Episode 529: Leftist Site Attacks Gold Standard; Here's Our Smackdown

Guest: Joe Salerno and Jeff Herbener

WOODS: I was talking just a moment ago, telling people about what we're talking about today, and I'm going to be linking to an article at TomWoods.com/529 in which Ted Cruz gets attacked for supporting what sounds like the gold standard, at least something like the gold standard. And he's being attacked by ThinkProgress, and the attack is really kind of lowbrow, but yet they're the type of arguments that could stump a beginner. And I was so curious about this article, though, because the arguments are frankly so low brow that I just had to click on the name of the author. I guess his name is Alan Pyke, and I found out that his credentials consist of that he wrote on economics for another site, Media Matters, and Media Matters, like ThinkProgress, is one of these heresy-hunter websites looking for heretics everywhere, who say things that aren't approved by *The New York Times*. That's what they specialize in. They don't specialize in careful, scholarly refutations.

And Ted Cruz in the debate did step off what I call the 3x5 card of allowable opinion. He said we need sound money, and I think the Fed should get out of the business of trying to juice our economy and simply be focused on sound money and monetary stability, ideally tied to gold. All right, there's some wiggle room there, and he could step away from that, but that's the most pro-gold standard statement we heard all night, that's for sure. So I want to give you the basic complaint that you'll hear about this, and that is that we had a system like this in the past, where the paper money was tied to gold, and the result was the Great Depression, so only an idiot would want to return to a system like that. Either one of you, how do you tackle that?

SALERNO: Well, Tom, the gold standard that we had during the 1920s and after World War I, in fact, was not really a gold standard. It's a very watered down version of the so-called classical gold standard in which gold was actually an anchor, actually restricted the amount of paper money that could be printed by the Fed or by the banks, and that was before 1914. But with the onset of World War I and the establishment of the Fed, the gold was concentrated, all the banks' gold and for the most part the gold that people themselves held were concentrated in the Fed by law, I think a law of 1917, which meant then that the Fed could pyramid, could print money on top of the gold reserves. So you didn't have gold as a restrictive mechanism against inflation. So the 1920s was an inflationary decade. It was an extremely productive decade; a lot of technological improvement and saving and investment with new goods coming onto the market. To make a long story short, the Fed pumped money in at a very rapid pace to prevent the fall of prices, and that caused financial bubbles, bubbles like we have today, real estate and the stock market.

WOODS: So in other words, the problems that we faced were due to the aspects of the gold standard that were not really the gold standard. The problems were the ability to engage in artificial money creation and credit expansion.

HERBENER: Yeah, it can even be pointed out that under the so-called classical gold standard, there were fiduciary issues in the system. So under the National Banking System in the 19th century, there was some degree of this pyramiding on top of gold reserves that Joe had mentioned as the gold reserves became more concentrated in the central reserve city banks.

WOODS: Now, the author here, Alan Pyke, says, "The idea of sound money'...is that it takes away the Fed's ability to manage the value of a dollar. The supposed benefit of this is that your money's worth is more real because it is pegged to a shiny, rare metal." So of course this is a caricature. It seems to me that not the supposed, but one of the actual benefits of this is that your money's worth stays stable or increases. It's not that it's more real or whatever, although I suppose if that's how you want to put it you could, but if I look at a market basket of goods in terms of a number of dollars in 1915 and compare it to 2015, there's no comparison at all. I mean, surely that at least counts for something. There's no acknowledgment of this, that people could buy roughly the same amount of stuff or even more over 100 year period under gold, whereas now under paper if you had been an idiot and saved for the future just in paper, you would be completely ruined.

SALERNO: Yeah, that's true, absolutely. In the 19th century, prices from 1800 or so to about 1896 fell by about 20%. In other words, $1 bought roughly 20% more in 1896 than it did in 1800, whereas if you compare the timespan that the Fed was in existence from 1914 until today, our dollar's worth about 4 cents. So in other words, the value of the dollar has declined by over 95%, and it has nothing to do with — that is, the 19th century performance — had nothing to do with the fact that the dollar was tied to a "shiny metal" and that the value was real; it's simply that the gold standard restrained the number of dollars that politicians could print.

