

# **Profit as Rent: The Federal Reserve, the Gold Standard and the Disaster of American Monetary Policy**

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As World War II began, Wilhelm Ropke wrote his famous *International Economic Disintegration* (1942). His argument was in favor of an objective standard in financial life. When this is missing, the speculative tendency takes over. When fiat money takes the place of gold, the framework for international relations breaks down. The lowering of currency values soon goes beyond money and drives state expansion, the constant search for raw materials and cheap labor. In other words, the foundation of world cooperation can only be based on an objective standard of discipline. However, in more normal times, gold serves as a brake on the desire of power elites to use the printing press to cover the results of their own profligate spending or professional incompetence. The Federal Reserve was the creation of this very outlook.

Bringing the power of the currency into the hands of elite private bankers was to shift the balance of power entirely to the hands of oligarchs. The gold standard became a dead letter once bankers became more powerful than governments. The formal dismissal of this standard in the 1970s was just a belated recognition of what had existed for decades. The point is that the present system of printing money by and for the Federal Reserve is wrong.

American monetary policy is one of the essential issues in global politics. This is because the dollar is one of the primary currencies of world capitalism and dominate the economies of the entire planet. The economic health of the world, but especially the livelihood of the American people, are at stake in any monetary decision. The argument is that first, the gold standard is a requirement of fiscal discipline but just as significantly, second, that the present structure and mentality of the Federal Reserve is not only dishonest, but irrational.

The Federal Reserve can best be summarized as a government entity ruled over by private interest. These includes members of the Board appointed by the President of the United States, the Federal Open Market Committee, and twelve regional Federal Reserve Banks. This structure is the financial focus of American life and to a great extent, is responsible for the economic health of the globe (Ropke, 1959: 75-77).

It should be noted that the strictly formal abandonment of gold under Richard Nixon was without substance. The Bretton Woods system was not a gold standard, but the dollar standard claiming it was gold. It was the American empire that decided on the value of currency, not a strictly pro forma acceptance of the standard itself (Rothbard, 2001: 8).

The presidential appointment idea assumes that the bankers appointed are politically weaker than the president. Since this is a “checks and balances” example (though a novel one), the president cannot be dependent on those he appoints. If he is, and if bankers are more powerful than presidents, then the system breaks down. Today, there is no one obtuse enough to argue that the American executive is anything but dependent on Fed policy.

The capital behind the Federal Reserve has a purely based on corporate and private ownership. In other words, the fiscal agents of the US Treasury are banks that perform for-profit transactions on securities, the payment of interest and dividends, disposal of loans and other financial services. Here, the “client” is the United States Treasury.

The “independence” of the monetary power is based on the desire to ensure a balance between taxpayers and the government. This is to say that the Fed justifies itself by arguing that putting money in the control of those who profit from market transactions is superior than putting the dollar in the hands of politicians. Putting it in the hands of the major banks is considered synonymous with “independence.” Gold, on the other hand, puts the value of treasury securities in the hands of the natural order, since gold is fairly rare, is not easy to mine and is normally not subject to sudden changes in supply (Rothbard, 2001: 11-15).

The Thirteen Colonies in North America under the British empire were generally well-off in many respects. The sheer size of the New World meant that land was both good and inexpensive, and the Protestant, Anglo-Norman settlers showed great determination. The connection to Great Britain meant they were plugged into the very center of world banking and commerce. However, the colonies were de facto independent. The proof of this is that they were not subject to London bankers financially. Prior to the Revolutionary War, Benjamin Franklin was asked why the colonies were so prosperous, he stated:

That is simple. In the colonies we issue our own money. It is called colonial script. We issue it in the proper proportion to the demands of trade and industry to make the products pass easily from the producers to the consumers. In this manner, creating for ourselves our own paper money, we control its purchasing power, and we have no interest to pay no one (Quoted from Goodson, 2013: 45).

The founders of the American Constitution all agreed that the present world of London banking was not to be imitated in the US. The idea of a currency that became itself a commodity with a value having nothing to do with any intrinsic merit made little sense. Part of the consequence of this view was that, until World War I, the dollar retained its value and the American economy grew in an extraordinary way (Paul, 2011: 55-57).

