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Hand to hand combat with Martin Wolf

"James and I both have Range Rovers for running around, but he's also got a black Lamborghini and a black Rolls-Royce, and I've a white Ferrari and a white Rolls-Royce.. I'm bored with designers like Dolce & Gabanna. I hate it when you know what label a person's wearing – it doesn't say luxury, it feels a bit Russian and cheap.. I don't live in a bubble though.. I clear out my clothes every few weeks and send them to Croatia.. Our bedroom's actually more like an apartment, with its own kitchen, bathrooms, lounge, dressing rooms.."

- Petra Ecclestone, keeping it real in The Sunday Times ('It's not easy being this rich').

On balance, if somebody had to all intents and purposes suggested to me that the entirety of my career had been a complete waste of time, I suppose I would have taken it somewhat to heart. So credit is due to the FT's Chief Economics Commentator Martin Wolf simply for responding to my unsolicited email last week. But I get ahead of myself. Here are some excerpts of what he had written earlier in the day in the UK's leading financial journal ('After the bonfire of the verities'). Red-rag-to-bull segments are highlighted in bold red.

"The huge expansions in central bank balance sheets are thought to be harbingers of hyperinflation. Those who live on income from savings are enraged by the low interest rates. Almost everybody is angry about the bailout of the banks. **The fact that the central bankers saved the world from a second great depression is disregarded.** Nobody gains credit for eliminating a hypothetical event. It is perhaps surprising that central banks have not been even more discredited."

"The fears of imminent hyperinflation are idiotic."

"Domestically, the issue will be how to secure needed co-operation among the fiscal authority and the bodies charged with oversight of individual institutions, oversight of financial stability and management of monetary policy. Even where, as in the UK, the last three responsibilities are all going to be part of the central bank, relationships with the ministry of finance will be crucial. Moreover, **the centralisation of authority in one institution carries its own risks of insufficient airing of differences, groupthink and ultimate failure."**

This last observation recalls a similar one voiced in a letter by economist Roger Alford in the previous week's FT ('BoE Governor: an almost impossible role for one person'):

"Sir, The choice of the next governor of the Bank of England is an important matter, but it is even more important to reconsider the functions of the bank.

"The role of the Monetary Policy Committee is to use all its expertise in macro-management to assess in detail the prospects for the British economy over the next two years or more and, given its remit from the Treasury, to decide on the appropriate level of short-term interest rates – bank rate – for the economy as a whole. The traditional role of the bank requires it to have a deep understanding of London's financial mechanism and to manage the money market and other short-term markets which usually required it to look forward days or weeks rather than years.

"**The utterly disparate time horizons and the very different experience and skills required for these two tasks make it virtually impossible for any one person to have the experience and depth of understanding to provide effective leadership in both fields**."

Mr. Alford identified the problem but did not manage to marshal his thoughts toward the obvious conclusion: if the role is so difficult as to be virtually impossible, why have the organisation in the first place ?

But when the discredited former chairman of the Swiss National Bank, Philipp Hildebrand, was granted an op-ed piece in the FT to boast about the triumphs of his central banking peers ('Now is not the time for boring central bankers'), the red mists descended again. Mr. Hildebrand opined:

"During the past couple of years, a period during which I chaired the governing board of the Swiss National Bank, central bankers have found themselves routinely criticised, vilified and attacked for all sorts of things. Being boring was not one of them.

"**Those who argue these policies were unnecessary or have planted the seeds of a greater future crisis are as wrong as the "liquidationists" of the Great Depression**. The global economy was on the edge of the abyss in 2008. If central banks had failed to overcome their inherent bias for boredom, the global consequences would have been dire at best and catastrophic at worst.

"**Instead, the worst of the fallout from the crisis appears to be behind us**."

This triggered our automatic 'Letter to the editor' response, as follows:

"Sir, I think we can all agree that Philipp Hildebrand, the former chairman of the Swiss National Bank, who recently resigned amidst some scandal, barely warrants the description "boring". But his self-serving and triumphalist tone (Comment, May 1) certainly displays the tin ear of the modern central banker to any sense of criticism.

