GOLD BACKWARDATION

AND THE

COLLAPSE OF THE TACOMA BRIDGE

THE DAILY BELL INTERVIEW

with Professor Antal E. Fekete
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Q. Nice to speak with you again. Let's jump right in. Why is the price of gold declining?

A. Columbia University professor Michael Woodford, the world's most closely followed monetary theorist said recently that if we are going to scare the horses, might as well scare them properly. He said it in an allegorical sense: loose talk about ending QE and about exit strategies are amateurish. Telling the world that central bank financing of the public debt is here to stay and that QE is forever, is professional. The allegory can be extended from fiscal policy to monetary policy as well. The demand for dollars is waning spectacularly due to its unprecedented debasement that, to add insult to injury, is done with great fanfare. The price of paper gold was declining in April because Bernanke now thinks it's time to scare the horses properly. They have strayed too far afield to graze. They should get back to the dollar turf.

Q. Where is the price of gold headed from here?

A. The price of gold is headed for extinction. I for one don't believe that the price of gold is headed for five digits. Long before that might happen, permanent backwardation* would shut down the gold futures markets. Gold could no longer be purchased at any price. Gold would only be available through barter. World trade is facing an avalanche-like transformation flattening out monetary economy into barter economy. Practically all

economists, financial writers and market analysts have missed this possible scenario. They don't see the greatest economic contraction ever staring them in the face. They don't see the coming tsunami of unemployment. Very few see deflation as indicated by the progressive disappearance of cash gold. It never occurred to Bernanke that the new Federal Reserve notes he is printing galore could also go to purchase physical gold, causing the gold basis to shrink. Once the gold basis* goes permanently negative, the total U.S. debt, all $16 trillion of it, will not be worth one ounce of gold. That will pull the rug from underneath the international monetary system. Barter is the ultimate in deflation, and that is what the world economy is getting.

Q. Is gold a commodity?

A. Gold (and silver) must be distinguished from other metals and other commodities. Gold is a monetary metal due to the fact that its marginal utility declines at a rate lower than that of any commodity. For this reason 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. Also, the threat of a lower or falling price for paper gold, far from „scaring the horses properly", will induce people to dump paper gold and make them flock to cash gold. Keynesian and Friedmanite economics have wiped out the distinction between ordinary commodities and monetary commodities. Today no university offers courses treating the gold basis, the gold cobasis and their interplay, or on the apocalyptic threat of permanent gold backwardation. At the New Austrian School of Economics we do offer those couses.

Q. How about silver?

A. Silver is not an ordinary commodity either. Like gold, silver is also a monetary metal. Its marginal utility declines at a rate slower than that of any other substance save gold. The silver basis, just like the gold basis, has shown a secular decline from its maximum, the full carrying charge to zero and beyond, proving that the supply of 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. It is an intriguing question which event will come first. While there is a strong argument that its greater relative scarcity will trigger permanent backwardation of silver first, it's hard to see how permanent backwardation of gold can lag that of silver, making it probable that the two events might occur simultaneously. Be that as it may, either event will create an unprecedented and uncontrollable turmoil in the financial markets, for which Bernanke is utterly unprepared. Practically nobody realizes that the root cause of all the bubbles, price-shocks, currency crises, as well as the more recent deflation in Japan, Europe and America was the secular decline in the gold basis. The „Big Bang" occurred in 1971, when the U.S. defaulted on its international gold obligations.

Q. Why do they fix the price of gold in London? Is this how commodities should be priced?

A. Of course, they don't fix the gold price in London. It's more like taking a snapshot and pretend that the landscape was frozen thereby. It is another question that the London gold fix could come handy in trying to manipulate the gold price and to „scare the horses properly".