The constant financial Panics of the pre-Civil War era and the atrocious rise in Federal taxation changed everything. Worse, the American creation of its own global empire led to the creation of a privately-owned, for-profit corporation known today as the Federal Reserve. Known today popularly as the “Fed,” the term “Federal” in its title should be taken as the term is used in the company “Federal Express.”

The truth of the matter is that American monetary policy was created while the US grew into a highly centralized, militarized global power. As the Antifederalists predicted in the founding era, the centralization of federal power meant the creation (or the justification) of a ruling oligarchy having no connection with the broader population. Thinking globally and acting against the interests of the people, those with power served their own interests (Paul, 2011: 35-37 and 76-78).<sup>1</sup>

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<sup>1</sup> The term “ruling class” or “oligarchy” does not mean the American government or its empire. The American empire is only part of the broader globalist machinery. The form of government here is oligarchy, or the rule of the very wealthy. The ruling class refers to major corporations, government agencies, universities, foundations

From the start of World War I to the early 1920s, prices rose by almost 130%. Goodson's work on the American monetary development shows that the dollar lost almost 65% of its value within seven years. That this is very close in following the creation of the Federal Reserve is not a coincidence. This sort of inflation was connected to an equally abrupt drop in the value of federal bonds. These lost around a 30% of their value (Goodson, 2013: 53). When present bond values fall, older bonds, reflecting higher rates, then become more valuable. To compensate for this, the banking oligarchy then recalled the newer bonds, meaning that all this money was owed immediately (Goodson, 2013: 84-86).

After the Fed was chartered in 1913, the power to control the economy was then transferred to a conglomerate of bankers more powerful than the state. The initial group that created the first central bank were Senator Nelson Aldrich, Paul Warburg of the international Warburg banking clan, Frank Vanderlip, Harry Davidson, Benjamin Strong and the Assistant Secretary of the Treasury Andrew Piatt. These men represented powerful banking interests whose gross income dwarfed the federal state (Mehrling, 2002) and most countries of the world. Since the federal government (and states around the world) realized that lots of cash was required to expand power and control, the banks who are in charge of this liquidity became the true rulers. Political power was privatized.

The 1920s saw a prosperity dependent on short-term profits. This can lead to a lack of fiscal discipline. When printing money is not related to the economy directly, prices become distorted. One of the unpleasant consequences here was that money was soon seen as an independent commodity in its own right. It was not inherently connected to economic growth or production, since its quality could be raised or lowered arbitrarily (Garrison, 1992: 62-65).

Goodson argues that the increased money supply and naive confidence in the “new America” led to a regime where speculation was a way of life that trickled down to the middle classes. Much of this new liquidity went into stocks, which inflated prices. Lots of cash pushed into stock speculation means that stock prices were also disconnected from production. By 1927, the price-earnings ratio grew to about 52-55:1. This demonstrates the fact that stocks, currency and production were not necessarily connected. As the Depression loomed, the American economy, partly based on the newly chartered Federal Reserve, was artificial and distorted (Goodson, 2013: 51-55).

When demand and price are based on speculation rather than actual need, easy money becomes something taken for granted. When the consequences of this mentality became clear, the Fed increased rates suddenly, bringing them to about 6% in 1929. The most elementary economics, of course, can only conclude that the Depression was based on the Fed's desire to burst the speculative bubble once the short-term profits began drying up. The stock market plunged by well over 80% as banks and investors were rapidly bankrupted (Goodson, 2013: 89).

The well known Ludwig von Mises wrote *The Theory of Money and Credit* in 1953. This book became one of the central texts in monetary theory then and now. He argues that personal liberty, the purpose of the state, is gradually destroyed by two things: first, by the ability of a small group to dominate the printing of money (or more specifically, the ability to control its value), and the removal of the discipline gold makes possible. In more practical terms, his general argument is that property rights cannot be real if the value of this property can be destroyed by the arbitrary actions of bankers. Their interests are not that of the population.

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and their supporters.