"Mr Hildebrand claims that critics of our hyper-stimulating central bankers are as wrong as the "liquidationists" of the Great Depression. There is no counter-factual example, so we will never know whether he is right, or dead wrong. Mr Hildebrand has probably not read the classic study 'America's Great Depression' by the Austrian scholar Murray Rothbard. Mr Rothbard posited that government typically exacerbated and prolonged depressions by, amongst other things: preventing liquidation by the ongoing lending of money to insolvent businesses; encouraging further inflation, thus blocking the market's natural price clearing process; and by stimulating consumption and discouraging saving. That all looks rather like what every major central bank has done for the past four years in bailing out fundamentally bankrupt banks (and in many cases governments), distorting the prices of all financial assets – and rewarding bankers handsomely for their folly, at the expense of all other investors.

“I do not really expect a former central banker to question the role of central banks. But I do expect a higher standard of analysis from the Financial Times, rather than mute obedience to a highly questionable monetary regime that I suggest is indeed sowing the seeds for an ongoing financial crisis way beyond the powers of Mr Hildebrand and his ilk to understand.”

Like so many that went before it, this plucky missive failed to make it through enemy lines, so it is published above instead. But when Martin Wolf followed up with more hostile fire, this commentator felt another call to arms. The email conversation which followed is published below in full, with Mr. Wolf’s responses in blue:

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Dear Martin,

Every time FT writers discuss central banking, I find it difficult to retain my natural good humour. It is taken as an immutable given that we need central banks to, in your words, act as guardians of financial stability, and latterly to attempt to control inflation. They have utterly failed in both regards (I would define the act of money creation as itself inherently inflationary, let alone the second order price effects on goods and services) but let’s not let the facts get in the way of an idiotic monetary belief system. Why do we need central banks to control the price of money ? We let markets operate across all other types of asset to agree on a price level via supply and demand. Why should interest rates be any different ? You say fears of imminent hyperinflation are idiotic. Please explain why fears of ultimate hyperinflation might be similarly idiotic in which case we are only arguing about a matter of timing given the extent to which central banks have expanded their balance sheets since the crisis hit. I would point out that the US dollar (for example) has lost 98% of its purchasing power since the inception of the Federal Reserve in 1913. Most western governments are already insolvent – granting them further unserviceable credit will only impoverish more and more future taxpayers.

You may have seen the recent video of Jim Grant discussing the forgotten depression of 1920 in the US. The US economy endured a short but savage deflationary contraction and then bounced back, without any government intervention whatsoever. I happen to subscribe to Murray Rothbard’s view that government (including its central bank) has a tendency to exacerbate depressions rather than solve them, by well-meaning but ill-founded attempts at price manipulation when simple market clearing would, in the final analysis, do a better and quicker job.

You state that the central banks’ rescuing of the world from a second great depression is a fact. Your definition of fact and mine obviously different somewhat, given that you are talking about a hypothetical. Lehman was allowed to fail (by an alumnus of one of its largest competitors) and yet the world still turns, despite the attendant disruption. It is a fact that our commercial and investment banks have been allowed (by whom, I wonder ?) to become too big to fail, so it may be beyond the best efforts of Austrian school deflationists to rescue the rest of us from a mess of central banks’ own making.

Yes, central banks also exist to allow governments to spend beyond their means and finance the shortfall. Facilitating that service doesn’t appear to be going that well globally, don’t you think ? Your blind support for central banks should end when it interferes with and indeed frustrates my desire to save and invest sensibly and prudently (on behalf of myself and my clients) without fear of colossal currency debauchery, asset price manipulation, and paying handsome taxpayer-funded rewards to bankers who don’t even deserve to be employed, let alone granted lavish bonuses for services certainly not rendered. This crisis looks like it will morph into an international political crisis involving widespread social disorder.

A wise man once said: “I contend that we are both atheists. I just believe in one fewer god than you do. When you understand why you dismiss all the other possible gods, you will understand why I dismiss yours." I dismiss your discredited, statist, Keynesian, inflationist, banker-friendly, central banking god, and I have grave doubts about what lies ahead for both our financial and currency system and broader society.

Best wishes

Tim.

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Thank you for your views. I didn't realise we had Austrians in the UK, too. I thought that was a purely American disease. Obviously, I am wrong.

The 1920 recession is irrelevant. It was not a debt deflation. Since it had different causes, it had different consequences.

Martin Wolf

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Thanks too, especially for the unwarranted and gratuitous insult. I agree that you are wrong, though not in the terms you suggest. Your inability to consider other views to your own discredited monetary orthodoxy is staggering, though perhaps not surprising. But then I am tasked with managing people’s money, as opposed to sharing my own unsubstantiated opinions in a journal to articulate failed conventional beliefs. Better my disease than your cure.