HERBENER: It might also be added that contrary to this being some kind of a fringe view, this is a fairly standard view among economists. You could even find articles written and published, written by authors at the Fed and published on their websites that say basically the same thing, that under the classical gold standard, there was a at least the advantage of stability in maintaining the purchasing power of money, even though it may have had empirical drawbacks compared to, say, Bretton Woods.

WOODS: Yeah, now that is interesting, that at least even there we get some acknowledgment of something. Here there's no acknowledgment of anything; it's stupid and only an idiot would support it. And he goes on to say that the reason that gold standard proponents prefer the term sound money is that to refer to the gold standard is to invite complaints by almost all economists. So almost all say the gold standard was terrible. Now, I personally use "sound money," because "gold standard" doesn't accurately describe my own position, because gold standard implies some kind of government role. The government is going to privilege gold in some way or whatever, and I don't favor that. I favor no involvement in money at all. "Gold standard" is close enough to what I believe, but I prefer "sound money"; it's not like I'm trying to hide something by saying that.

And he goes on to quote *The Atlantic's* Matt O'Brien — I don't know who that is; I have no idea. It could be some journalist who writes for *The Atlantic*. "Economics is often a contentious subject, but economists agree about the gold standard – it is a barbarous relic that belongs in the dustbin of history." So again, it's an idea that's from a while ago, and we all know the money's been managed super duper well since then, so really only a fool and a moron would even think there could be any merit to it. When you hear a quotation like that, that economists basically agree that the gold standard was a terrible mistake and thank goodness we don't have it anymore, what is your response to that?

HERBENER: Well let me just point out something along the lines I mentioned a minute ago, this actually isn't a kind of fringe view. The Nobel Prize-winning economist Robert Mundell gave a talk at Saint Vincent college in 1997, where I think the title of it was something like, "The International Monetary System in the 20th Century: Could There Be a Role for Gold?" — something like this — where he makes a case for some kind of a role for gold in the international system of currencies. So again, I think it's just wrongheaded. It' just factually wrong to make this claim.

SALERNO: Yeah, I would add to what Jeff said. I think in the last 20 or 25 years, there's been a lot of research on the gold standard, and as Jeff mentioned earlier, mainstream economists admit that the gold standard was effective in restraining inflation. What they didn't like or what they claimed is the flaw with the gold standard was the fact that it caused real output to be volatile. In everyday language, that means it caused recessions; it caused more recessions and deeper recessions than would have been the case if the money supply was sort of managed by a central bank. But no one poo-poos the gold standard any longer — no mainstream sane economist really does.

WOODS: It's interesting that even Christina Romer, who is not obviously a rightwing free market ideologue, went back and said that actually when you look at the correct data and you look at the period before we had the Fed and after — and before we had the Fed and after we had the Fed is not exactly the right breaking point for sound money, but it's a rough estimate — she says that the Fed is perhaps given artificially given too much credit for economic stability and the economic instability that we think we see in the 19th century has been exaggerated, that it's apples and oranges, and that when you adjust the data, it's not quite so clear that the 19th century — even though it's certainly not a hard money paradise, but it was closer to what we want — it's by no means clear that that was an inferior system. So this is Christina Romer talking. My sense is that Alan Pyke is not reading Christina Romer's scholarly articles, but I'm prepared to be corrected on that, but I rather doubt it.

And then, by the way, he says, "The gold standard" — and again, we're back to the 1920s — "forced governments around the world to restrict monetary policy just as markets crashed in the late 1920s, which helped turn a crash into the Great Depression." So okay, there are two different things we can say about this. Of course I'll link to a description of the Austrian theory of the business cycle on the show notes page so people will know where depressions come from, but also, this whole "the gold standard forced governments around the world to restrict monetary policy," it takes for granted that the monetary policy of the 1920s was sustainable, was a policy that could be carried out over the long term. And Jeff, in one of the courses you did for LibertyClassroom.com, you gave some astonishing statistics about the Dow Jones figures in the 1920s, and the growth rate or whatever the figures were were so dramatically out of keeping with past and subsequent history as to show practically anybody reasonable that something screwy was going on.

