Europe & USA will not allow deflation to take root

written by Edward Maas | December 5, 2012

THE MATTERHORN INTERVIEW – December 2012: Ambrose Evans-Pritchard

"Europe and America will not allow deflation to take root"

We are extremely pleased to publish this 'must read interview' with the international business editor of The Telegraph, **Ambrose Evans-Pritchard**. I consider Ambrose to be one of the top financial journalists in the world and one of the few who really understands what is happening. In this exclusive Matterhorn interview with Lars Schall he talks about, among other things; his conviction that the United States isn't dead yet; ; that China might not make it to the big league, the destructive nature of the EU against democracy; the upcoming bond massacre; why it is significant that central banks have become net-buyers of gold; the German gold reserves; his objections to a gold standard and his support for a "catallaxy of money" and much, much more. It is a long interview but it is packed with so many incredible insights that once you start reading you will not stop until the end.
Egon von Greyerz

Ambrose Evans-Pritchard, who was born in 1957, is the international business editor of the British newspaper The Telegraph. He was the Telegraph's Washington bureau chief in the 1990s. In 1997 he wrote a controversial book about the Clinton administration, "The Secret Life of Bill Clinton: The Unreported Stories" (Regnery Publishing). In the same year he left Washington. Until 2004 he served as the Telegraph's EU correspondent in Brussels. Before joining the Telegraph, he has worked for The Spectator (in Washington under Reagan/Bush I) and The Economist (in Latin America). Mr. Evans-Pritchard attended Malvern College, Trinity College, Cambridge University, and La Sorbonne.

By Lars Schall

Lars Schall: Mr. Evans-Pritchard, you have been a correspondent in Washington DC during critical years. With what kind of feelings and thoughts did you have when you finally left the US in 1997?

Ambrose Evans-Pritchard: Well, I have a great affection for the United

States. I spent a large part of my early career in the 1980s into the 1990s in the United States, and also going back there a lot when I was working in Latin America, so there were times I was sort of becoming an American, very nearly did in fact decide to stay there.

I feel there a tremendous reserves of dynamism in the country and it is always a great mistake to write off the American people. We did it in the end of the seventies, early eighties with the Carter Malaise. I was there in the early eighties and the early Reagan administration. People thought Japan was going to take over the world, would be the dominant economy, and America was finished.

It proved completely untrue, there was a huge recovery and the US went on to become the sole world superpower by 2000. And now people are once again talking about America being finished and I think that's very unwise, I think America will be the dominant superpower in the world in 2050. Probably throughout this century. I think the 21st century will be the American century just like the last one for all kinds of reasons.

L.S.: How important were the Clinton years that you have witnessed?

A.E.P.: In a way Clinton was symptomatic of a sort of moral decay that went on. I think this instant gratification culture of the baby boom generation which he so represented – reflected in the debt binge that occurred, with debt reaching incredible levels only achieved once before in US history at the end of the 1920s.

He represented that it was as if there were no consequences to your actions, that you could just do whatever you wanted, and the future would worry about itself. This was a president caught on camera committing perjury. He was testifying under oath, and there were no consequences to it. The senate decided not to convict him. They acquitted him basically, after the house impeached him, so there was no consequence to it.

The feeling was, well, you can get away with anything. I think that was a very insidious era in America and they have sort of recovered from it; they are finding their moral bearings again. So he represented a baby boom era where you are not really answerable for what you do. But this of course went beyond America. We had the same kind of credit bubbles in Europe and in many different countries. It wasn't just him, but he represented that.

L.S.: Should a major event that took place after you departed from the US, the repeal of the Glass-Steagal Act, be reversed?

A.E.P.: I think that was a terrible mistake. I think you should separate the ordinary high street banking that regular people use from the casino banking by the prop desks of these financial institutions. It was introduced in the 1930s precisely because this sort of concentration effect had been so destructive and you wanted to create fire walls.

So I think that was a huge mistake, but I would also say that I don't really share the view that the banks were the cause of the great crisis of 2008/09 and the worldwide stagnation that we've had ever since. There are much deeper causes to it. The banks are simply the agents of this. The real cause of the massive imbalances is in the capital and trade flows that occurred under globalisation over the last twenty years – the China effect if you like. The surplus countries were building up huge foreign reserves and instead of recycling their surpluses as demand and buying goods, they were recycling it as capital and it was flooding the world economy. That is why there was so much money pouring into Spain and pouring into Iceland with no questions being asked.

You could get capital for nothing, and you could get capital for nothing because the emerging economies were accumulating ten trillion dollars of excess reserves, and it had to go somewhere. Furthermore, you had the Japanese leaking about a trillion through the carry trade into the system. You had all these sources of capital.

Part of the problem of globalisation was that it was slowly undermining the position of the workers in the developed world, in Europe and in America, and was causing a deflationary effect in these economies. The central banks of the western countries felt they could cut interest rates safely and hold them very low, at negative real interest rates in America, in Europe. That's what caused the huge bubbles.

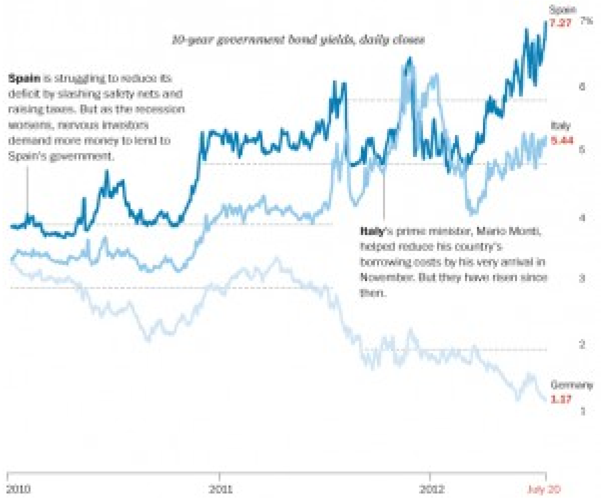
So this combination of this flood of capital coming from Asia, negative real interest rates by the Fed and by the ECB, and the combined effect of that was to create a massive credit bubble.

But if you go then into the roots of this, the real cause of our crisis is – and I hate to say this because people don't really react very well – is excess savings. There's too much savings in relation to consumption in the world, and when those two get out of balance as they did in the 1930s: you get into a slump/depression and you can’t get out of it until you put it back into balance

L.S.: Do you see indications for a change of thinking and action?

A.E.P.: None whatsoever. I mean, some of the imbalances are slowly being closed. The Chinese, the massive Chinese surplus, trade and current account surplus, is shrinking. China could even be in deficit within a couple of years which is an incredible thought. Nomura says their current account will be in deficit in 2014. So that part of it sort of solving itself.

‘The North South widening gap’



The problem in Europe is that the big surplus states – and actually that’s Germany, it’s the Netherlands, outside the Eurozone that’s Sweden, it is Switzerland – are not recycling their surpluses, so they are still accumulating large surpluses that are not going back into the system. That is becoming incredibly destructive within monetary union where the surplus states are not recycling money back into the south to balance the currency system. The currencies have to balance. The whole system has a contractionary bias at the moment. All the burden of adjustment is being put on the southern states: essentially Spain, Italy, Portugal; they are all cutting and cutting and cutting. You’ve got this austerity spiral going downwards, but the northern states, the creditor states, are not offsetting this by stimulating demand.