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I didn't consider it an insult. If you did, I apologise.

I do regard these ultra-free market ideas as a disease. But, after all, you pretty comprehensively insulted me first. I suggest you re-read the final paragraph of your email to me.

I am happy to admit that you are vastly more important than I am. I am a mere scribe (like your heroes, by the way: so far as I know von Mises and Rothbard were not money managers). But I don't accept your Austrian free market god. The Austrian macroeconomic view was rejected in the 1930s, for good reason.

Mr Rothbard was a libertarian fanatic. This is a man who believed property rights give a parent the right to abuse his or her children, unhindered! If you don't know this, look it up.

Martin Wolf

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Hi Martin

I sincerely apologise for any offence caused but you will detect how strongly some of us feel about these issues. You have the bully pulpit of an FT column and I don't, so your power to influence the many is a lot greater than mine. I cite the quotation about religion because that aptly describes, in my view, how the differently polarised advocates of economics and finance congregate around their different belief systems. Belief tends to transcend rational analysis.

We are destined not to agree about money, which is a fairly fundamental barrier to getting to any sense of common ground. You consider that money is a thing of government, and I consider that money is (or at least should be) a thing of the free market. Since you (narrowly) mention morality, here's one. The First World War could never have been perpetuated under a gold standard. Each of the warring nations would have run out of money in a matter of weeks. Government monopoly money and deficit financing facilitated the killing of millions of people, as it did again some thirty years later. Where do your priorities lie ? Perhaps you believe that the Great Depression was solved by WWII. I don't think this logic bears serious scrutiny.

I'm not an economist, and every day I give praise for the fact. This is a faux science that under Leon Walras misappropriated principles from the world of physics and then misapplied them to the behavioural world of the economy and financial markets. Garbage in, garbage out. Has poor financial modelling played a key role in the crisis to date ?

I suspect we both instinctively realise that the current environment will end in tears. I fail to see how a crisis of overmuch credit can be resolved by more of the same. You will be familiar with Mises' warning about the endless extension of credit resulting in a final and total catastrophe of the currency system. I would say that so far, he is winning the argument on points. I would prefer that we don't get there, but it seems that our politicians and central bankers have run out of conventional ammunition and are doing everything in the rulebook that virtually guarantees Mises' end-game, albeit over a timeline that is uncertain.

Other than the fact that the price of every financial asset including currency has been distorted by inflationary QE by central bankers that believe they do know better than any market what the price of money should be, I am frustrated that any semblance of debate is either not covered by the likes of the FT or dismissed out of hand by its senior columnists as an American disease.

Kind regards

Tim.

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I do, in fact, intend to write about this topic in the next few weeks, maybe even next week.
My observation about money is empirical: it is created by government and has always been, so far as we know. The good reason for this is that it is a public good. The bad reason is that it is an instrument of power. Of course, you are right that, under the gold standard, WWI could not have been fought. That was, of course, why the gold standard was, at once, abandoned, as it had been in the Napoleonic War, as well.

Salus rei publicae suprema lex: the safety of the state is the supreme law.
In the end, politics cannot be made illegal! It is a fundamental and inescapable attribute of human civilisation, without exception. It is a product of the Fall.

On your narrower point, I think there is an interesting question whether the contemporary credit system can be abolished. But, so long as it exists, the chances of making money purely private seem to me to be zero.

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Like I say, we are destined not to agree, not least because we disagree fundamentally and profoundly about money. Disparage the Austrians all you like – they are winning the argument about credit and debt-based money and the neo-Keynesians are not. (I'm a non-combatant, but I certainly have sympathy for the Austrian view, both from a practical as well as a moral perspective.) Did the Austrians even feature in your original PPE course[1] ? I suspect they didn't, because they didn't feature in my brother's pure economics course at Cambridge, either.

I cite Professor Jörg Guido Hülsmann in my defence:

"In the history of mankind, a great variety of commodities - cattle, shells, nails, tobacco, cotton, copper, silver, gold, and so on - have been used as media of exchange. In the most developed societies, the precious metals have eventually been preferred to all other goods because their physical characteristics (scarcity, durability, divisibility, distinct look and sound, homogeneity through space and time, malleability and beauty) make them particularly suitable to serve in this function.