Q. Are gold and silver manipulated or is the current shake-out a result of too-high market expectations?

A. My own position is that manipulation in the gold and silver markets, if that's what's been occurring, is far less important than it is made out to be by market observers. Having said that, I also believe that after four decades of neglecting to study the phenomenon of the secular decline in the gold basis, Bernanke woke up and realized the extremely grave danger of permanent gold backwardation. The likely cause of the 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".

Q. Should gold and silver compete with other money to provide the world with a free-market money standard?

A. I don't have much respect for Hayek's position that choosing the monetary standard should be „left to the free market". The market has already spoken. Hayek was not a friend of the gold standard. He didn't really understand Menger's point that market has promoted gold to the status of most marketable good in making its marginal utility decline at a rate slower than that of any other substance. There is no need to put the world through the agony of death throes of irredeemable currencies once again. Gold would beat fiat money hands down, were it not for coercive laws making paper money 'legal tender'.

Q. Should gold be the only money?

A. It would not be practical. There is need for money for making large payments, for example, purchasing territories such as Louisiana and Alaska; and there is need for money to make small purchases and to pay the wages of day laborers. So there is need for both gold and silver. However, it would be a grave mistake to fix the exchange ratio between the two, as was done in the U.S. when Congress enacted the Coinage Act of 1792. It is significant that this mistake was *not* made by the Founding Fathers of the Republic. The U.S. Constitution did *not* mandate bimetallism. It established one monetary standard, that based on the Constitutional silver dollar. It also established the gold eagle (without naming it) but did not make it the standard coin of the realm. 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. That mistake led to a charade of tampering with the monetary standard, to the outrageous demonetization of silver in 1873, and to the even more outrageous demonetization of gold a hundred years later, in 1973. Time will show that these two demonetizations caused the greatest anguish in history second only to the world wars, namely, the collapse of the international monetary system that is still shrouded in the future.

Q. Should the state fix the price of gold within the context of a neo-gold standard?

A. It is an error to say that the essence of the gold standard is to fix the price of gold, and the way to return to a „neo-gold standard” is to re-peg the gold price. This error was maliciously spread by Milton Friedman in an effort to promote the view that the „natural state of things” for currencies is floating, and it was an inadmissible state intervention in the free market to fix the price of gold thus putting the straitjacket of the gold standard on the economy. In truth it was not the gold price that was fixed in terms of government promises to pay, but the value of promises to pay was fixed in terms of gold. 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.

Q. Is gold susceptible to private market forces? You indicated recently that it is.

A. What I said was that one ought to distinguish between the *value* of gold and the *price* of gold. The value of gold, like the length of the yard, is not subject individual preferences or to market forces. The price of gold, insofar as it is the reciprocal of the price of the dollar in terms of gold, is susceptible to individual preferences and to market forces. To say that the price of gold reflects the value of gold is akin to saying that an anamorphic mirror renders the true shape and form of things.

Q. Is it possible that there is too little gold in a free-market economy? Would you say that in such a case people gradually cease to hoard it and recycle their hoarded gold into the market?

A. You got it. 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.

Q. What means too much or too little gold? How does an economy tell?

A. Under the gold standard the amount of gold in circulation tends to be just right. If people think there is too much, they could melt, hoard or export the gold coins of the realm in their possession; if they think there is too little, then they could exercise their Constitutional right to free coinage, take their old jewelry or newly mined gold to the Mint and exchange it for gold coins of the

realm. The result of this flow of gold from the Mint to the refinery and back is that the number of gold coins in circulation is always optimal, conforming to the wishes of the people (and not to the wishes of the bank or the government).

