# GOLD IS THE CURE FOR THE JOB-DRAIN

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**Executive Summary**

Falling (as opposed to low but stable) interest rates are lethal to the economy, especially if prolonged. They make the rate of marginal productivity decline. As it does, it prompts capital export. Migrating capital takes industrial jobs with it. This paper analyzes job-drain that is threatening America with de-industrialization. The process will continue as long as wild swings in the rate of interest do. The cure is to be found in the stabilization of interest rates. It can be effected by opening the U.S. Mint to the free and unlimited coinage of gold, as mandated by the U.S. Constitution.

**De-Industrialization of America**

The true story of the de-industrialization of America has never been told. It started with the U.S. Treasury defaulting on its gold obligation to foreigners in 1971, thereby foisting a regime of irredeemable currency upon the world. An unanticipated side-effect was the setting of the rate of interest adrift. It then started its wild roller-coaster ride, first up well into double digits by 1981, then down to zero, a move that twenty years later is still in progress. Greenspan takes credit for the low rates as a measure of his success in "licking inflation". The claim is an empty one. The credit belongs to bond speculators, the big money-center banks among them, that have got away with obscene profits on their bond holdings and long positions in the derivatives markets. It is too early to say that the plunge of interest rates is over. There is more dough still where these profits have come from.

At whose expense are those obscene profits made? Why, at the expense of the producers and laborers, naturally. Economists have missed the curious coincidence that *pari passu* with the unprecedented swings in interest rates America is being de-industrialized. Of course, they noticed the migration of industrial jobs from America to Asia. But they blamed it on the sweatshops in China and India. However, Asian wage rates had been lower for the entire period of modern age, causing no migration of jobs as long as industrialized countries adhered to the gold standard. The difference in wage rates in itself does not establish a cause for the job-drain.

Greenspan in a testimony before a Congressional committee stated that the de-industrialization process is market-related as Americans demand ever more services. This is as false as it is self-serving. The real cause of the de-industrialization of America is the mega-swings in the rate of interest. They are far from over. Unless interest rates are stabilized soon, America will be denuded of its park of capital goods and American labor will be reduced to poverty. *Labor leaders should pay attention and demand that interest as well as foreign exchange rates be stabilized forthwith by opening the U.S. Mint to the free and unlimited coinage of gold, as mandated by the U.S. Constitution.*

**Marginal Productivity**

Here is the evidence that causal relation exists between the swinging dollar-rate of interest and progressive de-industrialization, as manifested by the massive export of industrial jobs from America to Asia. To understand it we have to make the concept of productivity precise.

Every industrial plant and equipment has its own rate of productivity that can be calculated as the annualized percentage of increase in the value it imparts to the goods under production. Not all plant and equipment will find employment, however. Even though in each case the value of output is greater than that of input, the opportunity cost of employing certain capital goods may be too high. *This is a point that has been missed by all discussions of productivity so far*. If we rank all capital goods according to their rate of productivity, then we find that there is a lowest-ranking one that can still be employed profitably in production, but all others with a lower productivity must remain idle as their application would be uneconomic in view of their high opportunity cost. It is the marginal item of industrial capital, and its productivity is called the *rate of marginal productivity*. It goes without saying that the marginal item shifts constantly, and with it changes the rate of marginal productivity.

The key question to ask is what determines this rate. This is important because capricious changes in it could play havoc with the economy. Contrary to conventional wisdom, an increase in the rate of marginal productivity is not beneficial. It is actually harmful to the economy when prolonged, as it is the chief cause of unemployment. Indeed, the new marginal item has a higher ranking than the previous one, therefore all capital goods below its rank must be idled, making the labor-complement superfluous. Superficial thinking may suggest that a decrease in the rate of marginal productivity is beneficial as it would press idle plant and equipment back into service restoring employment. Not so. Actually, the decrease is also harmful if capital is mobile internationally, as it is today under globalization. When the rate of marginal productivity drops, capital will be exported to foreign countries with abundant cheap labor. Note that the only way to keep industrial jobs in the country is to keep the rate of marginal productivity relatively stable. Violent changes in the rate cause capital and labor to divorce, whereupon capital migrates abroad taking industrial jobs with it, and leaving domestic labor unemployed.

What then determines the rate of marginal productivity? Since capital goods are an earning asset, they are in direct competition with other earning assets. In particular, capital goods compete with bonds. When the yield on the bond rises (the market price of the bond falls), the opportunity cost of employing capital rises with it. Arbitrage from physical capital to bonds takes place. Seeking a better return owners of capital goods sell their plant and equipment, and buy bonds with the proceeds. From producers of real goods they become coupon-clippers. Moreover, not only do increasing interest rates discourage production, they actually *destroy* domestic capital. This is so because an irreversible process is at work. Please note the difference between finance capital that is mobile, and domestic capital consisting of producer goods that is not. If and when interest rates turn around and start falling again, arbitrage goes into reverse. Bondholders take profit. They sell their bonds and want to put the proceeds into capital goods. They look for the most profitable applications. They will find them abroad where labor costs are a fraction of that at home. They will send their capital abroad. Thus capital goods at home that have been idled earlier when interest rates were rising will not be re-employed. They are doomed. Falling rate of marginal productivity is the leading cause of the export of industrial jobs, the destruction of domestic capital, and unemployment.

