Gold, Interest, and Land

Creating money not based on gold, manipulation and inflation rather than the natural interest rate, and land-value subsidies, all skew and distort prices and profits.

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Three seemingly unrelated variables are in fact deeply connected. Gold has been the most widely used money, and in a pure free market, gold would most likely come back as the real money. Free-market banking would mostly use money substitutes such as bank notes and bank deposits, but these could be exchanged for gold at a fixed rate. Free banking would combine price stability with money flexibility.

Interest is ultimately based on time preference, the tendency of most people to prefer present-day goods to future goods, due to our limited lifespan and the uncertainty of the future. In a free market, the rate of pure interest would be based on the interplay of savings and borrowing. Interest is not just income and payment, but has a vital job in the market economy. The job of the interest is to equilibrate or make equal the amounts of savings and borrowing. This also equalizes net savings (subtracting borrowing for consumption) and investment. Investment comes from savings, and the job of the interest rate is to make sure that net savings is invested.

Economic land, meaning all natural resources, is related to interest, since land is usually bought with borrowed funds. The buildings and other capital goods in land are also often produced using borrowed funds. Thus the vital connection is credit. Developers borrow money at some rate of interest to buy land and construct buildings, and then households borrow to buy the real estate. With equity finance, such as with partnerships and shares of stock, the rate of return on the assets are related to the rate of interest. The interest rate also capitalizes rent into land value, as the price of land rises as interest rates fall.

In a pure free market, gold, interest, and land are in harmony. The pure market interest rate is set by the equilibrium of savings and borrowing. Income not saved is used for consumption, and savings goes to investment, so all income is spent. Landowners pay for territorial services such as streets, parks, and security, and with no subsidy, there is no excessive land buying and construction, and no holding of land out of use in anticipation of future subsidies.

In a pure free market, there is no real estate boom-bust, and no business cycle. There is full employment, because workers keep their full wage, and the cost of labor is not artificially increased by taxation and restrictions. There is no credit crisis, because with no subsidies, land prices would be very low, and borrowing would be for capital goods and enterprise, not for land.

In today’s economy, we use fiat money, not based on any commodity. Money is centrally planned by the monetary authority. Since the correct money supply is unknowable and can only be determined by a pure free market, the central bankers will often create instability in their attempt to either stimulate or “cool off” an economy. The interest rate is unable to do its job, since it is manipulated by the changing money supply, and inflation masks the real interest rate. Markets cannot properly conduct economic calculation, because the observed interest rate involves both inflation and the artificial rates targeted by the central banks.

In today’s economy, land values are grossly inflated by subsidies, mostly implicit. Low interest rates caused by money expansion promotes real estate construction and purchasing, inflating land values.

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landowners get the implicit subsidy of services paid for by taxing workers and business, but real estate gets special tax breaks: tax deductions for interest and property taxes, capital gains exemptions and postponements, multiple depreciations, and low capital gains taxes. Housing guarantees and government-sponsored secondary mortgage markets further puff up land values.

Fiat money rather than gold; manipulation and inflation rather than the natural interest rate; and land-value subsidies, all skew and distort prices and profits. An unsustainable land boom financed by artificial credit has to collapse, and the financial crash then further brings down the economy.

And then politicians, commentators, and even economists blame the non-existent free market. Why are they blind to the interventions? There is a cult called "statism" that most people suffer from. Curing it is almost impossible, since the state also controls education. Even when statists are given the explanation, they don't believe it. Logic and evidence cannot penetrate a deeply held bias. Perhaps the remedy will be the creation of new countries on floating platforms in the ocean, islands of economic sanity in a world of economic madness.

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FRED E. FOLDVARY, Ph.D., (May 11, 1946 — June 5, 2021) was an economist who wrote weekly editorials for Progress.org since 1997. Foldvary's commentaries are well respected for their currency, sound logic, wit, and consistent devotion to human freedom. He received his B.A. in economics from the University of California at Berkeley, and his M.A. and Ph.D. in economics from George Mason University. He taught economics at Virginia Tech, John F. Kennedy University, Santa Clara University, and San Jose State University.

Foldvary is the author of *The Soul of Liberty*, *Public Goods and Private Communities*, and *Dictionary of Free Market Economics*. He edited and contributed to *Beyond Neoclassical Economics* and, with Dan Klein, *The Half-Life of Policy Rationales*. Foldvary's areas of research included public finance, governance, ethical philosophy, and land economics.

Foldvary is notably known for going on record in the *American Journal of Economics and Sociology* in 1997 to predict the exact timing of the 2008 economic depression—eleven years before the event occurred. He was able to do so due to his extensive knowledge of the real-estate cycle.

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