Walter Block's survey of monetary policy (1999) argues that the free market is served best by gold. One reason is historical: when societies are able to choose a monetary standard, they have always decided on gold. He writes:

However, it is a matter of historical fact that whenever societies have been “free to choose” in this regard they have always evolved to gold. It is for this reason that an actual misnomer has arisen within the field of economics: although “gold standard” would appear to imply that the yellow metal has something to do with monetary arrangements, this is not strictly true. In actual point of fact, the phrase “gold standard” now denotes whichever commodity emerges as money from the free interplay of market forces (Block, 16)

By “gold standard” the western consumer really refers to an objective standard of value. To extrapolate, what is really being argued is that, in a free market, consumers all have an interest in a stable standard of value. If there is one proposition that can unite (almost) all classes, it's that money should be stable. That is, long term planning should never be hampered by the fact that the value of a dollar will change radically. However, the retort to such an argument comes from a 1962 book by Milton Friedman where he argues,

The fundamental defect of a commodity standard from the point of view of the society as a whole, is that it requires the use of real resources to add to the stock of money. People must work hard to dig gold out of the ground in South Africa in order to rebury it in Fort Knox or some similar place. The necessity of using real resources for the operation of a commodity standard establishes a strong incentive for people to find ways to achieve the same result without employing these resources. If people will accept as money pieces of paper on which is printed ‘I promise to pay x units of the commodity standard,’ these pieces of paper can perform the same function as the physical pieces of gold or silver, and they require very much less in resources to produce (Friedman, 1962: 40).

The problem here is that we don't know who “people” are. Is this a reasonable line of thought from the average consumer? Are they more worried about how hard it is to dig gold rather than the stability of the currency? Even more, is it even remotely reasonable to argue that fiat currency has “the same result” as a commodity standard? That gold and a promise from a bank are identical? That is the argument here, and it must be dismissed as fantastic.

Friedrich Hayek takes a substantially different view. He makes the historical point that the rise in American industry and the broader improvement of American life came under the protection and stability of a gold standard (Hayek, 1976: 9). Further, he makes the defensible statement that “With the exception only of the 200-year period of the gold standard, practically all governments of history have used their exclusive power to issue money in order to defraud and plunder the people” (16). The term “government” is dishonest. It's hard to tell if this sleight of hand is deliberate or not. Milton is well aware that private bankers are the ones making the decisions. Governments are their bodyguards.

The difficulty he sees for the future is that, given the historical records of government working with their local sources of capital, any gold standard would have to be imposed without

their consent. Even with their consent, however, their old habits would soon discredit the gold standard regardless (15). This is similar to Ropke's argument that the elimination of one standard has a tendency to affect the rest. This is especially true when the standard is for something as powerful and omnipresent as money.

To get a glimpse as to how the Fed works on a day to day basis, Charles Eisenstein explains:

Usury is built into the very fabric of money today, from the moment of its inception. Money originates when the Federal Reserve (or the ECB or other central bank) purchases interest-bearing securities (traditionally, Treasury notes, but more recently all kinds of mortgage-backed securities and other financial junk) on the open market. The Fed or central bank creates this new money out of thin air, at the stroke of a pen (or computer keyboard). For example, when the Fed bought \$290 billion in mortgage-backed securities from Deutsche Bank in 2008, it didn't use existing money to do it; it created new money as an accounting entry in Deutsche Bank's account. This is the first step in money creation. Whatever the Fed or central bank purchases, it is always an interest-bearing security. In other words, it means that the money created accompanies a corresponding debt, and the debt is always for more than the amount of money created (Eisenstein, 2011)

This being the case, the economy must then go into high gear producing goods such that this interest debt can be kept at bay. Capital, under these circumstances, is driven to monetize everything. Debt and interest force producers to seek new forms of revenue. Today, bottled water is an example of monetizing something that had been free of that for millennia. Marketing campaigns create demand rather than responding to it. Soon, the final end is the total monetization of life, which also means a world where banking and credit rules everything. In modern capitalism, the "economy" is ruled over by bankers. Eisenstein's argument is that the system forces the consumer culture from its inception. It forces it as an economic necessity.

Further, he argues that "Because interest-bearing debt accompanies all new money, at any given time, the amount of debt exceeds the amount of money in existence. The insufficiency of money drives us into competition with each other and consigns us to a constant, built-in state of scarcity." The system requires the constant extension of credit.

Another consequence of the fractional reserve system is that interest payments and obligations are almost always greater than economic growth. That being the case, the cost of capital to the capitalist is always greater than the rate of return overall. He writes, "If debtors cannot, in aggregate, make interest payments from the new wealth they create, they must turn over more and more of their existing wealth to their creditors and/or pledge a greater and greater proportion of their current and future income to debt service" (Eisenstein, 2011). Wealth becomes concentrated into fewer hands, and these tend to be those associated with finance capital. It is in this context in England that Darwinism emerged.