We conclude that FED policy of purchasing bonds in the open market in order to combat deflation is not only counter-productive; it is distinctly anti-labor. The FED bids up bond prices, which is tantamount to driving down interest rates. Falling interest rates do, in turn, lower the rate of marginal productivity. The upshot is that capital is exported along with industrial jobs to low wage countries.

**Falling Interest Rates and Deflation**

In earlier papers I showed that while a low and stable interest-rate structure is beneficial for producers of goods and services, a falling one is an unmitigated disaster. Not only does it fail to stimulate economic growth but will, in fact, underwrite deflation by actually increasing the cost of capital for established producers. I must confess that most of my readers have found my argument utterly counter-intuitive and contrary to their personal experience. They have not seen any evidence of falling prices during the period of twenty-two years of falling interest rates.

This is because they ignore the invasion of American super-stores by cheap consumer goods made in China and elsewhere in Asia. They also ignore the sales tactics of those stores in keeping the sticker price high while selling merchandise at deep discount. Be that as it may, the fact remains that capital has been exported from America to China and is used to assist Chinese labor to produce merchandise which is then re-imported to America and sold at incredibly low prices. There is no way American manufacturers using domestic facilities and domestic labor can possibly match those prices, and they are going bankrupt in droves. American domestic manufacturing and employment shrink. If that is not deflation, then I don't know what is.

Moreover, the deflation has not been caused by cheap foreign labor. That has always been available. The cause is the falling interest-rate structure that has, for the past 22 years, made the rate of marginal productivity decline. *This decline would, in and by itself, have produced deflation even in the absence of export of capital and jobs.* Suppose for the sake of argument that the government controls the export of capital. In that case the falling rate of marginal productivity would have pressed previously idled plant and equipment back into service, using new labor component at lower wages. The additional supply of consumer goods would have depressed prices and caused bankruptcies as well as unemployment. It is foolish to blame Chinese sweatshops for the plight of American producers using American labor. You should blame our unconstitutional monetary system that allows the rate of interest to shoot up to 20 percent and then to plunge to 1 percent.

There is no comfort in the thought that the rate of interest is already so low that it can hardly go any lower. In view of the Japanese experience, it can. In fact, it can go on falling indefinitely. This is because the effect of a move in the rate of interest on the economy is commensurate, not with the size of the move itself, but with its *logarithm.* In other words, cutting the rate of interest in half has the same effect, whether it started from 20% (a 10% move) or from 1% (which is only a 0.5% move). There are still lots of industrial jobs available for export in America--for example, in the auto industry. What if China wants a piece of the auto market in America? Well, just cut the rate of interest in half three or four more times and: bingo! Auto jobs, too, are gone to China.

**Gold Standard: Protector of Labor**

Keynes disparaged the gold standard as "contractionist" and "deflation-prone". He also charged that it has failed to stabilize prices. However, the great merit of the gold standard must be seen not in its power to stabilize prices that is neither possible nor desirable, but in its power to stabilize interest rates at the lowest level compatible with the productivity of capital and labor available in the country.

Why are interest rates stable under a gold standard? We may define the going rate of interest as the rate at which the market price of the bond is amortized by the stream of interest payments plus the payment of face value at maturity. Under the gold standard a gold bond has a stable market price because it promises to pay a *definite* value. Compare this with a dollar bond that is exchanged for an irredeemable promise of *uncertain* value at maturity. The dollar returned to the bondholder is not the same as the dollar he paid for the bond. Its value is lower thanks to monetary debasement that has taken place in the interim. The market price of such a bond changes with the fortunes of the issuer and is therefore inherently unstable. Since the market price of the gold bond is stable, the rate of interest under a gold standard is stable. Historical charts fully bear out this theoretical conclusion. The wild swings we have seen in the dollar rate of interest since 1971 have no precedent under the gold standard. Noteworthy also is the fact that there was no bond speculation, just as there was no foreign exchange speculation, under the international gold standard.