So you have exactly the same situation you had with the gold standard when the gold standard went badly wrong in interwar years, when the surplus states did not recycle their surpluses and forced all the burden of adjustments on the deficit states, particularly Germany at that time; they suddenly cut off funding to Germany in 1928 and we all know what happened. Germany went spiralling into a depression, the reason being that America and France at that time were not balancing the system, they were not stimulating to offset it, that’s exactly what’s happening internally in the Eurozone right now.

So Germany is doing to Spain exactly what the US and France did to Germany in 1928 to 1933. They pushed Germany into five years of depression and ultimately the democratic system blew up as we all know. We had the famous

Reichstag elections of July 1932, when the national socialists and the communists won half the seats; you had an unworkable government. Unfortunately exactly the same is now being done to Spain where you're putting Spain into a five year depression. Basically, the system is going to blow up. They are repeating all the errors of the 1930s.

It's not a Keynesian argument by the way. It is simply a mathematical argument that the currency union within itself has to balance, and if you force all these deficit states to contract and contract and contract then the whole system will contract, and that is what we are seeing. That's why the Eurozone has gone back into a double dip recession, it is getting deeper and deeper and deeper, and why unemployment has reached 25.8pc in Spain, 25.4pc in Greece – and is going up and up and up. It could reach thirty percent in some of these countries by next year.

L.S.: We'll come back to the eurocrisis in a minute. But before that: would a tougher regulation of the financial industry be the order of the day? And why don't we see "sweeping reforms" that would be worth that description?

A.E.P.: There are certain things you need to do for reasons of social equity. You need to control the bonus structure of the banks, the payoff systems they get when they screw up, and the golden handshakes of vast sums of money; this is undermining popular consent for free market capitalism, the political consent for our economic structure. If the bankers screw up they should basically have, whatever it is, six months severance pay or whatever you get under the normal system, same as any other citizen, same as any other worker for an ordinary company, they shouldn't get the special golden handshakes, they shouldn't get vast bonus structures written into their contracts regardless of what their annual performance is. The whole thing needs to be sorted out, yet I didn't think that this solves the problem. That deals only with one aspect of it, which is people feel the whole system is unfair, is rigged in favour of these banking elite, it is operating as a cartel.

I think that does need to be dealt with.

However, you will not solve the global economic problem by cracking down on banks. I'm sorry, the opposite is the case right now. One of the reasons why we are not recovering from this slow motion depression is because banks are being forced to boost their capital ratios. The EU regulations are forcing them to put aside more and more capital – it is going up and up and up. That means they have to shrink lending basically. They are selling of assets and de-leveraging. I'm all in favour of doing that, but you do it during a boom, you don't do it during a bust. You should be counter cyclical, not pro cyclical. This is a fundamental error.

They should have been doing this in 2005 and when the boom went on, we should have done it more in 2006 and then more in 2007. They should have done what's called in central banking "leaning against the wind". So as the growth of credit gets out of control, you should be stepping in there and fighting it. You throw everything you've got at it. Singapore, Hong Kong and others have been very good at this. What they've learned to do with their property markets is that they cut the loan to value ratio on mortgages – it goes to eighty percent then to seventy percent to sixty percent, fifty percent, until you basically can't borrow anymore to get a mortgage because they simply shut it down. You can do these things, but these sorts of controls are for booms. When you're in a bust, you do the opposite: you loosen up, you actually make it easier for banks. What they are doing right now is classic: they are closing the stable door after the horse has bolted, it's too late.

They have so screwed up. The whole regulatory culture has made a total mess of it. They didn't see the crisis coming, they allowed rampant credit growth, they allowed the shadow banking system to get out of control, they made so many mistakes – and then suddenly in panic they swing to the other extreme, they go wild and go do overkill at the worst possible moment, which is right now. That is another reason why the Eurozone is being tipped straight back into a recession. It is because the banks are cutting and cutting and cutting to meet their new targets.

There seems to be no joined up thinking about this; people are not thinking through what are the implications of the banking regulations for the rest of their economic policies. So you've got fiscal policy, you've got fiscal austerity, you've got monetary policy, you've got banking regulation, and they are all being pursued independently of each other. Nobody is sort of thinking how do these interrelate, and this is the critique I have. So yes, I'm all in favour of having a very tough enforcement of excess credit and this crazy casino banking stuff that goes on during booms, but you do it in a boom and only in a boom.

L.S.: Is it fair to call the City of London, as some people do, a cesspit of financial fraud?

A.E.P.: I think whenever you've got three hundred and fifty thousand people thrown together in one place whose main function is to make money, it is going to happen, isn't it. This is the sad bit, I guess it was ever thus. But there were also periods of incredible dynamism for the global economy. That's why the agricultural revolution began in England. It's why the industrial revolution began in England and then spread around into Europe and around the world. It was the motor of all of this incredible growth, yet you could also call it financial excess.

If you subscribe to Schumpeter's theory of creative destruction, you have big booms, and these big booms generate quantum leaps as in technology investment, and in the way an economy functions, and then you have a big bust and you clear away the dead wood – and then you start again. In aggregate it is a very brutal way to do things and on the whole I'm not in favour of big busts, but that sort of system has been quite successful over the centuries.

I get the feeling now people want to eliminate it. They think because there is a boom and bust therefore it is bad; well, it can be, but the booms and busts are actually a hell lot better than stagnation, which is the alternative if you're overregulated. So I'm suspicious of the overregulation drive frankly. I need to be careful what I say here but I detect a little bit of a kind of scapegoat hysteria going on with the bankers, and there's a side of me, as soon as I hear that, as soon as I feel people are targeting certain groups of the population and sort of blaming them for things in an indiscriminate way, it makes me think of pogroms, and it makes me uncomfortable. Therefore, I'm not really willing to join this jihad against the banks. I'm suspicious of it. I think what lies behind it obviously often is a human emotion that shouldn't be unleashed.

L.S.: Let us go back to the United States. What are your thoughts nowadays vis-à-vis the US? Do you see the country as a declining power, or do you believe that for example the developments in the US oil industry can be taken as a sign that there's life in the old dog yet? (1)

A.E.P.: Yes, I think there is a lot of life in the old dog yet. They had the shock of their lives in 2007/ 08, when they had the huge energy and oil price rise, when it got to $147 a barrel, they suddenly felt incredibly exposed. Their current account deficit was huge, much of that was imports of fuel; they became very reliant on essentially unfriendly countries that supply them with the energy and it just freaked them out. So they are really throwing everything at it now to achieve energy independence, they are doing everything; windmills, solar power, shale gas, whatever it takes, they don't care. It is not religious, anything will do the job and they are really going for it massively.

The Energy Department there has all kinds of projects going on, and yes the Americans, when they put their minds to something, and they throw resources at it, they tend to deliver. They can be complacent, they can be slow, but finally when the penny drops and they realize there is a big problem, when they throw all their weight behind it, then they deliver and we are seeing it now with energy.

We just heard the International Energy Agency saying the United States would overtake Saudi Arabia by 2017, which is only five years away, to become the world's biggest oil producer, essentially because of the shale gas and shale oil revolution. Because of shale gas they will be very soon self-sufficient in gas and they will probably become a net exporter of gas before long– so the whole energy structure of the world is changing. Natural gas prices in America are about a third or a quarter of prices in Europe, and about a fifth or sixth of prices in Japan. That gap will narrow, but because there aren't enough plants to ship liquefied natural gas you can't transport this gas very easily, this gap is going to remain for a long time. This could be a huge advantage to the American chemical industry, the American plastics industry and the American glass industry, to half a dozen industries where America will have a structural advantage for probably ten to fifteen years over competitors in Asia and in Europe.