"When a medium of exchange is ***generally accepted*** in society, it is called money. How does a commodity such as gold or silver turn into money ? This happens through a gradual process, in the course of which more and more market participants, each for himself, decide to use gold and silver rather than other commodities in their indirect exchanges. Thus the historical selection of gold, silver and copper was not made through some sort of a social contract or convention. Rather, it resulted from the spontaneous convergence of many individual choices, a convergence that was prompted through the objective physical characteristics of the precious metals.

"In all known historical cases, paper money has come into existence through government-sponsored breach of contract and other violations of private-property rights. It has never been a creature of the free market."

Money good is a creation of the market, not government. If you insist on quibbling, please try and identify a fiat currency that has ever lasted. Good luck in your search, because as you must be well aware, there are none, and never will be. Government has a tendency to turn everything productive it touches to ash. So far, the mission with government money is going exactly according to plan.

[1]Back in my day, Oxford University did not permit undergraduates to study pure economics, instead insisting that this bastard "science" should be demoted to third on a list which also includes politics and philosophy, hence the abbreviation PPE. Martin seems to concede, below, that the course did not include any mention of the Austrian school, which is ironic considering that Austrian school economists seem to be the only ones who identified the current financial crisis while it was still brewing.

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I read the Austrians quite deeply, after my university course. I have been particularly influenced by Hayek, though not so much on macroeconomics.

The quote you give is a partial monetary history. As I am sure you know, in civilised societies, metallic money was always stamped by the state (and, from time to time, debased). Look at the coins of the Greek city states or the Roman empire. Today, going back to a purely metallic money is obviously absurd. How on earth would it work. One ends up with a gold-exchange standard, which is inherently unstable.

I don't understand the remark about violation of property rights. But I have never understood the notion that property rights are antecedent to the state. Organised society defines property rights and, in the agrarian and industrial ages, that means the state.

Martin

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You are trying to defend the indefensible. For reasons I cannot fathom, you defend the right of the state to destroy the real wealth of the very people it relies upon for its perpetuation: this is the triumph of the parasite. You support state-sanctioned inflationism, end of story. (This story does not end well, as we surely both know.) We have only lived with unbacked money for 40 years, and the system is already dying. So, print and be damned.

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I am not trying to defend anything. I am trying to understand how the world works. For example, your statement that we have had unbacked money only for the last four decades, though a common gold-standard trope, is false. The US has not been on gold, in any meaningful sense since at least 1914. (You will remember that it devalued in the 1930s, for example.)

I actually agree that the present monetary system has large drawbacks. But the idea that we can go back to the monetary system of the 17th century (and so before central banking) seems to me truly insane. (Please don't take that remark personally: it is not meant to be). We don't live in the 17th century and we are not going to.

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You defend the central banking status quo. **We are simply going round in circles**. I don't trust government (ours or anybody else's) or its central bank with our money. I merely make a case for sound money and I'm not hung up on how we get there. But I cannot see how we can get sound money without replacing the current global Ponzi scheme farce and its cretinous commercial and central bankers. If you cannot have sound money, how can you possibly have a sound economy or banking system ? My thesis is simple to articulate (though not to resolve): there is too much debt in the world and it will not all get paid back. Since we also have debt-based money, this represents something of a problem. Austerity is incompatible with the growth required to service all that mounting debt. So the blunt choices are either debt default or inflationism. You are evidently backing the latter. (A debt jubilee is the only other alternative.) I agree that inflationism is the most likely course and indeed is already well in train, given that the politicians are steering. But it is going to kill creditors, savers and investors, and reward the feckless debtors of this world, not least among which are the governments themselves and their banker friends. Difficult to see how this will not all end in widespread social disorder.

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I agree we are going round in circles.
I believe that your views, while perfectly comprehensible, are simplistic. You believe that my views are immoral.
So let us leave it at that.
Martin

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So there we have it. The latest in an occasional series whereby we lob squibs at professional economists and the inhabitants of the FT's ivory towers. My heart swells with irreverent pride to be described as "simplistic" by a professional economist – the advocate of a false science that invariably reduces our complex behavioural economy to an overly simplified model that doesn't even work. Happily, no sooner had the dust settled on the debate with Mr. Wolf than we opened our FT to find an op-ed from Ron Paul, entitled

'Our central bankers are intellectually bankrupt.'

Proud to have been part of the fight, Mr. Paul.

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