing that, on the contrary, he was 'closing the gold window' – a euphemism for defaulting on the international gold obligations of the United States. It became clear that Nixon spurned the Nobel-prize laureate Keynesian in failing to consult him, of all people, in making a decision of such historical import.

**Daily Bell**: You have also said that "people would dishoard gold if its scarcity pushed up interest rates. In the 19th century there was a saying that the Bank of England could pull in gold from the moon with a bank rate of 5 percent." These two statements seem slightly contradictory. Can you explain?

**Antal Fekete**: Yes. The second statement refers to the routine operation of the gold standard, in the absence of a confidence crisis. Once the rate of interest has risen, the marginal bondholder buys back his gold bond at a lower price. In doing so he relinquishes the gold coin he obtained when he had earlier sold his bond at a higher price. This is known as the Fullarton Effect, an anathema of Mises. By contrast, the first statement refers to a crisis of confidence. Gold takes flight into hiding and drastic measures are needed to stop the flight and to coax gold out of hiding.

**Daily Bell**: You also told us, "Today no university offers courses treating the gold basis, the gold cobasis and their interplay. They are silent on the apocalyptic threat of permanent gold backwardation." Can you expand on what you meant?

**Antal Fekete**: Here I am talking about the ominous and frightening parallel with the flight of gold into hiding in 476 A.D., the year when the Western Roman Empire collapsed − after centuries of monetary mismanagement, debasement diluting the gold and silver coins of the realm by adding base metals to the alloy. The result was a disastrous return to barter and the breakdown of law and order. Today the situation is analogous with the difference that we now have a concrete measure of the flight of gold: the gold basis. When permanent gold backwardation sets in (meaning that the basis has turned and stayed negative), it will mark the withdrawal of all offers to sell gold. Those who want it must get it through barter. This will kick off a contagion, spreading barter to all markets trading highly marketable commodities such as food, fodder and fuel. Not one university in the world is sounding the alarm that the collapse of civilization may be in the offing comparable to that experienced during the "Dark Ages." The New Austrian School of Economics is the only place where one can learn about the negative gold basis, permanent backwardation of gold and the drowning of the world in hopeless barter.

**Daily Bell**: You told us that silver available for futures trading is dwindling and disappearing fast. "Permanent backwardation of silver is a matter of time, probably not a very long time." Where are we on the time curve?

**Antal Fekete**: That is hard to say. The interesting question to ask is whether gold or silver will be the first to go to permanent backwardation. Either event would trigger the other. You must watch both markets for early signs of budding permanent backwardation. I conjecture that probably silver will go first, but the evidence is circumstantial at best.

**Daily Bell**: You said: “The likely cause of the recent shake-out in the gold futures markets is not what you call ‘too high expectations’. Rather, it is Bernanke's belated recognition of the threat of permanent backwardation, and his attempt to 'scare the horses properly.' ”In simplest terms, what is the consequence of backwardization and why should Bernanke be worried about it?

**Antal Fekete**: The correct term is ‘permanent gold backwardation’. As I have indicated a moment ago, it would usher in barter economy that is grossly insufficient to serve the multifarious needs of our complex world trade. All kind of shortages would appear; famine, pestilence, unemployment would be rampant. Bernanke should be worried about it because it would mark the operation of a black hole with its irresistible pull, from which there is no escape. Bernanke should know, he has been there. He studied the black hole of the Great Depression sucking in the world economy in the 1930’s.

**Daily Bell**: You pointed out to us previously that the "Constitution left it to the market to determine the rate at which the gold eagle would be tariffed in terms of the standard silver dollar. The Coinage Act of 1792, championed by Alexander Hamilton, the Secretary of the Treasury, established an official bimetallic gold/silver ratio at 15 to 1. This was price-fixing and as such unconstitutional." Did Hamilton know what he was doing? Did he realize he was destabilizing the US currency?