This means that the gold standard is a source of great benefits to labor. It doesn't allow the rate of marginal productivity to change capriciously. Compare this with the regime of irredeemable dollar where the roller-coaster ride of the rate has wiped out whole industries such as the manufacturing of TV sets and, by the same token, threatens to wipe out auto manufacturing. In the end only the defense industry may remain. As we have seen, an increasing marginal rate of productivity idles plant and equipment, while a decreasing one drives capital and jobs to low wage countries. In either case, unemployment is the result. Keynes did great disservice to labor when he instigated the overthrow of the gold standard. Far from being contractionist or deflation-prone, the gold standard is the sole source of stability in an unstable world. Only when the government lends credibility to unprincipled adventurers such as Keynes by paying attention to agitation against the gold standard, does gold get nervous and go into hiding. But when the government firmly stays the course of monetary and fiscal rectitude, gold comes out of hiding and partakes in the great work of building up the productive and financial strength of the country to benefit all segments of society, first and foremost labor that needs protection most.

It is customary to make a case for the gold standard by referring to features such as relative price stability; protection of the value of savings, pensions, and life insurance; obstacle to the "beggar-thy-neighbor policy" of predatory governments using foreign exchange rates as a weapon promote exports; protection of the assets of individuals against encroachment by banks and the government; obstruction to credit abuse and unlimited debt creation; keeping fair play between the productive and financial sectors, etc. The merit of the gold standard in protecting the individual's right to work, and as an obstruction to exporting capital and jobs and so to prevent the impoverishment of labor, is never mentioned. It is time to lay out these merits as well before American labor is put through the wringer as it is being robbed of the industrial jobs remaining in the country.

Under the gold standard the rate of interest and, by implication, the rate of marginal productivity, are not set by politically motivated central bankers and Treasury bureaucrats. They are stable. If they change, they do so almost imperceptibly, reflecting capital accumulation and its effect on productivity. Recall that in the early 1980's the U.S. Treasury cavalierly printed double-digit figures on the interest-coupons attached to its bonds, because they wouldn't otherwise sell. But these double-digit figures were a death sentence on capital goods that consequently became idle as higher interest rates pushed up the rate of marginal productivity, causing wide-spread unemployment. It was a capricious transfer of wealth from the productive sector to the financial sector. It was highway robbery. This puts the gold standard in a new light: the policeman to prevent highway robberies.

**"Honey, I have shrunk the jobs by mistake!"**

Greenspan himself admitted that the FED's war plan against deflation is wholly experimental, as it has never happened in history that deflation had to be confronted under a regime of fiat money. It is atrocious and revolting that unelected bureaucrats are allowed to experiment with American society in pushing laborers, producers, and savers around like the player pushes pawns around on the chess board, in an effort to prop up an unconstitutional monetary regime. As a result of this experimentation American capital and jobs are being exported. America is in the process of being de-industrialized. America has been turned from the greatest creditor to the greatest debtor country. All for no better end than protecting the turf of the FED. How much more experimentation, sacrifices, and suffering is needed before we are allowed to conclude that the fiat money regime established by deceit and stealth is an abysmal failure? Greenspan, being responsible to no one but himself, can shrug. If he is compassionate, he may utter words to the effect: "Sorry, a mistake has been made", and get on with another experiment.

It is time for a wake-up call. Under the fiat money system the FED has arrogated unlimited powers to itself, namely, the power to print unlimited amounts of money. The justification offered for this unconstitutional arrangement is the woolly theory of a monetary adventurer from Britain, one John Maynard Keynes, who has been dead for over 50 years and can no longer be summoned as a witness. But Keynes was willing to admit that he might be wrong, in which case he would have let us fall back on the gold standard. Greenspan, on the other hand, stands in the way of drawing that conclusion.

**If You Don't Use Your Eyes for Seeing You Will Need Them for Weeping**

It is not well-known that Keynes published a eulogy of the gold standard in the *Manchester Guardian Commercial* (Reconstruction Supplement, April 20, 1922). This eulogy, of course, is never cited by latter-day Keynesians.

"If gold standards could be reintroduced throughout Europe we all agree that this would promote, as nothing else could, the revival of not only production and free trade but of international credit and the movement of capital to where it is needed most. One of the greatest elements of uncertainty would be lifted. One of the most vital parts of pre-war organization would be restored. Any one of the most subtle temptations to improvident national finance would be removed; for if a national currency had once been stabilized on a gold basis, it would be harder (because so much more openly disgraceful) for a Finance Minister so to act as to destroy this gold basis."

No one has the right to gamble with the welfare of the American people, neither the President, nor the Chairman of the FED, not the politicians, not the judges, not the bureaucrats. That is why the Republic has been given a Constitution. The Constitution denies power to the government to monetize its debt. As we have seen, this provision is the first line of defense to protect labor, as it acts to keep capital and jobs together and within the country's own borders.

The Constitution's monetary provisions have served this country well, and the unconstitutional monetary experiments conducted by the FED have served it badly. The latter were a series of unmitigated failures that have gone a long way to de-industrialize America, and threaten to drive the remaining capital and industrial jobs abroad. Open your eyes and see for yourself. God gave us eyes so that we may see.

As Friedrich Wilhelm Foerster (1869-1966), the great Swiss pedagogue once said: "if you don't use your eyes for seeing you will need them for weeping".