Now, in in good years, high growth can ease the pressure of debt for a time. Debt is easier to bear when things are expanding. However, diminishing returns is quickly reached and the costs of supply (such as infrastructure, health or education) continue to rise as the economy develops in more complex ways.

Now, take this analysis and apply it to nations. Debtors will soon run out of options. One

can only go so far in borrowing to pay the principle on previous loans. Soon, it will be all one can do to maintain the interest obligations. Yet, this cannot last forever. There are only so many things that can be turned into commodities. Even the American market has its limits.

The problem with any justification of the abandonment of gold is that they usually are not forthright in describing the real issues involved. Any increase in the circulating medium has no relation to gold. Smaller units might be created out of the same stock of bullion. The standard itself is not affected (Rist, 1962). The situation is discipline and the constant growth of the state. All told, it is very strange how, in any circumstance, any increase in economic growth means a concomitant increase in state spending (Rothbard, 1992: 4-7). This latter can then demand an abandonment of any barriers to its growth through the smokescreen of abstract and ultimately irrelevant variables. One example is the argument of JF Boschen and KE Talbot, where they state the following:

The monetary-base hypothesis emphasizes the sum of currency and reserves as the crucial monetary variable in the determination of the price level and inflation. The transactions aggregate hypothesis focuses on transactions media, which would include some classes of bank deposits, as the relevant monetary variables for fixing nominal prices and inflation. Because inflation is a key macroeconomic variable and deposit creation is a major aspect of banking activity, evidence on these hypotheses is important in understanding whether there is a special relation between banking and macroeconomics (Boschen and Talbot, 1991: 383).

The required increase in the need for dollars, it is argued yet again, means that economic institutions, unable to deal with their own success, needed gold to be abandoned. This is a non-sequitur that needs to be read more than once. The discipline of the gold standard does not become irrelevant in economics as it does not becoming irrelevant in morality.

The greater the number of transactions, the greater the number of units that are required for it. There is no reason that it needs to be dollars, or that the US is required at any level to “rule” a system whose cardinal tenet is that markets require no ruling. Again, the only thing that makes any sense is that the growth of the state needed constant and invisible devaluations of the currency. The population, perpetually aware that something is wrong without knowing exactly what, will always blame the political leaders of these states for the sins of their financial superiors (Rist, 1961: 23-25).

This argument was summarized in 1971 by Ludwig von Mises:

The belief that a sound monetary system can once again be attained without making substantial changes in economic policy is a serious error. What is needed first and foremost is to renounce all inflationist fallacies. This renunciation cannot last, however, if it is not firmly grounded on a full and complete divorce of ideology from all imperialist, militarist, protectionist, statist, and socialist ideas (Mises, 1978: 44).

The implications here are very apparent. First, pressure on the dollar only exists when the state begins diverting productive investment into its own growth and expansion. Second, so long as this mentality lasts, there is no standard that can control it. Third, the growth of markets and

their productive power always has the consequence of giving the state a new pool of wealth to draw from. Hence, as the market produces, the state consumes. The only difference is that when the state consumes, it does so for its own interest, which itself is not based on any market transaction. Thus, the growth of the state destroys the fiscal discipline that its own functioning depends on (Rothbard, 2001: 32-38).

The Federal Reserve prints money and gives it to the federal government in the sale of bonds. As the state buys these, it is buying back money that belongs to it in the first place. Adding insult to irrationality, interest is built into each dollar, since each dollar is only printed for a profit. As few Americans know, each dollar is, in fact, the property of the banks issuing them and is only loaned to productive labor or capital at a price (Mises, 1953).

Thomas Edison once argued that the profits from these bonds lead to a world where those profiting from each make twice as much as its face value. On the other hand, each dollar printed must only take its true value, that is, long term value, from actual labor. The problem, as Barry Goldwater once quipped, is that most Americans have no idea about how international lending operates, and this is about the same as the functioning of the Fed (cf Wills, 2006 for a full analysis of Edison's position).