**Antal Fekete**: Hamilton was not a friend of the ideal of limited government. He wanted to enlarge the power of the federal government at the expense of state governments. He may not have realized that he was destabilizing the dollar, but he certainly believed in the omnipotence of the federal government to make his bimetallic ratio stick. Well, it did not and, as they say, the rest is history.

**Daily Bell**: You told us, "Historically money is not the creature of the state. It is the creature of the market in promoting gold as the most marketable substance on Earth over the millennia." It is probably safe to say that you don't believe along with assorted Gesellians and Brownians asserting that money is the province of the state and it cannot exist absent government control. True?

**Antal Fekete**: Yes and no. Comparable in importance to the invention of the wheel was the invention of the gold coin in the fifth century B.C. It made gold payments possible by *tale*. The expression ‘paying by tale’ means counting out gold coins rather than weighing them − a clumsy procedure by comparison. Paying by tale is made possible by the government’s guarantee to strike gold coins to exact standards, and its willingness to absorb losses due to wear and tear – much the same way as it absorbs the cost of keeping the highways in good repair. The original meaning of ‘legal tender’, before advocates of monetary duress distorted it beyond recognition, was that the weight of the gold coin must fall within the range of established tolerance standards. Legal tender gold coins were those the weight of which complied with the standard. Legal tender gold coins were accepted at face value when paid out by tale, even if they were slightly under-weight. Coins that fell outside of the tolerance standards were not legal tender. They were accepted, but only by weight, not by tale. It can be seen that the involvement of the government in minting and circulating gold coins was an essential one, and we haven’t even mentioned how the government was supposed to deal with counterfeiters. But at this point government involvement must stop. In particular, the decision as to how many new gold coins ought to be put into circulation was not up to the government to make. It was up to the people. If they thought that there were not enough gold coins, then they could do something about it. They would take new gold from the mines, or old gold from jewelry to the Mint and get the same gold back in coined form, ounce-for-ounce. The right to regulate the money supply was the prerogative of the people, not of the government or of the banks.

**Daily Bell**: You have pointed out a weakness of the theory of the business cycle according to Mises. Why do people allow themselves to be fooled by money magic over and over again? Why don't they learn from experience that banks are tempting them with teaser loans, and would lead them to their downfall? They should invest in new projects only after extra careful study leaving a wide margin of safety, after due allowance was made to for the distortion of interest rates by the banks. Your perspective is that "an improved theory of the business cycle must consider the causality relation between varying prices and varying interest rates." And you explained it thus: "It is reasonable to appeal to the phenomena of economic oscillation that has often been talked about, and economic resonance that has been talked about much less. Here are the details. Apart from leads and lags, rising (falling) prices make interest rates rise (fall) and, conversely, rising (falling) interest rates make prices rise (fall)." This induces oscillation for both prices and interest rates. A huge money-flow from the bond market to the commodity market is generated. When commodity prices reach absurd heights, the money flow abruptly changes direction. Now it flows from the commodity market to the bond market, until bond prices reach absurd heights, when the direction of the flow changes again. And so on and so forth. This is economic oscillation: prices and interest rates both oscillate. If the frequency of oscillating prices happens to coincide with that of oscillating interest rates, then resonance occurs. It could be dampened or the opposite, self-boosting (also called runaway) resonance. In the latter case there is trouble. The energy-level of the oscillating system increases and gets arbitrarily large. It leads to what is known as *hyperinflation*, provided that it occurs during the phase when money is flowing from the bond market to the commodity market. Could you elaborate on that?

**Antal Fekete**: Hyperinflation always means that the velocity of money-circulation is getting ever higher, in fact higher than any given velocity, however large. This may or may not be accompanied by central-bank money printing. The fact is that the underlying flow of existing money from the bond market to the commodity market can do the trick, regardless whatever the central bank does or wishes.

**Daily Bell**: But then you added: "there is also a second variety of the malady for which there is no precedent because governments never before experimented with irredeemable currency on the global scale. Up to now in each episode some governments have preserved their sanity and refused to join the insane experiment. This is the first time in history that all governments have joined in the suicide-pact. The result is *hyperdeflation*. That is what we are apparently going to have." Please elaborate on that as well.