We’re seeing ethylene plants being built in the United States now in Texas, Pennsylvania, places in old Rust Belt, they are being re-industrialised even as these ethylene plants are being shut down in Asia. I saw that the head of BASF, one of Europe’s great chemical companies, saying that they simply can’t compete with the US any longer on shale gas prices. It’s becoming a huge problem for Europe.

Europe needs to sort itself out. It does not have a proper energy policy. It has a sort of incoherent wish list. In Germany in particular they are taking a huge gamble by shutting nuclear plants and relying on wind. German industry faces very high electricity prices for the next ten to fifteen years that will frighten away investment. The US shale revolution is cascading right through the manufacturing industry. There are probably three million extra jobs that will be created in the next six years as a result of this energy advantage in the United States. You will get re-industrialisation.

I think that when historians stand back and look the damage the US suffered in 2008/09 with the Lehman crisis and financial bubble, they’ll see it wasn’t as deep as people thought. In fact the property market, I think, has already cleared. I mean, prices are now back below normal levels of affordability in the US. Price to income ratios have fallen right back. At the same time the dollar has come down to levels where it is really quite competitive, so I don’t see anything that will hold the US back.

Their public debt is much too high, that is a big problem. But their private debt is coming down very fast, unlike Europe where it is not coming down at all. We have an interesting laboratory experiment going on right now on over the best way to bring down debt. Do you bring down debt by just having massive austerity? Or do you bring down debt by maintaining enough growth to grow your way out of your debt? is actually that more efficient way to do it? We’re seeing this tested on each side of the Atlantic at the moment, it is a very interesting debate but it is kind of complex.

L.S.: There’s another complex problem, and that is the relationship between the US and China. Do you think the days of “Chimerica“ are coming to a close?

A.E.P.: I do actually. I think it’s quite worrying. When Obama took over, he decided to make a big effort to bring China into the global system as an equal partner at the G20, bringing China into the World Bank and the IMF as equal players, basically make them stakeholders in the whole system, and working very closely with them, and I thought it was basically the right policy actually. I know many people in America wanted a much more confrontational style but I thought that would be foolish.

The great risk is doing to China what Britain and others did to Germany before the First World War when you had this great rising force, this huge industrializing Germany – I mean, Germany’s growth levels in the period from about 1880 to 1910 was comparable to China today. It was an incredible growth period, I mean, really explosive levels of growth, and the correct way to handle that should have been to draw Germany as much as possible into the family of – well, it was already part of the family of nations, but draw it into the governing system – and we all failed. They didn’t handle Germany well, and they created misunderstandings which fed on themselves, and eventually flew out of control. We all know what happened, and I think the risk is that this would be repeated with China.

What concerns me right now is the dispute that China is having with all its neighbours basically over islands and territorial claims in the South China Sea and the East China Sea. I was told by a Chinese professor that you are starting to see some of the `Japanese officer's syndrome' in the Japanese army in the 1930s when these militant, quite aggressive officers were simply slipping control of the political authorities, and famously invaded China without the authorization in 1931; they got bit between their teeth and just charged off and essentially launched an invasion. The difficulty is you are starting to see some of these attitudes creeping into the mid-levels of the Chinese army and navy, and that is a problem, as they rise to higher ranks. For fifteen years you've a deliberate policy of `patriotic education' by the communist authorities in China essentially trying to sort of revive their legitimacy by switching from Maoism, which had lost its potency, towards nationalism.

Unfortunately it has now become something that is very hard to control. We are seeing these kind of orchestrated showdowns in the East China Sea, and Japan has got an extremely tight defence alliance with the United States. The US is bound by treaty to defend Japan if those islands are attacked. So this is where it is getting very, very dangerous.

Two things could go wrong here: firstly, you've got Japanese nationalists, who could over play their hand and just drag America into a conflict that America does not want. Secondly, the Chinese are using this dispute to test America's resolve. They are trying to see how will America react: will America stand behind Japan or will it sort of take a much more nuanced position? So they are testing America, they are testing America's resolve in the region and whether America will stand behind its allies. I think this is all potentially very dangerous and I think it is much more dangerous than anything happening in the Middle East.

L.S.: But then again we saw that the Chinese and the Japanese are now trading in their own respective currencies. (2) Do you see that as significant?

A.E.P.: The Chinese have been buying Yen bonds for quite a long time. They have been wanting to diversify their holdings and diversify their trade patterns away from the dollar. The fact that trading in different currencies takes place, I don't think it is necessarily that tells us that much. We're seeing a complete collapse in Japanese car sales in China. I mean, it's dramatic. There was a 40pc to 50pc collapse in Honda and Toyota sales for October.

Essentially you've got a boycott of Japanese cars in China, you've got people in provincial cities in China driving Japanese cars being pulled out and being beaten up by mobs. To what degree this is being encouraged or at least to what degree are the authorities acquiescing and turning a blind eye, I don't know; but it is going on and you've got a de-facto economic war between the two countries. So this to me is what is in front of our eyes, it is undeniable. Is it just a temporary flare up or is it something deeper? I don't know, but it shows is how volatile and dangerous this is and how it can very quickly get out of control.

L.S.: Will China remain the economic engine for growth in the world, or do you expect a hard landing for the People's Republic?

A.E.P.: I think they already had a hard landing. I think it occurred in 2012. I think they jammed on the breaks. They had this massive property bubble, as you know, in the East coast cities like Beijing, Shanghai. They jammed on the breaks. I might add by the way that the credit growth in China as recorded by the IMF was about a hundred percent of GDP in five years from 2006 to 2011. Now that is twice the level of credit growth to GDP that occurred in Japan in the five years before the Nikkei bubble burst in 1990 and in the five years in the US before the sub prime bubble burst in 2008. So this is a huge level of credit growth. I mean they had an explosive bubble in China and a lot of people leapt on this thing and thought it was going to go on forever; it's not.

We have a combination of two things; a classic catch-up growth story as they took away years of blockages under the old communist system, and unleashed all this massive energy. It was based on cheap labour and imported technology, it's classic. They then pushed it in a latter phase by massive credit boom. It's fairly conventional catch-up story. Its not some special Chinese way; they haven't found some miracle cure; we've seen it before in many countries, and then they hit the rocks. China started to face infiltrate. It hit the brakes in late 2011, and then in 2012 we've had basically a hard landing. Probably growth is negative if you look at electricity use, freight, rail freight, what is actually going on in China rather than the official data.

Probably you are going to get some kind of temporary recovery, they are stepping up a lot of spending now on infrastructure projects, stepping up banks are lending again and massive investment in the railways is picking up again, in all the regions they are spending a lot of money like confetti to try and stimulate their economies. So there's going to be another spurt of growth for a while.

The question is, over the long run, can they sustain anything like the kind of growth rates they had for the last thirty years, I don't believe so. There is a report that came out earlier this year by the World Bank and China's development research council, which is the Bible of reformers such as China's Premier Wen Jiabao, and they warned that China was going to fall into the `middle income trap‘, the trap that has ensnared so many countries that seemed to be on the cusp of a breakthrough into the upper league before they faltered and hit this invisible glass ceiling and just fell back. They warned that China has reached this moment now, the thirty year growth model they had – relying on exports, massive investment, not enough consumption at home, imported technology – has basically run its course. Its low hanging fruit has been picked already, and basically if they are going to make it to the next level, the breakthrough that Korea has made and Japan has made, then they need a second economic revolution, they need to open up the system, they can't be top down. Creativity at the technology frontier is a completely different game.