In exchange for the money that it creates out of thin air, the Federal Reserve receives guaranteed government bonds and sells them at auction. Given that the government is obliged to pay interest on these bonds, the amount of debt that arises as a result of this transaction is greater than the amount of money created. This is especially true through the alchemical magic of compound interest. A snowball of absurdity is created that plunge the entire society into unrepayable debt. In truth, it combines the worst features of a centrally planned economy with the exclusively bad features of oligarchy (Rothbard, 2001: 20-22).

Since the Fed is ruled by the most powerful oligarchs in America, they are free to do as they please. In 1970, the five largest banks in American controlled about 16% of total financial assets in the US. In 2012, these same five control far more than half. This immense growth in power and centralization is identical to the growth and power of the Fed, since the big five all have members of the Fed's board (Wills, 2006: 195).<sup>2</sup>

Because of this concentration of power, not only does the state become insignificant by contrast, but credit then flows to these centralized powers who, of course, control this same credit and, more importantly, see themselves as a good bet. Favoring only the most powerful firms, credit is monopolized by the oligarchs in the system. This becomes a growing problem until the economy is largely structured by only the most substantial firms (Mises, 1949: 799). Small business struggles to be considered for credit. Mises writes,

Credit expansion is the governments' foremost tool in their struggle against the market economy. In their hands it is the magic wand designed to conjure away the scarcity of capital goods, to lower the rate of interest or to abolish it altogether, to finance lavish government spending, to expropriate the capitalists, to contrive everlasting booms, and to make everybody prosperous (Mises, 1949: 794).

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<sup>2</sup> Just by way of example, those on the Fed's board are required to take care of the home office. Recently, loans with very, very good terms have been given en masse to Citigroup, Morgan Stanley, Merrill Lynch and Goldman-Sachs totaling about \$3 trillion. This is just since 2013.

For Mises then, it is not merely the monopolization of credit that poses a problem, its that it is a substitute for workable capital. Credit, in other words, is offering a cheap tool to justify spending more than the economy can produce. It is a way to keep a distorted economy going for a little longer.

The record of the Fed has been disastrous. Ben Bernanke stated in 2005 that housing prices were not a problem. There could be no debt bubble because such bubbles are impossible. In 2006, he stated that housing prices are market based and will continue to grow indefinitely. The following year, he instructed the hoi polloi that the junk mortgage paper was perfectly safe and that in 2008, that there was no recession (Lowenstein, 2008).

Bernanke stated on March 28, 2007 “At this juncture, however, the impact on the broader economy and financial markets of the problems in the subprime market seems likely to be contained. In particular, mortgages to prime borrowers and fixed-rate mortgages to all classes of borrowers continue to perform well, with low rates of delinquency” (Business Insider, 2010). At the time, he knew this was false. In May, he stated that any problems with subprime mortgages will have little effect on the overall economy. In July, he said that the GSEs were in good financial health (Business Insider, 2010).

This needs to be explained. Since this is the Federal Reserve chairman who represents clients far more powerful than the federal government, these errors are not just absurd and humiliating, they go to the heart of the corruption of the private-money system. The power of the Fed is such that Bernanke is insulated from the consequences of his feigned or real incompetence. His mistakes, whether strategic or just humorous, are indicative of the erosion of any sort of accountability when the true rulers of the economy are not known to the public and largely kept secret.

In matters of fiscal discipline, a gold standard is essential. When a government such as the United States decides that it wants to spend another billion dollars, it merely asks for loan in this amount. It then prints a multitude of government bonds and transmits them to the Fed (Mises, 1978).

The Federal Reserve creates a billion dollars out of thin air and is then exchanged for federal bonds. It is not real money since it comes into existence through a lack of discipline. It is printed without regard for economic realities, but since the state is not something that can go out of business, their investment is guaranteed. Hence, it is an inversion of strict fiscal policy, the free market and even the most basic canons of fairness (cf esp Rothbard, 2001: 15-17 and Rist, 29).

Therefore, the real problem can be boiled down to a few basic propositions. The gold standard is justified as a check on the power of elites to print money. It acts towards elites what law does to criminals, it serves as both a deterrent and a punishment. There is a clear historical connection between the rise of state power and the abandonment of any standard against reckless printing or lending. The Fed is the result of the “fiat currency” mentality in that it places immense and colossal power in the hands of bankers. The average educated and politically active American can probably not name a single board member. Finally, the proof of the Fed's failure is simply in the condition of the economy, the value of the dollar, and the consequences of state expansion.

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