**Antal Fekete**: Hyperdeflation means that the velocity of money-circulation is getting ever lower, in fact lower than any given velocity, however small. The important thing to note is that this is happening regardless what the central bank does. It is the direct consequence of the spontaneous money-flow from the commodity market to the bond market. No amount of money-printing will change that. Hyperdeflation takes place when resonance and breakdown occur during the phase when commodity prices and interest rates are falling.

**Daily Bell**: Mises definitely did not believe that deflation could occur during a money-printing episode such as the one we are experiencing right now. Could you revisit this topic and make the process clearer? How does "economic resonance" affect interest rates?

**Antal Fekete**: As money flows from the commodity market to the bond market, commodity prices fall along with interest rates (because bond prices rise). Under a gold standard this process would be stopped sooner or later as commodity prices cannot fall to zero. Under our global fiat money experiment, however, the central bank is compulsively halving interest rates again and again, unwittingly causing further price declines in the commodity market. There is a vicious downward spiral in operation: falling commodity prices chase interest rates lower, and falling interest rates chase commodity prices lower. It is crazy. It is unbelievably stupid, but there it is. The central bank in blind faith in the Quantity Theory of Money is destroying the economy. Everybody is expecting hyperinflation, but what we are getting is hyperdeflation.

**Daily Bell**: You seem to believe that the velocity of money is entirely a monetary phenomenon. Misesians tend to believe that falling monetary velocity has to do with lack of demand because economic vitality is distorted by central bank money printing. Which is it? Or is it both?

**Antal Fekete**: Arguing in terms of a lack of demand is a Keynesian trait. I dislike arguing in terms of the velocity also. Mises once said that the velocity of money is always zero, period. At any one moment in time money is in the cash-balance of someone, sitting there with zero velocity. I think the correct approach to the deflationary spiral is through arguing in terms of resonance between oscillating commodity prices and oscillating interest rates. Mainstream economists do not understand speculation. Post-Mises Austrian economists are no better at it. Risk-free speculation in the bond market explains everything without a hitch.

**Daily Bell**: Please explain.

**Antal Fekete**: Speculators know full well that the central bank is buying bonds hand over fist. They can also time the central bank's purchases pretty accurately. In fact, central bankers shout from their rooftops about QE and other imbecile tricks. They even give the timetable for the scheduled purchases away. Speculators react by pre-empting central bank purchases. They simply buy the bonds beforehand. True, sometimes the central bank falsecards. But it cannot fool speculators who risk their own capital and face hired hands of the central bank in the poker whose losses are automatically charged to the public purse. The result is that speculators have a free ride. (Think of George Soros and his busting the Bank of England.) They profit without taking any real risk. They win big, and the merry-go-round keeps running out of control.

**Daily Bell**: Please share with us your criticism of the idea that fractional reserve banking is a crime, as Murray Rothbard once held.

**Antal Fekete**: This is a major departure of Rothbard and, before him, of Mises, from Carl Menger's monetary theory. Menger held that commercial banks, quite properly, make more loans than their net gold reserves would on the face of it justify. The excess is balanced by gold bills, that is, bills of exchange maturing daily in gold coins. You can look it up in Menger's *Geld*, third edition (1909). Mises published his *Theory of Money and Credit* just three years later, in 1912 (we do know that he wrote the manuscript in 1911). He must have read Menger's *Geld* before his book went to press. It is totally incomprehensible to me why Mises fails to refer to Menger's analysis of the commercial banks' practice of monetizing gold bills. Or why he did not criticize it if he disagreed. Be that as it may, "fractional banking" is a malicious misnomer. The commercial banks' reserves are not "fractional". They are full because their portfolio of maturing gold bills is as good as gold. The same is true of central bank reserves.

**Daily Bell**: You're a proponent of real bills. Can you remind us of why Misesian Austrians like Rothbard dismissed real bills as inflationary?