Ludwig von Mises dismissed the idea of gold having constant marginal utility. According to him constant marginal utility would imply infinite demand for gold which is contradictory. This is the greatest flaw of the economics of Mises: the rejection of the essential nexus between gold and interest. Mises ridiculed John Fullarton for conjuring up the *deus ex machina* of gold hoards. This was as unfair as it was untrue. The concept of constant marginal utility is *not* contradictory, because the rate of interest is obstruction to gold hoarding. If it is sufficiently high, gold hoarding fades out and gives way to dishoarding. Equally important is the fact that if the rate of interest is too low or, more precisely, if the government and the banking system pushes it down to a level lower than the rate of marginal time preference, then gold hoarding kicks in. People present their bank notes to the banks for redemption, or withdraw gold coins against their bank deposits. Bank reserves contract. The banks must call their marginal loans. Gold hoarding is not an aberration: it is one of the main excellence of the gold standard. It is an essential part of the system of checks and balances. It constrains the banks and the government preventing them from expanding credit or running open-ended budget deficits and going into debt without seeing how the debt will be retired. It gives teeth to time preference which would otherwise be just a pious wish. Take gold out of the hand of the people, and you give free rein to the banks for unlimited credit expansion, and to the government for constructing a Babelian Tower of Debt.

Q. When there appears to be too much gold, do people begin to hoard?

A. Instead of saying that there is too much or too little gold, it would be more accurate to say that the rate of interest is too high or too low. Under the unadulterated gold standard the rate of interest gages the amount of gold in circulation that is needed for the optimal functioning of the economy. According to Mises, interest is *not* a market phenomenon. It is *apodictic*: the manifestation of time preference. However, like marginal utility, time preference does not exist in the abstract. It always refers to an individual, whether he be a Scrooge or a prodigal son. Time preference varies from person

to person. Therefore it makes sense to talk about it only if *marginal* time preference is meant. Mises failed to make this refinement.

Q. If there is too much or too little gold, do mines react by opening or closing? Is this a free-market supply and demand response?

A. I have an extremely low estimate for the I.Q. of the average manager of a gold mine. However, he probably can tell profit and loss apart. The problem is that the lag or reaction time between the mines increasing output and what you call too little gold is far too long. In the 1980's the gold mining industry invented „hedging" that in reality was no hedging at all. It was forward selling of gold, completely oblivious that short positions must eventually be covered making gold miners scramble at the exit door trying to squeeze through simultaneously when the gold price explodes. In the 1990's I warned Barrick's Jamie Sakolsky (then CFO, now CEO of the company) in person, but he spurned me. „Hedging" was his baby, no one could question its beauty. Well, the baby grew up to become a monster that is still haunting Barrick, as the abrupt abandonment of Pascua Lama shows. What was the rush to sink the shafts when the gold price was languishing in the $300 - $400 range? They should have worked on the title of the property instead. The point is that the gold mining industry got it all wrong about its product, the monetary metal gold. Gold miners treated it as if it was just another base metal like copper. They did not have the foggiest idea about the anomalous behavior of gold in relation to the Law of Supply and Demand. Gold mines sell gold hand over fist, rain or shine, but *never buy it* as sometimes they should. Nor would they consider cutting production back when the gold price is soft.

Q. Has gold always been money? Was gold only considered money when it was coined by the state?

A. Silver was money before gold. The first coins were made of electrum, a natural alloy of gold and silver, in the 6th century B.C. We know that silver and gold ingots circulated long before the invention of coinage (and seigniorage) by the state.

Q. Did the state invent money as Greenbackers maintain?

A. According the Knapp's *State Theory of Money* it did. Keynes embraced Knapp's doctrine. That was how he purported to explain the forces which make value for irredeemable paper. When Knapp's thesis that whatever the state declares to be money *is* money was met with the objection that state paper money, if irredeemable, was bad money, he was still sticking to his gun: „because indeed it has to be money in order to be bad money." We may rest our case *contra* irredeemable state money with that statement of Knapp's.

Q. Wasn't Silvio Gesell a Greenbacker and also a Fabian? Why did he try to engineer a gradual state-mandated decrease in the value of money so as to speed up the velocity of money?

