“THE DISMAL MONETARY SCIENCE”

The Goldbug Variations I.

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Overture

This is a rejoinder to a piece of the same title by Paul Krugman, MIT professor (now at Princeton) and columnist of *The New York Times*. It was *posted* on the internet on November 22, 1996, with a note saying that it was to be *composted* two weeks later, on December 6. It wasn’t. I came across it a few weeks ago while surfing the internet. At first I thought that it fully deserved to be composted in short order. But on second thought I decided that it called for a careful rejoinder. Bad-mouthing the gold standard is a periodically returning pastime for mainstream economists. Their arguments have never been put to rest by an authoritative rejoinder, which I therefore venture to present.

Krugman’s piece was part of a series entitled “The Dismal Science.” If I continue with these variations, which I am rather tempted to do, then I shall call my series “The Dismal Monetary Science.” I apply this name to the monetary science, so called, of the Krugman variety, more precisely, the demand-side theory of money according to Lord Keynes, as well as the Quantity Theory of Money according to Nobel Laureate Milton Friedman, also known as monetarism.

In what follows quotations from Krugman are under the caption “Recitativo,” and my rejoinder under “Rondo.”

Recitativo

The legend of King Midas, the original goldbug, has been generally misunderstood. Recall that his prayers were answered by the gods: everything he touched turned into gold. The catch was that “everything” included food and drinks as well, and the poor king was starving to death as his system could not ingest gold. The gods wanted to teach him a lesson. Most people think that the lesson was in the perils of avarice. This is a mistake. Midas’ true sin was his failure to understand monetary economics. What the gods were telling him was that gold was just another metal. If it sometimes seemed to be more, that was only because society has found it convenient to use gold as a medium of exchange — a bridge between other, truly desirable, objects.

Rondo

Krugman is cutting down the difference between “sometimes” and “always” to microscopic size. Gold has been the preferred means of exchange since time immemorial. After barter was phased out as inefficient, and after a relatively brief period of experimentation with other goods such as oxen, shells, and tobacco to mention but three of them, the marketability of gold (and silver) snowballed relative to that of other contenders. Gold became king, and silver the queen. Gold would still be king but for a *coup d’etat* overthrowing the constitutional monetary order in the United States and imprisoning the king.

In 1933 it took all the violence and duplicity a government could muster against its own subjects to grab the gold belonging to the people. There was wholesale confiscation of monetary gold, under false pretenses. No sooner had the U.S. government laid its hands on the people’s

gold than it wrote up its value. This piece of chicanery was used to conceal the act of robbery. People were "compensated" for the confiscated gold in the form of paper money.

In 1935 the U.S. Supreme Court dismissed charges that value was taken from the people without due process of law arguing that paper money continued to have the same purchasing power as gold coins. This flies in the face of the fact that the loss of purchasing power of the dollar abroad was instantaneous. Domestically it was gradual, and by the 35th birthday of the irredeemable dollar it amounted to 90 percent, an unprecedented monetary destruction in the history of the republic up to that point. (Much worse was to follow during the next 35 years.)

Gold's forcible removal as the monetary metal was done in two convenient steps, 35 years apart.

(1) In 1933 the U.S. government defaulted on its domestic monetary obligations, including the dishonoring of the promise printed on every Federal Reserve note, to pay the bearer gold coin of the specified weight and fineness upon demand, and the repudiation of the gold-bonded public debt held by its own citizens. To be sure, it was repudiation. If you contract debt payable in gold, and then at maturity you pretend to pay off your debt with another promise payable in never-never land in the never-never future, then you have repudiated the debt, haven't you? And the pretense that you have discharged the obligation has made the repudiation worse, hasn't it?

(2) In 1968 the U.S. government defaulted on its gold obligations to foreigners as well (the initial *de facto* gold embargo was made official in 1971). To add insult to injury, the U.S. government (after some behind-the-scenes arm-twisting) put a gag-order into effect. The injured party was not allowed to call a spade a spade. An international obligation, solemnly agreed to at an international conference enjoying the widest publicity, duly ratified by Congress and subsequently affirmed by four sitting presidents, was unceremoniously and unilaterally abrogated by a stroke of the pen. Foreign creditors of the U.S., the primary victims, were not allowed to say "ouch." They were ordered to call it an "enlightened monetary reform," dropping nothing more substantial than the trappings of a "barbarous relic," in the words of John Maynard Keynes.

Such a level of bad faith in monetary dealings, compounded by the gag-order, was surely unprecedented in the financial annals. Previously, a defaulting government had to bear the shame, and live it down before it could rejoin the exclusive club of credit-worthy nations. Now the offender's deserts were not only high praise for a courageous deed in fighting superstition, but also license to keep on plundering its neighbors' natural and human resources through the fiat money system.

Even today textbooks refrain from calling the 1933 and 1968 repudiation by its proper name, default. A new breed of professors, including Krugman (who was born after these defaults took place) lionize the U.S. for cheating its domestic and foreign creditors, and plunging the nation and the world into the worst experimentation with fiat paper. Some dismal monetary science, indeed!

Recitativo

There are other possible mediums of exchange beside gold, and it is silly to imagine that this pretty, but only moderately useful, substance has some irreplaceable significance.

Rondo

It is incredible that this monetary economist has apparently never heard of marginal utility. Every substance, in addition to its main applications, has a marginal application (which determines its marginal utility), as well as several submarginal applications. Bread, for example, has its main application as staple food for humans. A marginal application of bread was inadvertently found by Queen Marie Antoinette of France who later paid with her head for her discovery on the scaffold during the French Revolution. When she had heard that people had no bread to eat, she asked:

"Well, why don't they eat cake?" Accordingly, the marginal utility of bread is determined by its marginal application which is to be eaten for dessert, instead of cake, if you have it. But bread could also serve as fodder to animals, and it could be used as fertilizer of agricultural land. If it isn't, it's because it is far too valuable for these "submarginal" applications.