**Antal Fekete**: They call the monetization of gold bills fraud for the silliest of reasons. They hold that bank notes are fake warehouse receipts. They do not understand that bank notes are not warehouse receipts at all: they circulate as proxies of gold bills that are also capable of monetary circulation themselves. Bank notes are more convenient, and have a higher name-recognition. Post-Mises Austrians hold that issuing bank notes is fraudulent. It is inflationary – they say – as it increases the money supply. What they fail to see is that gold bills rise and expire together with new consumer goods morphing from semi-finished into a finished good, before they disappear in consumption. The gold coins surrendered by the consumer liquidate all claims that have arisen along the passage of semi-finished goods from the producers of higher order goods to those of lower-order goods. Rothbard would have the producer of lower order goods pay the producer of higher order goods in gold coins. But this is absurd! No producer has ever paid a single gold coin for a semi-finished good, never ever! Payments in gold coin are made exclusively for *finished* goods, and that by the *consumer*, not by the producer! Producers of higher order goods get paid for their semi-finished goods by drawing bills on the producer of lower-order good, and that's that.

**Daily Bell**: Explain to us again how commercial banks arose in reaction to the inconvenience of real bills denominated in odd figures, as compared to the convenience of bank notes denominated in round figures.

**Antal Fekete**: That was the smaller inconvenience. By far the greater inconvenience was that the discount had to be calculated and paid every time the gold bill changed hands, which it did often. But calculating and paying the discount was eliminated when turnover increased and people held the gold bill for such short periods of time that the amount of discount became negligible, not worth bothering with. People were happy to forgo the discount due to them, in exchange for the great convenience of being able to use bank notes. A third inconvenience that was eliminated by the appearance of bank notes was the need for endorsing. Paying with a gold bill was not complete until the payer endorsed it on the back. A fourth inconvenience was that gold bills had an expiry date to watch. Bank notes have no expiry date, although the bank of issue had the obligation to withdraw as many of them from circulation as the sum total of the face values of expired gold bills demanded. If the bank of issue failed to do that, then it was guilty of fraud. This was a crime dealt with by the Criminal Code. The bank of issue could not pay out bank notes that had been withdrawn from circulation at the time their gold-bill backing expired, unless it rediscounted an equal amount of fresh gold bills, or it purchased an equal amount of gold.

**Daily Bell**: Explain as clearly as possible how real bills ceased to function. Why were they attacked? Last time you mentioned that the real bill market was a casualty of World War One. Please expand and explain as simply as possible.

**Antal Fekete**: Gold bills did not cease to function. I shall put it bluntly: gold bills were brutally murdered covertly, after the young men put in uniform had been murdered in the field overtly. The blame goes largely to the victorious Entente powers that in 1918 acted unilaterally, without consulting anybody, keeping their plan in secret, covering their trail. What was their motivation? Well, they feared post-war German industrial competition that they were not prepared to meet head-on. They were of course obliged to lift the blockade of Germany in compliance with the terms of the peace treaty, but they thought they could finesse their way through. Blocking the trade of gold bills in the London clearing houses promised to be a clever, if dishonest, substitute for the blockade. However, the Entente powers were caught in the trap of their own making that was supposed to harm their antagonists. They shot themselves in the foot. The gold standard Britain re-established in 1925 failed because it missed an organic part: the clearing house, that is, the market for gold bills. No gold standard could ever succeed without a proper gold bill market. British politicians, among others Winston Churchill, the Secretary of the Exchequer in 1925, were not bright enough to see that.

**Daily Bell**: You also explained that withering of the real bill market caused the Great Depression. This is a decidedly minority view, even within the hard-money community. Please revisit this topic.