A. He was also a Communist. Gesell was the Commissar of Finance in the short-lived Bavarian Soviet Republic in 1919. During his very brief tenure he tried to establish Freigeld in Munich to make sure that money is returned to circulation and is never hoarded, by imposing a stamp tax also known as demurrage on bank notes. That would make people scramble to spend it before the stamp tax fell due. Freigeld earns its name by the property that it makes the incentive to hoard money disappear completely. It is supposed to be an anti-deflationary measure speeding up the velocity of money. Money automatically loses part of its value with the regularity of the clock striking the hours. Freigeld was claimed to be the safest way of reducing interest rates to near zero and to increase the velocity of money. We may recognize ZIRP (Zero Interest Rate Policy) of Bernanke as an imitation of the scheme of Gesell. Keynes also looked at Freigeld to keep the wolf of *liquidity preference* away from the door. The theoretical case for the gradual suppression of the rate of interest to near zero rests on the fact that it increases the present value of durable goods, thus providing incentives for investments – as opposed to paying down debt.

The theory of gradual reduction of interest rates as a way to stimulate economic activity is totally untenable. Businessmen will stay lethargic as long as the fall continues. They will refuse to take the loans offered. They know that what looks like a low rate today will be a rate too high tomorrow.

Entrepreneurs who finance their business today will have a hard time to compete with those who finance theirs tomorrow, who in turn will have a hard time to compete with those who finance theirs the day after tomorrow. The upshot is that no sound investments can be made as long as the fall of interest rates continues. Bernanke and his Fed think that they sow the seeds of inflation, but they will only reap deflation, lots of it. The tragic thing is that people are preparing for inflation whereas they should be preparing for deflation. They will be devastated when they find out that the leadership at the Fed and the Treasury didn't know what the heck they were doing while they were ZIRPing.

Q. You have a theory asserting that a regime of falling interest rates causes capital erosion and, ultimately, capital destruction. You have been criticized by those who find this counter-intuitive. They say that as interest rates keep falling, so does the cost of capital, reviving profitability and stimulating investments. How do you resolve this apparent contradiction?

A. You must distinguish between a *low but steady* interest rate regime that is salubrious and a *falling* interest rate regime that is lethal to the economy. I have just explained how falling interest rates make it impossible for businessmen to make sound investments. Actually the situation is far worse. Not only is capital formation inhibited, but on the top of that existing capital is endangered. Under a prolonged decline of interest rates capital is being eroded and, ultimately, destroyed. If this seems paradoxical, it is because of the reluctance of the mind to admit that a higher bond price represents a higher liquidation value of the underlying debt – an obvious proposition. In other words, a fall in the rate of interest, far from *alleviating* the burden of debt, *aggravates* it.

Here is what happens. The rate of interest falls. The liquidation value of debt, contracted earlier at higher rates, rises. Why? Well, because now the stream of amortization payments is being discounted at a *lower rate*. Therefore at maturity there appears a shortfall. *This shortfall represents the impairment of capital.* Accountants may ignore it, but only at the peril of the firm that one day will wake up to find that, surreptitiously, it has been denuded of capital. All accountants and bank examiners in the world, aided and abetted by governments, overlook the impairment of capital due to the falling interest rate structure.

Q. Is there such a thing as velocity of money? Is it necessary for a viable economy?

A. Most certainly there is. Money is a two-dimensional entity. Quantity is one and velocity is the other dimension. The Quantity Theory of Money tends to forget about the second dimension. Zero velocity means barter: the death of monetary economy. Too high velocity means that money is unfit to be saved and people will increasingly refuse it in exchange for real goods and real services. Keynesian economics teaches that saving is a vice; it is anti-social or worse. Items in the balance sheet of the government can be freely shifted from the liability column to the asset column. That way, capital can be made a free good. Keynes, who studied Gesell's Freigeld thoroughly, arrived at the conslusion that gentle inflation was superior to Freigeld. Friedman chimed in suggesting that the rise of prices can be checked through fixing the rate of increase in the stock of money. They were all wrong. They all promoted the exponential explosion of debt. Gold is indispensible as the only ultimate extinguisher of debt. It weeds out unwanted and toxic debt automatically. It is the flywheel regulator of the economy: it keeps the velocity of money at its optimum.