You can't do it by central planning. You have to unleash market forces and no authoritarian state has done it yet. It was quite a dramatic report and the new Premier who has just come in in the last few days, Li Keqiang, said he offered his unwavering support. Unfortunately we've just seen the line-up of the new standing committee and it's backed with conservatives. By conservatives in China I mean dinosaurs. I mean people who want to maintain the old behemoths, the big state enterprises. It's a way for party bosses to control their regions. Many of them are loss making, they are very unproductive, fantastically wasteful of investment; they are a dammed disaster basically. They worked for China's development ten to fifteen years ago; now they've become the problem. China has to get rid of them. Unfortunately it looks as if they've promoted people who want to protect that whole system, so I'm afraid that the message we had from the eighteenth party congress in Beijing, which has just finished, was not optimistic at all.

I believe that China's economic destiny is in doubt now. For the next 20 years, the decisions they make today will determine whether they make the breakthrough to the big league, with per capita income sort of reaching western levels, or whether they just get stuck in the trap. I think it is still open, it can still go either way, but if they continue with the current system and get away with tinkering, I don't think that they are going to make it. Then they are never going to close the gap with the United States, and then they will grow old with a massive demographic crunch hitting later this decade and then accelerating in the 2020s; they will get old before they get rich.

L.S.: The BRICS nations are increasingly unsatisfied with the international monetary system. Is this justified?

A.E.P.: I don't have much sympathy for

this. China pegs its currency to the dollar, it doesn’t have to peg it’s currency to the dollar. It could do what other countries do and have an independent floating currency and then it wouldn‘t have any of these problems, it wouldn’t then be importing American monetary policy which was too loose for them 2009/2010 when America cut rates to zero; it basically imported this monetary policy, causing a huge inflationary surge in China. Well, that is their own policy and they didn’t have to do it. Countries that peg their currency to the dollar and then complain about the Federal Reserve cutting interest rates; frankly, I have no sympathy for that whatsoever.

And then the case of Brazil, for example, where Montega, the Finance Minister, is always going on about currency debauchery, or currency wars. It’s a complete cop-out. The reason why the Real in Brazil was much too strong was because of the completely inappropriate policies in Brazil. Essentially they were running a fiscal policy, budgetary policy that was much too loose, and therefore, to avoid inflation, the Central Bank was having to ramp interest rates up into the stratosphere to double digit levels to choke off the inflationary consequences of the government’s overspending. That caused a lot of money pouring into the country under the carry trade to take advantage of the high interest rates in Brazil. It was an entirely self-generated problem. So no, in answer to your question, I have no sympathy whatsoever for these people complaining that the currency system in the world is not working for them. They are simply deflecting blame from their own internal mismanagement.

L.S.: Since you’re very familiar with South America, what do you think about the “estrangement” of some major countries there (Brazil, for example) towards the US?

A.E.P.: Brazil is kind of losing its way, and I think people who deal with Brazil are quite concerned about this protectionist lurch that occurred. We’re returning from a period where they had a lot of free market reform towards policies that I think are entirely self-destructive. Brazil has not gone nearly as far down that road as Argentina, Venezuela and Ecuador, but it is beginning to edge into areas that are going to hold back Brazil and ensure that Brazil also gets stuck in the middle income trap.

The truth is they had a huge growth rate surge over the last ten years during the commodity boom, which is partly over for the time being. Iron ore prices have come right down, so it’s not quite as glorious for Brazil any more. They didn’t use that money very well; they didn’t spend it on dealing with the massive infrastructure problems, which in many respects are still third world, and now they are turning protectionist to deal with the consequences, they didn’t become properly competitive during that period. So I’m slightly concerned about the way they are developing.

I suppose what I’m saying is the whole BRICS story is overblown. I’m old enough to remember the 1970s when Latin America was doing really well and it was all due to the oil boom and the commodity boom and it looked for a while as if they were going to sort of catch up the west, catch up Europe and America and per capita levels of income, but then it all just fizzled up, price of oil came down, commodities came down, it all fizzled up and then they had to deal with the consequences for ten years and they had a lost decade in the eighties and it all came down to earth.

I don’t think it is going to be that bad this time, but I think they are coming back to reality. People got ahead of themselves on the BRICS story. They thought something profoundly new had occurred and it hadn’t. It was just one of those cycles, you have commodity cycles through economic history and then it settles down. In terms of your political question, I’m not quite sure I understand what you were driving at there.

L.S.: Well, some countries such as Venezuela do not have the kind of close relationships with the US that they used to have, and I think the same is true for Brazil.

A.E.P.: Yes, I mean, America’s relationship with Latin America has always been schizophrenic; you know the Monroe doctrine. They sort of basically declared it to be their backyard and no other country should interfere, and then at different times when they took over of those countries – Nicaragua, Honduras, Panama. In Mexico we’ve had this conflictive history for two hundred years; the US actually seized a large part of Mexican territory in 1848, the famous treaty of Guadalupe Hidalgo, and the whole of California and New Mexico and so forth all became part of the United States.

And so these wounds are still there and frictions continue with a very strong anti-immigrant movement as you know in the United States. It has become quite aggressive and it seems to be directed against Latinos because that is where a lot of the immigration is coming from. It has created this cultural hostility. It is the big brother syndrome and resentment against being pushed around, it is always there, it will always come back until such a time as Brazil fully gets its act together and claims it’s place, which it is perfectly capable of doing, as a complete equal of the United States.

L.S.: Now we are coming back to the Euro crisis. Is this problem the biggest danger for the global economy right now?

A.E.P.: Absolutely. I mean this thing has not been resolved. They’ve been buying time. The fundamental issue is that several of these countries in my opinion are not solvent. There’s been a pretence that somehow this is going to be solved without anybody taking any losses, but it can’t be, I’m afraid, and the reality is that at some point Angela Merkel is going to have to go to the Bundestag and explain why she has lost fantastic amounts of German tax payer’s money. The same is going to happen in the Netherlands and so forth and the parliaments of these creditor countries in the Eurozone. At the moment everybody is trying to deny, they are trying to kick the can down the road a little bit longer, but the essential problem is currency misalignment between North and South Europe; they should not be in the same currency.

That is a fundamental problem, there is a huge competitiveness gap, they are trying to solve it by enforcing austerity on the South through what is known as internal devaluations. That is an incredibly destructive way to do it because the way an internal devaluation works is to push up unemployment levels to such excruciating levels that you break the back of labour resistance to pay cuts, but to do that first of all you have to create a massive social crisis, and in democracies people don’t take very kindly to that. And secondly an internal devaluation forced upon countries with a very high debt level means you are shrinking the underlying economy, but the debt remains the same, so the debt to GDP ratio continues to rise. It’s been absolutely classic in Greece. The more they cut, the bigger their debt gets, the opposite effect of what was intended.

Normally with an IMF program, when they go into a country, they say right, there are three things. One, we have big austerity, fine. Two, we have devaluation of 30pc or 40pc. Three, we have a debt restructuring, we cut back some of the debt and on that basis we can rebuild a country. In the case of the Eurozone the IMF wasn’t allowed to do that so they had to keep Greece in the Eurozone. They couldn’t violate the sanctity of the Euro Project, so they had to keep Greece in the Eurozone. There could be no devaluation. They had all the austerity, but without the cure which is the 40pc devaluation that Greece needed, and we didn’t even have the debt restructuring for a long time. Eventually we had part of it in the private sector but they didn’t do enough, it wasn’t big enough. The public creditors, the governments in northern Europe, have not taken any haircut yet, and until they do you are not going to solve Greece’s problems.