**Antal Fekete**: This is the view of a minority of one: me. I again object to your choice of words. It was *sabotage*, not *withering*. In deliberately destroying the bill market, the Entente powers have unwittingly also destroyed the wage fund out of which workers producing merchandise for consumption could be paid, a good three months before their products were sold for cash. What politicians and economists forgot in 1918 was that without the bill market there is no wage fund, and without the wage fund there is no employment. Instead, there is unemployment, lots of it. There is no way to finance the production of consumer good *now*, for which the consumer will pay only 91 days *later*, unless gold bill financing is available. In the euphoria after the Entente victory several bubbles were blown: the bubble in the U.S. government bond market in 1921, the bubble in Florida real estate in 1925 and, most notoriously, the stock market bubble in 1929. Nobody realized that the bubble-financed consumer goods market would be starved of funds once the last bubble was pricked. That happened in 1930 when it dawned on the world that the bloated inventory of consumer goods was unsalable.

Had the bill market been rehabilitated in 1918 as it should have, adjustment in inventory would have been made in time to avoid the glut, and financing for further production would have been available through discounting gold bills. The upshot was that workers producing consumer goods had to be laid off in six-digit contingents. Puerile pseudo-theories were concocted by Keynes and others, such as the theory of oversaving, the theory of underconsumption, the theory of disappearing demand in ‘mature’ capitalist economies, the theory of ‘contractionist’ nature of the gold standard, to mention but a few. No one was looking for an answer in the forcible destruction of the global gold bill market that alone makes multilateral trade possible, inspired by the chauvinistic jealousy of the victorious Entente powers that stemmed from their neurotic fear of German industrial competition. They thought, wrongly, that bilateral trade, through which they wanted to control German exports and imports, could be a working substitute for the system of multilateral trade as embodied by the international market for gold bills. Bilateral trade turned out to be a disaster.

**Daily Bell**: For readers who may be reading this for the first time, please explain how real bills work and why they are so important.

**Antal Fekete**: The market for gold bills is entirely spontaneous. It was invented by no one; it was promoted by no government. Like money itself, the gold bill was the result of an evolution. Here is how it works. The wholesaler delivers supplies to the retailer and bills him. Once endorsed by the latter the bill goes through a metamorphosis and becomes money in the hand of the wholesaler (and his suppliers, and the suppliers' suppliers, etc.) that can be used in replenishing inventory. The gold bill, the next best thing to the gold coin, becomes money, albeit an ephemeral one. It is destined to expire in no more than 91 days. Gold bills are the best earning asset a commercial bank can have. Demand for them is virtually unlimited. Not only will producers and distributors of semi-finished goods scramble for them. Everybody with a large payment coming up, such as bond issuers just before the maturity date of their issue, or purchasers of real estate just before the closing date will, too. They would not accumulate bonds, for example, in preparation of paying their obligations at maturity. Bonds are far too illiquid for that.

**Daily Bell**: Please review again your criticisms of the Quantity Theory of Money. It certainly makes sense on a simplistic level. When you print too much money, you devalue the rest. Why isn't this an accurate statement?

**Antal Fekete**: You can print all the money you want, but once you put it into circulation, you no longer have control over it. Money flows where it will; the only thing certain is that it will not flow uphill. Instead, it will flow to the place where the fun is. Right now the guys at the Fed hope against hope that their freshly printed Federal Reserve notes will flow to the commodity market or the housing market. But that's not where the fun is. The fun is in the speculative financial markets. That's where the money flows, frustrating the Quantity Theory of Money and those who believe in it.

**Daily Bell**: You stated your theory implies a rehabilitation of Adam Smith's Real Bills Doctrine. But how is the Real Bills Doctrine linked to the denial of the Quantity Theory of Money?

**Antal Fekete**: The Gold Bills Doctrine is a living reminder that the Quantity Theory is false. It is thorn in the flesh. Certainly, drawing gold bills will add to the money supply, but it does it in such a way that will *not* make prices to rise.

**Daily Bell**: Why did Rothbard dislike Adam Smith? He criticized Smith based on the title of his book, Wealth of Nations, pointing out that nations didn't own wealth, people did. Is this a valid criticism? If it is, does it imply a basic misconception on Adam Smith's part?