Q. Is the Misesian business cycle theory valid?

A. I have criticized the Misesian business cycle theory for suggesting that businessmen are unable to learn. Time and again they fall for the false signals of low interest rates, caused by the propensity of the banks and the government to expand credit, leading to economic miscalculation as to the quantity of available capital goods. But in fact successful businessmen are the most intelligent people we have. Why don't they learn and take correction, factoring in the undercutting of interest rates by the banks and the government, in their calculation of available capital goods? Engineers make such corrections routinely. Why can't businessmen?

An improved theory of the business cycle would consider the causality relation between prices and interest rates. 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 (or falling) prices make interest rates rise (or fall) and, conversely, rising (or falling) interest rates make prices rise (or

fall). Prices and interest rates oscillate. There are three types: damped, steady and runaway oscillation. The first, where the amplitude peters out in time due to friction, is extremely common. Steady oscillation occurs if carefully measured boosting provided by resonance is present − as in generating alternating current or radio waves. Runaway oscillation is also due to boosting − not to say ’overboosting’. It makes amplitudes get ever larger due to periodic injection of energy. The injection of energy, here just as in the case of steady oscillation, is provided by resonance. Unless injection is cut back below the level of steady oscillation, runaway resonance will end in the self-destruction of the resonating system. Prices resonating with interest rates make for such a system. The oscillation of prices is boosted by the oscillation of interest rates. Resonance results. But because of the ignorance of the Federal Reserve, overboosting occurs: the periodic injection of excess credit kicks the system to ever higher energy levels. Empirical evidence is provided by the sloshing of excess money back and forth, like tide and ebb, between the commodity market and the bond market with increasing intensity, until the system breaks down. If breakdown occurs during the phase when the rate of interest is rising and money flows from the bond market to the commodity market, we talk about *hyperinflation*.

But there is also a second variety for which no precedent exists because we have no previous historic example of experimentation with *global* fiat paper money. If breakdown occurs during the phase when the rate of interest is falling and money flows from the commodity to the bond market, then we have what I call *hyperdeflation*. That is what we are apparently having right now. It started over thirty years ago in the early 1980’s. When in January 1980 interest rates failed to break out on the upside (as appeared likely at the time, with the gold price hitting $875), the system went into the mode of declining interest with such a force that put the Fed out of control. For the past three decades interest rates have been falling relentlessly. Of course, the Fed would like to have us believe that this is the result of deliberate monetary policy. I suggest it to you that it’s not. It is runaway resonance in action − on the side of interest rates and the velocity of money falling to zero. Fall they do inexorably. It is hyperdeflation. The Fed is desperately trying to fight it, but all is in vain. We are on a roller-coaster ride plunging the world into zero-velocity of money and into

barter. In my lectures at the New Austrian School of Economics I often point out the similarity with the collapse of the Tacoma Bridge in 1941.**

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

A. According to Rothbard and the American Austrians commercial banks claim that they hold gold reserves dollar for dollar against their sight liabilities, which is a lie, because up to 95 percent of their reserves against bank notes and bank deposits is made up by mere paper claims to gold. Fractional reserve banking is fraud, in whatever shape and form it may come – they say. However, there is such a thing called *self-liquidating credit* that Rothbardians refuse to recognize. It is represented by real bills covering goods in most urgent demand and moving to the ultimate consumer with all deliberate speed. It must mature in 91 days or less. This credit is self-liquidating as it is paid out of the proceeds of the sale of goods. The origin of this credit is not in *saving* but, paradoxically, in *consumption*. It is regulated not by the *rate of interest* that varies inversely with the propensity to save, but by the *discount rate* that varies inversely with the propensity to consume. Those commercial banks that abstain from borrowing short to lend long do not pretend that 100 percent of their reserves are held in gold coins. They point out that one ninetieth of their assets 'mature' into gold coins every day, and if that proves to be insufficient to meet redemption demand of their sight liabilities, then they can always liquidate real bills in their portfolio without losses. The bill market is very liquid, as there is a virtually unlimited demand for real bills, which are the best earning asset a commercial bank can have. The American Austrians are barking up the wrong tree. They should criticize the tendency to replace real bills with anticipation bills and Treasury bills, neither of which is self-liquidating. Instead, they throw out the baby with the bathwater in failing to distinguish between real bills and fraudulently constructed accommodation bills.