But Greece is just the first of these countries; it went into this downward spiral two years before Portugal. I’m not yet convinced that Portugal is different. The thing to remember about Portugal is that its total Debt/GDP level, private debt + public debt, is actually more than 100% higher than that of Greece. Company debt in Portugal is enormous. Household debt is enormous. The Greeks are actually quite frugal in comparison. Greece’s combined debt level when this crisis began was one of the lowest in Europe, don’t forget that.

So I don’t think the situation is being resolved in Portugal at all, and then you get the big ones of Spain and Italy. I think it could have been perhaps manageable if the policy settings of the whole Eurozone had been much more expansionary, in other words if they had QE from the European Central Bank early on. You wouldn’t have had the same level of contraction, you wouldn’t have had the same level of the debt crisis, you would have made the whole thing much easier. But we are where we are right now.

The people in the City (of London) who are tracking this very closely think Spain is going to need debt restructuring because it got many of the same problems as Greece. It is going into the spiral where despite all the cuts Spain’s budget deficit is hardly coming down at all. It is down to be about eight percent, but nowhere near what they originally thought. They keep miscalculating.

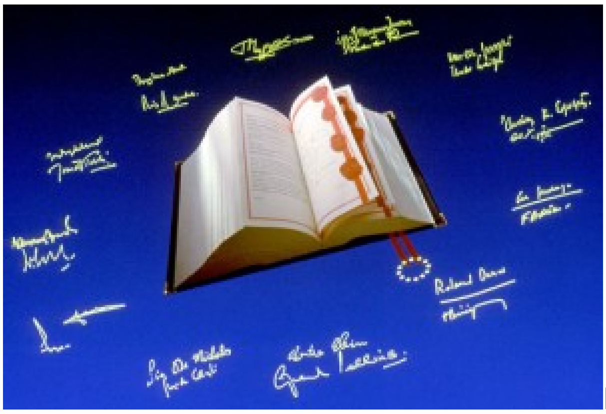
What they misunderstood and what the IMF has now come out to clarify, is that the fiscal multiplier is much higher than they thought. For every one percent of fiscal austerity you are going to get 1.5pc of contraction. This is self defeating and that is the problem. They are in a self-defeating downward spiral and I think the IMF, if you look at their new work on fiscal multiplier, have undercut the whole intellectual underpinnings of the

Eurozone’s response to this crisis. If you tighten your belt with a fiscal multiplier so high you are actually making it worse, you are not making it better. In Brussels and Berlin they are still in denial about it.

L.S.: Why do you view the EU project per se with very critical eyes?

A.E.P.: Well, first of all, I’m not against having an EU doing certain things. The problem is that the historic nation state is the natural forum of democracy in Europe. It has tried and tested institutions, institutions that are understood by the citizens and command their respect. You don’t achieve democracy by switching this to Europe. The problem is that they are concentrating more and more power in a structure that does not have any viable, working democratic institutions. You can try and pretend, you can create a European parliament, but in reality the European Commission, the executive arm of the EU, is not accountable to the European parliament, and nor is the European Council accountable to European parliament.

You’ve got a completely undemocratic structure, accumulating more and more power, and I don’t see how that could ever be made to function. You could make the whole leap forward to complete political union, you could replicate the United States with a genuine European parliament and an elected European president and so forth, but I think it is unworkable because there is no unified European people. There is no single language, there is no single way of looking at things, there is no shared political culture, it is a completely absurd project, and highly destructive for democracy.



Personally I covered many episodes where I saw this close up, like the European constitution which I covered in the Convention when they drafted it. It was initially supposed to restore civic faith in the Project – and remove the EU from the `nooks and crannies’ of national life – after the rejection of the Euro in Scandinavian states and a whole lot of anti-EU riots. The idea behind this was to bring Europe closer to the people, but in fact it was completely hijacked by the Euro elite. and on the presidium. Those who brought forward proposals saying, well, we don’t think the EU should be doing this, that these matters should be left in the hands of the nation states, they were overruled and treated with contempt. The convention was hijacked and eventually when the document came through, there were referenda as you know all over Europe. It was rejected in France, was rejected by an even bigger majority in the Netherlands.

It should have died then, but instead it was brought back. It was Angela Merkel who brought it back as the Lisbon Treaty, and I have never forgiven her for this. They pushed it through by Executive order. At that point France had a new government and Sarkozy decided for internal political reasons he'd go along with it. They ran it through the Lisbon treaty without a vote, and the one country that had a vote was Ireland, and Ireland said no. So they just told Ireland: you are disqualified, go and vote again, this is intolerable.

They simply ran roughshod over the popular will of Europe. And it is one thing to slip through these treaties without a vote the way they always used to do, but do so after a clear categorical rejection by the people in the referendum, to ignore this then to push it through without a vote is shocking. This is what they did. They pretend it is a different document, but by 99pc of the Lisbon Treaty it is the same damned thing as the European Constitution. And the crucial point is that this treaty creates a much more powerful European Court of Justice; it turns the ECJ into a Supreme Court. It makes huge areas of the EU law justiceable before the EU court.

This has far reaching implications and that is why Britain is withdrawing from all of this, from all the justice and home affairs stuff, we are pulling out of the whole thing. We had an opt-out when the Lisbon treaty came in, precisely because of these dangers. We are now exercising it; we're getting out of it. Britain is in effect leaving the EU and so, and to get back to your point, I was, I used to be in favour of it, but having followed it very closely, within the belly of the beast, I've seen how it works. I just felt that it was endlessly pushing and pushing and pushing, acquiring power without first securing popular support from within the member states, going beyond any sensible distribution of power between Europe and the nation states. I totally opposed this idea of political union. It is a terrible idea. And I know in Germany it is motherhood and apple pie, that everybody is in favour of a political union, but Germans should be careful because it could prove terribly destructive for Germany itself.

Germany has got a very successful democracy; it is a beacon of inspiration, it has got a constitutional court that is the only remaining body defending civil liberties in Europe any more, holding the European Court in check. Nobody questions the authenticity and vibrancy of German's democracy. It is a tremendous success story, so why would you give it up?

My view is that we should challenge this assumption that a political union in Europe is good; it is not, it is very bad, it's destructive to the achievements of Germany. Of course, in my own country, in Britain, we have a parliamentary system that goes back centuries. It has worked well and badly, but when it has worked badly we've been able to change it. It is not a bad record over time, so why would we give that up?

And then it is an absurd idea – that we need a leap forward to complete a new constitutional structure, that we need a constitutional revolution, and it is also passé, sort of twentieth century this idea that you can't have medium sized democracies trading with each other in an open cooperative way, you have to have some sort of super state structure, it's ridiculous.

L.S.: Do you interpret it actually as some sort of demagogy that the elites of the EU try to exploit the positive feelings of the European citizenry vis-à-vis Europe by saying on a constant basis: "The EU equals Europe"?

A.E.P.: They conflate a lot of things. They conflate sort of Europe and peace as if one has led to the other, they conflate Europe and democracies. First of all, we had a trend towards democracy across the entire world in the last two generations. It prospered in Europe because NATO forces contained the Soviet Union. I think there is a lot of confusion about this, there is a deliberate effort to make people equate peace, progress and democracy with the EU institutions as if they are functions of each other and that in my opinion is completely bogus.