**Antal Fekete**: No, it doesn't. The title of a book must be concise (not that the full title of Adam Smith's book is the paragon of conciseness!) Rothbard is right in saying that macroeconomic aggregates such as a nation do not act like individuals, nor do they create or dispense wealth. That's the trouble with macroeconomics. It is a silly anthropomorphism. It assumes that macroeconomic aggregates have free will. You must treat the "wealth of nations" as figurate speech.

**Daily Bell**: You stated previously that "the fratricidal war between the Time Preference School and the Productivity School of Interest must end." Can you explain the differences between these two theories?

**Antal Fekete**: The Time Preference School teaches that interest exists solely because of our innate preference for present goods as opposed to the same quantity and quality of future goods. The Productivity School teaches that interest exists only to the extent of greater productivity due to the application of better tools and methods in production. Interest theorists, in their conceitedness, have never considered that *both* theories may be right simultaneously. This omission resulted in a stagnation of the theory of interest that has remained the most backward chapter in economics to this day.

**Daily Bell**: You stated the following: "Using Menger's idea of the bid/asked spread, the two theories can be merged in a happy synthesis. Just as the price of goods is not monolithic but splits into bid and asked prices, so the rate of interest is not monolithic either: it splits into a floor and a ceiling rate. These two must be studied separately. Their rise and effect are different. The ceiling rate can be understood in terms of marginal productivity; the floor rate in terms of marginal time preference." Isn't this a bit complex for most people and is it not the reason why the quantity theory of money is accepted by popular acclaim?

**Antal Fekete**: The special theory of relativity is also "a bit complex", yet you have to master it if you want to understand high-velocity physics dealing with particles moving almost as fast as light travels. It is not popular acclaim that has made the special theory of relativity valid. The trouble is that the rate of interest was never properly defined. Here is the proper definition: *the rate of interest is that rate at which the stream of interest payments plus the lump sum payment of the (fixed) face value at maturity amortize the (variable) market value of the bond*. The reason why economists have never hit upon this definition is that the bond market was suppressed pursuant to secular and canon law for centuries. The last ban was lifted as recently as the $19^{th}$ century when the Vatican instructed confessors not to disturb penitents accusing themselves of taking or paying interest (read: buying or selling bonds). Once you accept this definition you will realize that there must be two interest rates, one having to do with the asked price and the other with the bid price of the bond.

**Daily Bell**: Update us on your New Austrian School of Economics. Also explain generally the main differences between your school and Mises. You seem to admire Menger more than Mises.

**Antal Fekete**: I admire Mises as long as he does not deviate from Menger. I feel I have to criticize Mises whenever he does. Post-Mises Austrians think that criticizing Mises is sacrilege. It is not. In science there is no Revelation. Instead, there is debate out of which truth springs in full armor in the fullness of time. Just this month, October, 2013, the New Austrian School of Economics held a Seminar at the British Museum in London where the New Austrian Economic Manifesto was formally adopted. It considers six points of disagreement between the two schools, all concerning the denial of either Menger or of Adam Smith by post-Mises Austrians. You may read it on my website for a fuller understanding of our differences.

**Daily Bell**: Will you bring out more material on your theory of economic oscillations and resonance? How about a history of real bills?

**Antal Fekete**: The history of gold bills is treated adequately in the literature. I am working on my treatise entitled *The Rise and Fall of Credit*, to be published in German next year, in which I give a full treatment of the theory of economic oscillations and resonance, and the destructiveness of the latter as it becomes self-boosting.

**Daily Bell**: Are you in the midst of a truce with the Misesians, or does the Cold War continue? You called the "altercation" a "tragic waste of talent" in the past. Status quo?

**Antal Fekete**: I do mean it literally. There should be a dialogue instead of altercation. Mediaeval theologians had endless dialogues on the question how many angels can simultaneously dance on the tip of a needle. Our dialogue ought not to be like that. It would be about something on which the future of all of us, and that of our children and grandchildren, indeed the survival of our civilization vitally depends.

**Daily Bell**: Thank you for the interview.

**Antal Fekete**: Thank you for the searching and penetrating questions.

**Note:** This is a revised version of the original interview with the Daily Bell on October 27. The date of revision is November 7, 2013.