Q. Are banks necessary in a free-market environment?

A. That's just it, they aren't. In the original model of Adam Smith the existence of commercial banks is *not* postulated. Real bills circulate hand-to-hand as cash through endorsement, while the discount is calculated and taken out of the proceed. Commercial banks cropped up because of the convenience of bank

notes denominated in round figures as compared with the face value of real bills in odd figures. Moreover, bank notes eliminate the nuisance of endorsing and the calculation of discount. For this convenience clients are willing to forgo the discount due to them. In my interminable debates with the American Austrians I have failed to convince my opponents that if they want to knock real bills, they must not refer to bank fraud because real bills do indeed circulate in the complete absence of banks.

Q. Could the banks offer real bills in a free-market money system?

A. No. Real bills earn their name by representing consumer goods in the greatest demand. Only producers and distributors of real goods and real services can draw real bills, not banks. Banks *discount* real bills.

Q. Please explain how real bills work and why they are so important.

A. It stands to reason that the demand for purchasing media varies with the seasons. Just before Yule-tide much more of it is needed than afterwards. It is utterly unrealistic to expect that the pool of circulating gold coins with its inelastic volume can meet the highly variable demand for purchasing media. The market responded by promoting the bill drawn on the retail merchant by the wholesale merchant, or on the producer of lower order goods by that of higher order goods, to become *ephemeral* cash. This is *not* inflationary because the ephemeral cash arises together with the rise of the new merhandise in production, and it expires simultaneously with the removal of the merchandise from the market and with its disappearance in consumption. The bill market made possible an incredible increase in world trade and prosperity in the 19th century. World War I put an end to it all. The victors, out of spite against Germany, vetoed the rehabilitation of the bill market after the end of hostilities. The *blockade* of Germany could not continue in peacetime, but the *blocking* of bill-financing of German trade could and did. Multilateral trade was replaced by bilateral trade, a major step in the direction of deflation since far more gold is needed to support bilateral than multilateral trade. This foolish, spiteful and, yes, deflationary policy boomeranged in the form of the Great Depression of the 1930's. As warned by the German economist Heinrich Rittershausen in 1929, the Wage Fund (out of which workers whose production

may not be sold up to 91 days, that constituted the major component of outstanding bills) was destroyed as a result of blocking the international bill market and mass unemployment ensued. The warning was dismissed as German chauvinistic propaganda. There was no one who could advance the wages of workers once the bill market was blocked. Evidence of the conspiracy to block the rehabilitation of the bill market in 1918 was hushed up and research of the causal relation between the cessation of bill trading and mass unemployment was put under a gag order. Keynesian economists use the whipping boy of the gold standard as the scape goat responsible for the Great Depression. I am in the minority of one pointing out that the real culprit is not the *gold standard*. Quite to the contrary, it is the *destruction of the gold standard's clearing house*, the international bill market.

As far as the future is concerned, the importance of real bills must be seen in the light of the inexpedience of barter in a complex economy. People will want to *trade*, they don't want to *barter*. After the demise of the dollar, in the absence of purchasing media people will reinvent real bills payable in gold at maturity. That is the only way to alleviate deflation and mass unemployment world-wide.