Essentially you've got a priesthood pushing a religious agenda for greater European integration, which I don't think has any intellectual validity. It is able to do so because most people don't understand how it works, they don't fully see the threat of it. They haven't fully resisted it, although in the case of Britain people do at last see the threat of it and it is now being resisted.

I suspect that if there had ever been a vote in Germany over whether to join the Euro, to launch the monetary union in the first place, the people would have said no. It would have been quite difficult to get a yes vote, frankly I think Germany would have probably said we'd rather keep our D-Mark. The point is they were never asked. They were lured into this project with far reaching implications. They were never told the truth about what it meant or what the implications for Germany would be. They were never told that it is going to be extremely difficult to run a monetary union with economies at different levels of development, with different commercial systems and different labour laws , and different productivity growth rates. This can be extremely hard and it can lead to severe frictions and severe tensions. Eventually it can only be made to function by moving to full fiscal and budgetary union and effectively creating a single European treasury and pooling all debt, which means all Greek debt and all Spanish debt and Italian debt becoming German debt. They were never told this. It was a huge lie.

The elites went into this knowing that there were massive problems and probably couldn't work as originally constructed. You have to have fiscal union and a debt union at the end of the day. German people were never told this. The Dutch people were never told this,. The people were not told this in any country in EMU and they weren't given a vote. This basic constitutional revolution was pushed through on the quiet, dishonestly and so if you ask me why I am very sceptical about the European project it is because of this method, this Monnet Method of creating "facts on the ground" as they call it; you push the thing forward and it creates a situation where at some later stage you need a massive leap forward in integration to make it work. So they create an unworkable Euro, knowing that fifteen or twenty years down the road you would then have to have much deeper European integration to make it work. That is incredibly dishonest and deceptive what they did, Machiavellian, to push a project which I don't think should ever have been launched in the first place.

L.S.: One thing that you seemed to like with regards to the Euro crisis was the plan that "Europe's debtor states must pledge their gold reserves and national treasure as collateral" for rescue measures. (3) Why so?

A.E.P.: Well, I don't think I said that I like it, I simply reported it. What I have said is that it is an option if you want to try and save monetary union without going to fiscal union or debt pooling, which entails abolishing the democratic systems of these individual countries because the power of taxing and spending in the parliaments is the bedrock of democracy, it is what the American Revolution was fought over and the English civil war was fought over. This is the power of the purse as we call it; this is the bedrock of the democratic parliamentary system. And if you can take that away and hand it over to a European body then you've destroyed the democracies of Germany and other countries.

Now, the alternative which has been proposed by the five wise men in Germany was their redemption fund which is the opposite of fiscal union, it goes away from fiscal union. You return to the Maastricht system, the discipline where every country is responsible for its own debt. What you do is to create a sinking fund that pools a chunk of the debt, above sixty percent of GDP, into a general pool which is covered by joint borrowing. That means the Italians and others would effectively use Germany's credit card to be able to borrow at their rates rather than what the Italians are having to pay, but then you reduce this every year in a sinking fund based on what Alexander Hamilton did in the United States after the American revolutionary war, and then after about twenty years you reduce it to zero, so then you are back to a level where everybody is responsible for their own affairs; the opposite of fiscal union.

I'm not saying I'm for it, I'm saying if you wish to save the Euro (and I don't think saving the Euro is the desirable outcome particularly, certainly not in its current form), but if you wish to do it, and it would seem to me that if you are German you would prefer that option to fiscal union. This is exactly what I was told when I went to see the Council of the five wise men:

they said, my god, this is much better than going where we are going at the moment, or letting ECB do it and effectively do fiscal union by the back door, by mutualising it all through Central Bank financing. So the redemption fund is a way of avoiding all the things that we are most afraid of. But it requires a courageous decision upfront to come and do it, it requires quite a big commitment at the beginning to do it. I'm neither for it nor against it. I've reported it as an interesting proposal by the German five wise men and I'm surprised it hasn't been given more thought.

L.S.: Do you consider it as significant that central banks outside the Western hemisphere have become big buyers of gold?

>A.E.P.: Yes, I'd say it is. I mean, I think it is certainly for an investor in gold. As you know, the western central banks were selling short in the gold market essentially for many, many years in the late 1990's until the early part of this decade, and they are – or were – a major force in the global gold market. But of course these days the western central banks don't really have any reserves, as you know; I mean, the Bank of England has nothing basically.

The reserves that are being built up are all in the developing countries, they are in China, in Taiwan and Philippines, and so on. And in the case of China, only two percent of its reserves are in gold. I think they probably would like to target a level of more like ten percent, as Russia has said it is already doing. I mean, given that China has reserves of 3.2 trillion it is going to have to buy an awful lot of gold to get there.

So I think it is incredibly important, but what the western Central Banks do and the European countries do is almost secondary. The net buyers, the ones who are really going to influence the market are going to be emerging economies that have far too little gold at the moment in their portfolios and far too many dollar bonds, and Eurobonds to a lesser extent.

They suspect that one of the ways out of this global crisis is going to be massive monetary reflation at some point. And that means if you are holding all this stuff, you are going to get burned, and that doesn't just apply to central banks, it applies to anybody holding bonds frankly. If you are in government bonds in any of the western countries I think you are going to get brutally burned in the next fifteen to twenty years. If you are hoping that this is going to be your pension, you need to think again because once inflation comes in earnest, that stuff is coming up in smoke. **You can see why people would want gold, as a big chunk of their portfolio**.

>**L.S.: We hear sometimes – in my humble opinion from very foolish people – that gold is in a bubble, but isn't it the truth that the bond market is in a bubble?**

A.E.P.: I think the bond market is fantastically mis-priced. I think the relationship of sovereign bonds to equities is completely out of proportion. This is unprecedented. I know this continued to occur in Japan and people said back in the nineties that bond yields couldn't fall any further, and here we are fifteen years later and they are still falling. You know they've gone below one percent on ten year bonds and so it could continue, but I don't think the rest of the world is Japan. They think that Europe and America are not going to go that route; I think they will reflate, they will engage in massive monetary stimulus to get out of this, **they will not allow deflation to take root**. So the outcome is going to be different and that means bonds will be massacred.

Call it a bubble? Difficult to tell. I mean, it's a safe haven flow, but also there's a lot of regulatory repression, I know in Britain the pension funds are forced to buy this stuff by regulations and unfortunately they are creating a long term disaster for people probably my age, when we get to retirement we're going to find that stuff has gone up in smoke. So yes, the bond markets are massively mis-priced; that's an accident waiting to happen, but it's not a prediction that it will happen immediately because the crisis right now is deepening and as long as that is the case the bond yields will continue to fall.

L.S.: What are your thoughts on the controversial topic of the German gold reserves that are held in New York City, London and Paris?

A.E.P.: Well, I think that it is quite extraordinary that the Bundesbank pulled out two thirds of its gold from London in early 2001 I believe it was. This seems an odd thing to do, I mean, they had a very large share of the gold reserves sitting in London, and why did they do this?

It happened to be a time when Gordon Brown had ordered the Bank of England to sell over half of Britain's gold. We were doing so at the bottom of the market, I might add. We managed to create the bottom of the market, these auctions were the lowest points reached – I think 252 dollars an ounce and Britain sold off some of its gold, a lot of it under 300 dollars; fantastically stupid thing to do in retrospect, but then Gordon Brown thought it was a "barbarous relic" and thought it had no place in modern finance. He entirely bought into the modern fiat triumphalism.