HERBENER: Yeah, that's right. If I remember roughly it was that the annualized return on the Dow from '25 to '29 was something on the order of the mid-30% per annum, so this beat even the buildup of the Dow in the '90s, where it went up maybe 25% per annum. And in fact, it's the fastest growth rate of the Dow Jones Industrial average, except for the reflation period of the early 1930s, so it actually was a faster annual percentage rate increase from I think '32 to '35 or '36. But yeah, this is certainly not sustainable. I mean, never in the history of financial markets has anything like that been sustainable, and it's pretty clear when you look, as Joe mentioned before about the monetary buildup that was allowed under the gold exchange standard, the fiduciary buildup, that that of course was the reason for the collapse, that asset prices had been boosted and stock markets reflecting that. When the collapse came, it was just popping those bubbles.

WOODS: Who was it who said — who was it — was it Benjamin Strong in the 1920s who said something along — in 1927, he said he was going to give a coup de whiskey to the stock market, and indeed that's what we got.

HERBENER: (laughing)

WOODS: That's what we got. All right, here's a thing that — I'm going to post the appropriate graph, and maybe I could label it, if I were in a bad mood, "Alan Pyke is a complete moron." But I'm not in that — I'm trying to be nicer and friendlier and warmer with people who — I mean, the thing is, if he had ignorant views about monetary policy, even if they happen to be reflected by the current crop of a lot of economists, I could let it go if he would just keep it to himself. But not only does he not keep it to himself, he insults everybody who disagrees with him. But here's what he says; he says, "By moving off the gold standard" — listen to this — "America gained the ability to manage inflation much more acutely. That's important because" — and now he gets into his I'm speaking to third graders mode — "That's important because volatile inflation makes the price of everyday goods and services bounce around wildly, which undermines economic security for consumers." I'm going to put a graph of purchasing power, and we're going to look at when it starts bouncing around wildly, and you'll never guess, gentlemen. It's not during the period of the gold standard.

HERBENER: Imagine that. (laughing) Surprise, surprise.

WOODS: I mean, that statement is so dramatically wrong — I mean, so preposterously at odds with everything we know — how does it get past the editors at ThinkProgress, he asks rhetorically.

HERBENER: Yeah, Joe and I have no role in the editorial process I guess is why.

WOODS: (laughing) And that is a shame. The world is much the poorer for that. All right, so let's go on here — oh wait a minute, hold on. No, I do still want to address this argument that the gold standard forced governments to engage in a contractionary monetary policy at the time of the crash. What does he have in mind there, and why would — if indeed it would — the gold standard have such an effect? And is that a good or a bad thing?

SALERNO: Well, I think what he means there is the contraction in the money supply between 1930 and 1933, the fact that the banks were failing and that people's deposits were disappearing and so on. But part of the problem of course is that the banks were overextended. I mean, at the end of a bubble, you're always going to find out that a lot of bad loans were made, and the alternative is to liquidate those loans. I mean, the good alternative is to allow those loans to be liquidated, to allow the investments to be liquidated, and to allow the economy to adjust prices. That's what liquidation means. It means adjusting the prices of assets and goods and labor to the underlying supply and demand realities. So the dilemma is that either you allow this to happen, and then yes, you do have unemployment, you do have a recession/depression, but then you move on after 16 months or 18 months or however long the average recession is. Or you try to prop things up, as we've done since 2009 or 2008, and you continue to have this grinding, slow growth, and people dropping out of the labor force and so on.