It is no different with gold. Its main application is to serve as the monetary metal. Marginal application is in jewelry. But the list of the submarginal applications of gold is endless, thanks to its fine physical and chemical properties such as malleability, ductility, conductivity, non-corrosiveness, among others. It is the last-mentioned property of gold which Lenin's fertile imagination used, dangling it before the hungry eyes of his starving subjects, to illustrate the blissful conditions prevailing under Communism. Lenin observed that there was no better material with which to plate public urinals. It was precisely this application to which the "capitalist metal" would be put after the final victory of Communism, Lenin said.

You may object that gold is far too valuable for this submarginal application and, as a consequence, the gold plating of public urinals would be picked just as quickly as they were installed, by the beneficiaries of the Soviet paradise. Lenin, of course, would have an answer ready to meet this objection. The Cheka (secret police) would take care of saboteurs who picked the gold plating of public urinals, and would shoot them on sight. To say that gold is only moderately useful betrays ignorance of Himalayan proportions. Ignorance of technology but, no less, ignorance of microeconomics.

Whether gold is irreplaceable or not as money remains to be seen. It will not be decided by quacks and imposters posing as doctors who have banned the use of gold as a thermometer, expecting that the patient will not run a temperature if he remains blissfully ignorant about his feverish condition. Can it be reasonably doubted that the patient, if he survives, will chase the quacks away, and rehabilitate the thermometer to its former use?

Recitativo

There *is* a case to be made for a return to the gold standard. It is not a very good case, and most sensible economists reject it, but the idea is not completely crazy. On the other hand, the ideas of our modern gold bugs *are* completely crazy. Their belief in gold is, it turns out, not pragmatic but mystical.

Rondo

I do not speak for the gentlemen named by Krugman as "modern gold bugs," but I am happy to present the case for the gold standard as I see it. I am prepared to submit it for general discussion before any competent and impartial forum to judge whether it is "completely crazy" or not.

The gold standard has nothing to do with stabilizing the price level that is neither possible, nor desirable. It has to do with the stabilization of the rate of interest at the lowest level compatible with savings and production, which is both possible and utterly desirable. Under a gold standard there is no bond speculation, just as there is no foreign exchange speculation. There are no derivatives markets in interest-rate futures the size of which, as measured by the liabilities of speculators, is in the *hundreds of trillions* of dollars, which is *more than the market capitalization of the entire globe* (or soon it will be). Under a gold standard talent must find outlet in productive enterprise rather than in gambling.

Bond speculation is the heel of Achilles for the regime of irredeemable currency, that will cause its self-destruction in due course. Like an incubus, it sucks all the economic resources of the world, and robs it of the best talent. The tricksters who grabbed the gold belonging to the people of the U.S. and its foreign creditors were unaware that their looting would let the genie of destruction, bond speculation, out of the bottle. How can we explain this colossal oversight?

Interest rates were stable under the gold standard, and the small variation in bond prices did not admit a profitable opportunity to speculate in bonds. But bond speculation started as soon as the gold anchor was cut in 1971, on the dot. The "brain trust" of apologists for irredeemable currency can develop theories about bond speculation, suggesting that it has a stabilizing influence on interest rates, just as commodity speculation has on the prices of agricultural goods. Let us bypass, for the sake of argument, the fact that this stabilization was automatic under the gold standard. Any effort to prove that speculation has an analogous stabilizing influence in both the commodity and the bond market is doomed to failure. It ignores the fact that the supply of bonds is controlled by man, in contrast with that of agricultural goods, which is controlled by nature.

The analogy is flawed beyond the hope of repair. Commodity speculation is self-limiting. It is limited by the size of available supply. By contrast, bond speculation is not self-limiting. It is self-aggrandizing. The more it grows, the more bonds will be printed. Or, to save the cost of printing, the more bond-derivatives (futures, call options, put options, options on futures, etc., *ad libitum*) will be invented. Thereby an avalanche is set into motion which will bury innocent villages in the valley. There is nothing that the protagonists of "managed money" can do about it. Bond speculation introduces distortions into the economy that will inevitably cause the downfall of the regime of irredeemable currency. It may or may not be through runaway inflation as in France during the last decade of the eighteenth century. It may be through runaway deflation. In either case, there will be enormous economic pain.

What Krugman calls "mystical," Keynes called "psycho-pathological." Another famous quotation from him is that "the desire to palm gold is a human aberration that the economist passes on to the psycho-pathologist for study with a shudder." Well, gold is *the ultimate* means of payment, such as the regime of irredeemable currency hasn't got and will never get. Gold is voluntarily accepted in final settlement of debts by all creditors. In this capacity, gold can be applied as the agent of the bubble-test. If an individual wanted to make sure that he would not be victimized in a check-kiting scheme, all he had to do was to demand that his check be paid in gold coin. Why is the joy one feels over one's ability to frustrate would-be criminals "psycho-pathological"? What is "mystical" about one's desire to protect oneself against check-kiting?

The litmus-test to find out whether a monetary economist serves the cause of the search for and dissemination of truth, or whether he has a hidden agenda, such as to cover up for the looting of the people's gold, is to engage him in a discussion on the subject of interest rates under the regime of the irredeemable dollar as opposed to the gold dollar. Apologists for the gold-looting invariably wriggle out.

I hereby challenge Paul Krugman to open the columns of *The New York Times* for such a discussion.

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