So the word going around in London is that the Bundesbank had reason to fear that those holdings were not secure anymore and that maybe the Bank of England had sold short some of its gold, leasing it out; or maybe got over extended. Clearly that didn’t prove to be the case as far as we know, but maybe they were concerned about that at the time. Apparently these gold bars in London were not numbered, so the Bundesbank was keeping un-numbered bars there. All they had was a metal account in the Bank of England. They didn’t have specific allocated bars under their name which is, I find, a completely extraordinary situation as they should have done that. I would think the Bundesbank might want to answer to its German citizens about why it was doing that.

L.S.: Well, maybe I will do it. – Another question related to this topic: have you seen any convincing reasoning why Germany should keep a large amount of its gold reserve at the New York Fed? After all, it is reportedly some 45 percent of the total amount of roughly 3.400 tons.

A.E.P.: The original argument given was because they were afraid of a Soviet tank attack over running Frankfurt in a few hours. They had to have it safe a long way away. Obviously that issue has become irrelevant. The other argument is you need it for trading, and I think a member of the executive board of the Deutsche Bundesbank, Andreas Dombret, mentioned this in fact in his speech in New York. So you need it there for trading. Well, ok, what are you doing if you are trading it, what are you doing exactly, in what way are you trading it, should a central bank be trading that stuff or should it be sitting on the asset? I think it asks for an awful lot of questions if they are keeping it in New York because they need it for trading. Then I think people might want to know what kind of trading it is and why are they trading it.

As I understood it, you might want to shift the weighting of your assets. I know the Bank of Italy very aggressively shifts its assets, so it switches from one holding to another. At one point it had a fantastic amount of sterling which it played the market beautifully; it bought sterling bonds just at the point when sterling was rising and then when sterling got too high it sold out its bonds and got some other bonds. So it plays the market beautifully. It has done a great job for the Italian citizens actually doing that. Even the Russians are doing this, they buy the dips and then sell the tops. The Russian central Bank is playing a market game with mid-term cycles.

I guess that’s what central banks are doing these days and it’s a question for German citizens, do they want their Bundesbank to generate profits as a trader buying dips and selling tops and thinking it can outsmart the market, does it just want to hold on to this stuff in case of an emergency one day. That’s a democratic choice frankly and probably not for me to answer.

L.S.: OK, I promise to you hereby that I will ask the press department of the Bundesbank these interesting questions that you have raised as soon as our interview will be published.

A.E.P.: Well, good luck. I don’t suppose they will be terribly forthcoming. I have heard that they have been clearing out their archives to make way for more gold. So some of the archives have had to be moved to other facilities because that part of the bank is going to be storing, it sounds as if the pressure movement in Germany has had some effect if they feel they need to bring more of this back.

L.S.: Hopefully it will be more in the future. Be it as it may, in a recent article of yours you showed yourself fascinated by a working paper of the IMF that calls for the replacement "of our system of private bank-created money with state-created money." Can you explain to our readers why this is indeed a major problem?

A.E.P.: This paper by the IMF is a revival of the Chicago plan from the 1930s. It is basically a shift to full-reserve banking, separating monetary and credit functions in the system. It is a very archane and complex area of banking and finance and this is getting a lot of attention. I don't take a view on it personally, I'm neither for it or against it. I think it is a fascinating debate in its infancy.

I was having coffee with a shadow finance minister, basically the finance spokesman for the opposition, from New Zealand of all places, and he had a copy of this in his hand he was waving it at me and saying this is incredible stuff. And it was actually New Zealand that pioneered the whole trend towards inflation targeting in Central Banks so you know these small countries can have influence. But he was saying this is incredible stuff, and so I began to think, well, maybe if the people in public positions take it seriously I should take a closer look, so I did and I wrote a piece about it.

They are basically arguing you could cure the entire debt crisis at one stroke. You simply change the whole monetary system, you force the banks to hold one hundred percent reserves. The government then gives them money as an equity stake. It is kind of complicated, but essentially just wipe out the debt at one stroke and America would not have any public debt – you know, you could do it in ten minutes. Same for all the western European countries, just eliminate your debt.

It sounds too good to be true, the magic wand, but they argue it in great length and I recommend anybody who wants to analyse just to read it for themselves because it is a very long complex document. It is quite a big thing. In it they go through the history of money and they argue that actually it is not true that money began as a commodity based currency, metals or something of value was exchanged and just developed privately.

All through history from the mists of time, as far back as they have any records, there were publicly controlled currencies. Aristotle's "Ethics" actually argues this explicitly that currencies are created by the law. The Athenians under Solon developed one, it was quite explicitly done. He had a debt jubilee after the debt crisis. They forgave debt, they created this new fiat currency controlled by the state. The Romans were so impressed that they eventually sent over a delegation later in the fourth, fifth century BC and copied it and brought it back to Rome. The whole early Roman Empire was based on a fiat currency, the metal I believe was iron, they knew it was worthless, just like paper is worthless, but that was the point. Because it had the imprimatur and the seal of Rome on it, that's what gave it its value, so it was a fiat currency. So this has always been with us.

I think there's a view out there among a lot of people that somehow we've always had hard currencies based on gold or whatever, and this is a very new thing when central banks came and created fiat currencies. That's when it all went to pieces, but no, we've always had fiat currencies. There has always been an argument going back for millenniums about whether it should be based on commodity or based on fiat. This is an ancient debate that has gone back and forward. Gold has always been valuable but that is not quite the same thing as saying it is the basis of the currency.

I have followed closely – as a historian – the gold standard, and how it worked in the twentieth century and how it all went wrong. I don't think the gold standard solves any problems; it is a human instrument. You can make a mess of it, you can run it well. And they ran it very well in the 19th century and made a mess of it in the interwar years and that led to disastrous consequences. So it is a completely human instrument. I don't really share this view that somehow if you switch to a gold standard system for currencies you would solve problems.

L.S.: No, it's absolutely fine – if we give our readers a few incentives to take a look at this IMF paper and maybe also at the original work of Irving Fisher, then we have fulfilled our duty with holding this conversation.

A.E.P.: Well, then let me elaborate. This plan was proposed I think in 1936, I believe it was by Irving Fisher and a Chicago economist who was a leading economist in the United States in those days, Henry Simons. They thought basically if they could separate credit and monetary policy you could run the economy much more smoothly, you could avoid these boom bust episodes, you could make sure you don't have banking systems running amok and creating uncontrolled amounts of credit. Frankly I'm a little suspicious of all of this. I think it is quite depressionary.

The creation of these private currencies and private banking accompanied a freeing up of the system and of people, when you got away from those medieval, authoritarian, control over everything. They freed it all up in the 17th century with the fractional reserve banking system, the modern banking system we now know, came into existence and was developed in England. It was incredibly creative and so I'm a bit suspicious when you have three hundred and fifty years of very successful history; the greatest leap forward in technology and wealth creation has occurred under fractional reserve banking, and now you're saying because of a crisis in 2008 that the whole thing has to be abandoned.

I don't find that very compelling as an historian. I like to see a bit more evidence on that. I mean one episode, the 2008 episode, 2007, 2008, 2009 episode in the great sweep of history, is a detail, it does not really tell us very much. And I know when you live through it it seems so engulfing and so important, but then stand back and say well actually what drove the last three hundred years of incredible global development; I mean what drove that?