WOODS: And of course, an analogy might be drawn to 2001, because there you start to get the Fed engaging in quite a few cuts in interest rates in 2001, and here maybe there was some kind of a correction attempting to take place, but as, I don't know if it was Jim Grant, put it, the market's trying to send red lights, but from the Fed all the lights are green. So it's not like, well therefore we won't ever have a recession now. We got the recession, but it was much worse, because now the errors, the entrepreneurial errors are perpetuated all during the interim. And so — now of course when we look at the '20 and we look at '29 and into the '30s, our opponent here may say, but look at the terrible cost of the Great Depression, and it went on so long. Well, that's again where we would have a disagreement: why did it go on so long? Did we have a laissez faire government who just sat back and let it go on? I mean, no real historian believes that about Herbert Hoover anymore. Even PBS admits — I mean, it's all over when PBS admits that Herbert Hoover was actually a progressive. Obviously he was. His whole mentality was that way. And that goes into the 1930s. It's just tinker, tinker, tinker, intervention, intervention, intervention, and then they scratch their heads and say, why is unemployment still in the double digits? And then they try to blame us for this at the end of all that, like we did that somehow.

HERBENER: Yeah, it's important just to mention Bob Higgs' great analysis of the '30s on regime uncertainty, when the government starts this kind of tinkering policy where they keep changing things and stop and go monetary policy and so on, it creates this increased demand for investors to just hold cash and to hold back from investing. And as Joe was saying earlier, that's what slows down and maybe even brings to a halt this liquidation process. And we've seen the same thing in our recent downturn, as he mentioned. It's the same kind of reaction that investors have to the way in which the government is intervening and changing things, creating all this additional uncertainty.

WOODS: He then says — he's talking about a racial wealth gap, which I don't even see what that has to do with Ted Cruz — but he says one of the things we're going to need to do is try to close that, and he says, "A stronger job market is only one piece [of that puzzle], but it's an important one. Higher working class wages and more people finding work instead of looking for it would at least establish a floor from which families could start building assets. The Fed has a major role to play in establishing that kind of economic launchpad."

So notice, here he is a progressive, he's supposed to question authority, but instead he looks at the most significant institution in the American economy and he thinks, well, this thing could actually be helpful. Maybe a few reforms and it'll help. There's never any radical questioning. We're the only ones who ever do this kind of radical questioning that leftists pretend to do.

Then he says, "Chopping off the Federal Reserve's hands and making the dollar dependent on the price of gold again" — well, even that is a misstatement — "making the dollar depending on the price of gold again isn't how you deliver the kind of stability that promotes business investments that create jobs." I'd like either one or preferably both of you just to respond to that little passage there.

SALERNO: Well, you made a good point, Tom, when you said the Fed is the most significant authority in the U.S. economy. In fact, it's manned by unelected, unaccountable bureaucrats. I'm surprised that progressives would applaud such an institution, be in favor of such an institution. It's completely out of control of Congress. Congress does not oversee its budget. The Fed receives the money that it uses from the securities that it purchases on the open market by creating money, and it rebates all that to the Treasury, it is true. But its appropriations are not controlled by elected officials, and that's a real problem, and I'd think it would be a real problem for progressives.

One other thing I want to say is that this whole idea of low working class wages, one of the main reasons for it is because there's been so much capital destruction since the 1990. Because of the Fed's manipulation of the interest rate, it has falsified people's wealth calculation, business' profit calculations, and it's caused a tremendous amount of waste of capital, on the one hand, investing in the wrong things, and people thinking they have more money — using their houses as ATM machines, for example — and spending instead of saving, taking that money out an spending it on, you know, second homes and luxuries and other things. So it's the Fed itself, these unaccountable bureaucrats who are responsible to a great degree for depressing the wages of the working class.

HERBENER: Let me just add to that last point that Joe's making, that it is this unimpeded capital accumulation process of a market economy that actually creates a prosperous middle class, and over time this process just if left on its own will in fact generate larger and larger wealth holdings among the average person and among the working class people. But the Fed, as Joe's pointed out, actually ruins this by slowing down this process or even reversing it, and it isn't the harbinger of stability but again, quite the opposite, these long periods of capital consumption that occur because of the Fed's manipulation of interest rates and so on.