Q. Is it necessary for the state to pass a law to ensure that real bills be accepted as money?

A. Absolutely not. Real bills circulate spontaneously, on their own wings and under their own steam. If a bill is refused at the discount window, it is a sign of trouble. Somebody somewhere is drawing bills on nonexistent goods, or on goods that have been arrested for purposes of speculation, or recycling bills drawn on unsold merchandise – all of which are against the rules of bill trading.

Q. For real bills to circulate would state coercion of any sort be necessary?

A. Absolutely not. Even Mises admitted this when he commented on bill circulation in Lancashire before the Bank of England opened its branch office in Manchester. The rules of bill trading were developed by the free market, not by the state.

Q. What about accounting? Is it necessary for the state to impose universal accounting principles from a free-market standpoint?

A. According to an old adage laws are made to be broken. The same idea applies with double the force to accounting standards imposed by the government from above. If the government can make them, it can also scrap them, it can ignore them overtly or covertly. This is happening right now, when governments routinely allow bank examiners and chartered accountants to disregard accounting standards. Sovereign debt is given the highest rating in spite of the absence of bids for it. Impairment of capital due to ZIRP is universally ignored − as I have just explained. Basel III rules on gold in bank reserves are established to make gold the fall guy, and later the whipping boy, just in case if public opinion succeeds in forcing a return to the gold standard. As a result of officially sanctioned fraud, the world's banking system today is not just illiquid; it is in fact insolvent. *It is operating without capital.* You cannot make mud liquid by adding a drop of water; you cannot make bank reserves liquid by allowing the admixture of an ounce of gold. By contrast, accounting standards developed by the free market cannot be tampered with as everybody would immediately learn about it.

Q. You started the New Austrian School of Economics. Can you explain what this name implies?

A. It implies the return to the letter and spirit of Carl Menger. It means the rejection of the Equilibrium Theory of Supply and Demand, replacing it with the Disequilibrium Theory as manifested by the dichotomy of the bid price and the asked price. It implies the dethroning the concept of price and enthroning the concept of spread. It implies the recognition of marketability as the prime gage of the *quality* of money, instead of its *quantity*. It also implies a respectful criticism of Mises. It implies the rehabilitation of Adam Smith's Real Bills Doctrine. It implies an abiding interest in studying the phenomena of econpomic oscillation and resonance. It implies spreading the truth about the universal impairment of capital under the regime of falling interest rates.

Above all, it implies the continuation of Menger's pioneering work on the origin of money, by working out the dual theory on the origin of interest. The fratricidal war between the Time Preference School and the Productivity School

of Interest must end. 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 but splits into floor and ceiling rates. These two must be studied separately. The ceiling rate can be understood in terms of marginal productivity; the floor rate in terms of marginal time preference.

Q. Why is the Austrian Rothbardian wing dismissive of real bills?

A. The Real Bills Doctrine is a thorn in the flesh of the Quantity Theory of Money to which the Rothbardians are uncritically committed. The Quantity Theory of Money is a clever mechanical metaphor rather than a valid theory. It fails because it is based on the misconception that change is always a *linear* phenomenon. It is not, save a few exceptions. The world runs on highly *non-linear* tracks and, just as in physics, non-linearity generally cannot be approximated by linearity. The Rothbardians are cultists. Their dogmatic approach endangers the success of a future gold standard that, Phoenix-like, will arise out of the ashes of this latest disastrous experiment with irredeemable paper money.

Q. Will real bills make a comeback?

A. Most assuredly they will. People will not go hungry, unclad and unshod, and they are not going to shiver in winter for the greater glory of irredeemable currency advocated by Knapp, Gesell and their *epigoni*, Keynes and Friedman. The circulation of irredeemable bank notes may seize up without warning, causing innocent people excruciating economic pain. But people will rise out of their misery and will continue producing food, clothes, shoes and fuel, and will trade them against payment in the form of real bills maturing in gold. That's what happened in the past, and that's what will happen in the future. The demise of the system of irredeemable currency is a foregone conclusion. Not only is it illogical; it is also immoral. A free society cannot be built on a coercive basis. Moreover, the regime of irredeemable currency is incompatible with the ideal of *limited* government. It grows into a system where farmers are paid for not farming, and workers are paid for not working.