The fact is that western societies did switch to develop a fractional reserve banking system which allowed this credit creation, and the Islamic world did not and actually clamped down on it, and made it even more difficult to have any kind of usury banking, and the Islamic world went into terminal decline, they went in totally opposite direction. This should make people a little careful about some of the conclusions they reach. And as I said, I'm just keeping my mind open on all of this. This debate about a hundred percent reserve banking and these variants in the IMF paper, this is going to be a major issue in the next few years, I think. It is fascinating, but I'm not ready to reach a conclusion either way.

L.S.: Talking about suspicion, in the same article you have said that the "100 percent money" approach à la Irving Fisher "would smother freedom and enthrone a Leviathan state". Why do you think so?

A 2010 video recording

A.E.P.: Well, I think I was quoting Professor Tim Congdon, who is a leading British monetarist. He is totally opposed to this. He is a defender of the current system; he thinks it should be run better. He thinks that Fisher was essentially authoritarian; he was a great believer in prohibition in America, he had this side to his character which was anti liberal. Basically he was saying these naughty bankers, these naughty casino capitalists should be stopped from doing all these things. And Congdon's view is that this is just a feature of human nature and what you're saying is people can't gamble, they can't do these things. He thinks that is illiberal.

I was also suspicious, whenever you concentrate more power in the state you create potential for some form of abuse later and I'm a libertarian personally and I think the power of the state should be limited always, should be carefully controlled. Every time you give further powers to the state you have to have a very clear argument in my view about to why this is being done. My natural reflex is one of the foundations of English common law which is that you should be able to do anything you want unless the law specifically prohibits it and the law must have a very good reason for prohibiting it and that should be the foundation of our legal and political system; that's a libertarian perspective .

You could have what von Hayek called a "catallaxy of currencies", you have competing currencies. You throw it all open and say right, well, if the state is running a bad currency let somebody else run a good one and see if people use that one instead – the good will displace the bad. If you have monopolies like this and you say only the state can do it and nobody else can do it then you know, well, ok if you have a good state fine, if you have a bad state it goes horribly wrong. You have no alternative that can hold the state to account.

This is another reason I'm against the gold standard, I think it is good to have free gold that is not controlled by any government, and instead of trying to use it as a foundation for currency which they will try to manipulate. It is better to have it as free, as a store of value and it holds public currencies to account – people can see gold rising against other currencies and that tells you something. It is the final reproach for the other currencies; it is sort of the umpire if you like. It sits there as a store of value and it goes up and down and by its movement it tells you about the other currencies. It holds governments to account. The last thing you want is gold to be concentrated in the hands of the government, who then say we have a gold standard; worst possible thing. You want gold to be completely free.

L.S.: And if the state would be the only issuer of money, couldn't it be that some influential people in high places will argue that the money supply should be checked by re-introducing the gold standard of the supposedly good old days?

A.E.P.: Well, we get back to this whole point about how the Eurozone is working. I mean the gold standard worked in the 19th century because the creditors, the countries in surplus had to stimulate and the countries in deficit had to cut and that's how we brought it back into balance. The problem is it all went wrong in 1928 when countries accumulating the surpluses, France and the United States, hoarded this surplus and refused to stimulate and then that just created a contractionary bias for everybody. You've got to play by the rules of the game so it only worked in the 19th century because those were the rules of the game and the Bank of England was enforcing it essentially for the whole system, but everybody played by the rules of the game and understood what they had to do.

It broke down after the First World War when America came back undervalued on the gold standard, and then France came back undervalued too, building up huge surpluses, it was incredibly destabilizing. It didn't stop the money supply expanding in America, it didn't stop the massive bubble that occurred in the mid-twenties in America. I don't see the attraction of the gold standard. I think it is an illusion actually that it will solve problems. And furthermore, what you're doing is you're taking away gold as a free store of value outside of anybody's control which I think is it's best use.

L.S.: As you have already mentioned, in order to democratise money wouldn't it be fine to get rid of the single national currency system and enable a "free money competition" with different kind of forms of money for different kind of purposes? Then people are free to choose and agree upon what they want to use as money, but they are no longer forced to by the state. Moreover, I can imagine – as you do – that this could be an impulse that "good money drives out bad money".

A.E.P.: Yes. I mean, oddly enough the British Chancellor Exchequer Nigel Lawson proposed a version of this. He was suggesting having a sort of competing currency, you could have a European currency that operated alongside the national currencies and if it worked it worked. That actually was a very good idea; it would be a lot better than what they did. I'm not against this sort of idea, this “catallaxy of money”; I’m all in favour of creative solutions, and if it’s good money and people accept it – excellent, just let the market decide.

However, this goes against the whole direction of the regulatory crusade at the moment; it wants to clamp down on anything like this. It wants to stop the private entrepreneurs or banks whoever they may be from doing anything. Basically at the moment it is trying to restrict their activities, not expand them, and the argument would be with people of this mindset, they will say; if you allowed them to start creating currencies, everything would be out of control. So you’ve got this mindset that you have to suddenly control everything, regulate everything and over-regulate everything. It is completely the opposite direction in which we are now going. So I think it’s a nice ideal in the distance, but it is not something remotely on the table at the moment.

L.S.: Thank you very much for taking your time, Mr. Evans-Pritchard!

A.E.P.: Thank you very much!

SOURCES:

(1) See for example “U.S. Expected to Become World’s Top Oil Producer by 2020“, Time, November 12, 2012, http://business.time.com/2012/11/12/u-s-expected-to-become-worlds-top-oil-producer-by-2020/#ixzz2C7m1JWXg. However, there are also dissenting views on the new IEA forecast of US and world oil production, see for example Gail Tverberg: “IEA Manipulates Stats to Predict Unrealistically High Oil Forecasts”, OilPrice.com, November 15, 2012, http://oilprice.com/Energy/Crude-Oil/IEA-Manipulates-the-Stats-to-Predict-Unrealistically-High-Oil-Forecasts.html

(2) See also that “South Korea, China and Japan will soon start talks for a free trade pact that will encompass three of the world’s biggest economies,” as quoted in: “South Korea, China, Japan to soon start talks for giant free trade pact”, Washington Post, November 19, 2012, http://www.washingtonpost.com/business/south-korea-china-japan-to-soon-start-talks-for-giant-free-trade-pact/2012/11/19/e3816e66-3223-11e2-92f0-496af208bf23_story.html

(3) Compare Ambrose Evans-Pritchard: “Europe’s debtors must pawn their gold for Eurobond Redemption“, The Telegraph, May 29, 2012, http://www.telegraph.co.uk/finance/financialcrisis/9298180/Europes-debtors-must-pawn-their-gold-for-Eurobond-Redemption.html. On the topic of gold backed bonds in the Eurozone see also European Parliament / Directorate General for Internal Policies, Policy Department A, Economic and Scientific Policy: “A More Effective Euro Area Monetary Policy than OMTs – Gold-Backed Sovereign Debt”, September 2012, http://www.europarl.europa.eu/document/activities/cont/201210/20121008ATT53122/20121008ATT53122EN.pdf

(4) Compare Ambrose Evans-Pritchard: “Bundesbank slashed London gold

holdings in mystery move”, The Telegraph, October 24, 2012, http://www.telegraph.co.uk/finance/financialcrisis/9631962/Bundesbank-slashed-London-gold-holdings-in-mystery-move.html

(5) Compare Ambrose Evans-Pritchard: “IMF’s epic plan to conjure away debt and dethrone bankers“, The Telegraph, October 21, 2012, http://www.telegraph.co.uk/finance/comment/9623863/IMFs-epic-plan-to-conjure-away-debt-and-dethrone-bankers.html