SALERNO: Can I say one thing, Tom?

WOODS: Yeah, please, come in.

SALERNO: This whole idea of a working class in a modern market economy irritates me to no end. There is no working class in a market economy in the sense that — using the term in the sense that there's people who earn money only from their labor and have actually no savings, no wealth holdings of any kind, no durable consumer goods, no pension funds and so on. There really is just a middle class who produce the wealth, and then there's a parasitic class, both the politicians and bureaucrats on the one hand and then the poor people who don't have jobs and so on who live off welfare who are the wards of the state. So those two groups are parasitic off the middle class, the wealth producers and wealth holders.

WOODS: All right, that's a good point. I'm glad you raised that. I want to conclude by looking at some of the suggestions of so-called progressive Fed critics. All right, I'm just going to read to you a paragraph from this piece, because at the end we get some points made about what progressives should demand from the Fed. So for instance, we get this: the central bank should "let inflation" — these are the exact words of the article — "The central bank [should] let inflation rise much more aggressively when it would help consumers, and discourage it from raising rates to combat inflation." Then they cite another progressive economists; we'll skip that. So it's stuff like this. So they're saying that progressive critics say that the Fed has ignored its employment mandate and focused only on inflation, but this point here that you should let inflation rise much more aggressively when it would help consumers, I can't even imagine what that could possible mean. Can you?

SALERNO: I think it's ridiculous. The statement on its face is totally ridiculous. Everyone who consumes has to obtain income in some way, so inflation always helps some consumers, those people who get the newly created money first. So the banksters, the stockholders in major firms who get low interest rate loans and so on because of the new money, these people are helped as consumers. But then other people, people on fixed incomes or people like myself who's sitting in New York on a pretty fixed salary that changes maybe every few years at a university, I don't get the benefit of that new money when the Fed's creating it. I might get it 15 months or two years later or whatever it might be, but by that time prices have risen. I'm paying the higher prices, and my real income has shrunk. So to use consumers as a class, when in fact it's really a function in economic theory is totally ridiculous.

HERBENER: It also might be pointed out that this idea that pushing interest rates down is helpful also could be criticized on similar grounds. It certainly isn't helpful for people trying to save and accumulate their wealth that the Fed is constantly involved in zero interest rate policy.

WOODS: Well, I think that pretty much does it for this piece. As I say, I'll link to this at TomWoods.com/529, which is our show notes page for today. But in closing, what would you gentlemen recommend for people who are anywhere from newbie to intermediate in this who would like to learn a little bit more so that when they see stuff like this they'll be in a position to swat it down? Where would you start people?

SALERNO: I would start them with Murray Rothbard's *What Has Government Done to Our Money?* and Henry Hazlitt's little book, *What You Should Know about Inflation*.

WOODS: Yeah.

SALERNO: Jeff, you have any suggestions?

HERBENER: No, nothing besides those. Those are of course excellent starting points. And then from there one might find a lot more literature on Mises.org of course.

WOODS: Right, right. I'm going to put those two, and then I think I'll put that collection of essays on the Austrian theory of the trade cycle, because that is an aspect of this whole issue and where is the instability coming from. We just have this vague sense that there's instability coming from somewhere, but there's nothing specific; there's no pinpointing of anything. They think the instability is somehow coming from gold, but I still can't believe this guy thinks that prices were unstable under gold and that consumers couldn't get a reliable sense of where prices were going or what they were going to be under gold. I mean, of all things to say about gold, that's the — I think that's the first time I've heard that particular complaint. It's totally crazy. We'll have a chart on the show notes page that will just blow this out of the water. I'll send it to the guy's editor over at ThinkProgress. (laughing) We'll see what happens with that. All right, gentlemen, I appreciate — I know you're both heading out the door to get to the conference up in Toronto this weekend, so safe travels, and thanks for your time.

HERBENER: Thanks, Tom.

SALERNO: Thank you, Tom.