Q. What is next for the New Austrian School of Economics?

A. We are doing research as well as teaching. We offered courses in the U.S., New Zealand, Australia, Hungary, Germany and, most recently, in Spain. There are plans to cooperate with the University of Avila. A more distant plan calls for presence in the Ukrainian city of Beregovo. Concerning research, we offer studies at the Master's and the Ph.D. level. An urgent topic to research is how the avalanche triggered by permanent gold backwardation flattens the landscape of monetary economy into barter economy. Another topic we intend to elaborate on is the theory of economic oscillations and resonance.

Q. Any literature you want to mention?

A. We have granted two Ph.D. degrees so far, one to Sandeep Jaitly and the other to Keith Weiner. Their dissertations are available from the authors and I can recommend them to everyone wanting to learn more about New Austrian Economics. A third Ph.D. degree is in the making; the candidade is Peter van Coppenolle. His proposed thesis has been published already in the form of a handsome volume under the title *The Austrian Business Cycle Revisited*, that is available from the author. I recommend it to the readers of this interview along with a book written by our Master graduate, Rudy Fritsch under the title *Beyond Mises.*

Q. Any other points you want to make?

A. The altercation between the American Austrians and the New Austrian School of Economics is a tragic waste of talent. We should settle our differences not by mud-slinging and by calling names, but through high level scientific debates. For starters, I would like to invite the critics of Adam Smith's Real Bill Doctrine to Avila, Spain, for such a high level debate. I sincerely hope that they accept and we can join forces in preparing the ground for the triumph of the gold standard after a brief reactionary period in history dominated by the regime of irredeemable currency.

Thanks for your time!

Thanks for the opportunity to present my views!

ENDNOTES

* By *gold backwardation* is meant a condition whereby the gold basis turns from positive to negative – an anomaly. *Gold basis* is the name for the difference between the price of the nearby gold futures contract and the price of gold for immediate delivery. If positive, we talk about *contango*, if negative, about *backwardation*. Contango is the normal condition prevailing in the gold futures markets *par excellence*, because the stocks-to-flows ratio for gold is the highest by far among all commodities.

Permanent gold backwardation means that, having been vacillating between contango and backwardation, the gold basis finally takes the plunge into negative territory never to become positive again. When that happens, it will be a unique historical event. It will mark the ignominious end of the forty-odd year long global experiment with irredeemable currency. Sovereign debt, including that of the United States government, will not be worth one grain of gold.

** By way of explaining the title of this interview, I recall the collapse of the Tacoma Bridge plunging pedestrians and occupants of passenger cars into the river below to their death in Washington state, U.S.A., in 1941. The disaster convincingly demonstrates the ferocity of runaway resonance. The event was triggered by gale-force winds. Yet the bridge was destroyed not by the winds *per se* – they did not carry energy sufficient to do that. It was destroyed by runaway resonance that was mounting energy to ever higher levels. It happened because the periodic strokes of the wind coincided with one the harmonics of the characteristic frequency of the bridge.

Ever since that disaster engineers take these harmonics into account when designing a suspension bridge. The event has been filmed and is available for viewing. It must be seen to be believed.

Permanent gold backwardation, if it occurs (as appears likely), will be an event similar to the Tacoma disaster. Designers of the global fiat money experiment that has been going on since 1971, just as the designers of the Tacoma bridge, have forgotten to take runaway resonance into account. THEIR RESPONSIBILITY, HOWEVER, IS FAR GREATER BECAUSE THEY HAVE BEEN WARNED REPEATEDLY THAT THEIR DESIGN WAS FAULTY. They went ahead anyway, and we have to suffer the consequences.