

# **ARCHITECTURE FOR A NEW WORLD FINANCIAL SYSTEM**

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## **Historical background**

The Symposium was held at the historic town of Hall in Tirol, Austria, for a good reason. Hall in Tirol (just east of Innsbruck) had been the “monetary capital” of Europe for centuries.

It all started in 1477 with the moving of the Mint from Meran in South Tirol (now part of Italy) where it had been operating since 1271, to Burg Hasegg in Hall, by Archduke Sigismund of Austria (1427-1496). At the same time the Archduke instituted important monetary reforms. *He opened the Mint to silver.* As a result, silver mining was revived in the valleys of Tirol, and new mining methods and technology were developed. Ultimately, the much-debased coinage of Medieval Europe was replaced by sound currency that brought heretofore unprecedented prosperity to the people of Renaissance Europe. The currency reform of Archduke Sigismund has laid the foundations for the architecture of a new world financial system.

The coins issued by the Mint were revolutionary in several respect. The fineness of silver coins was 937. Prior to this date, practically no silver had been coined in Europe. The size of silver coins was also increased, first from 4 to 6 Kreuzers and again, in 1484, with the introduction of the half-guldengroschen, from 6 to 30 Kreuzers. The runs were still small. The real revolution occurred in 1486, when the size of the silver coins struck at the Mint was doubled, and serial production was introduced.

As the fifteenth century drew to a close, coinage throughout Europe was in a shambles. The financing of ceaseless wars between dukes and kings over territorial disputes was largely done through the debasement of the silver coinage. The fact that the rate of debasement differed from country to country, from dukedom to dukedom, only made matters worse. Trade, investment, and progress were hampered by the lack of uniform, easily recognizable, and reliable means of payment.

The Great Debasement of Middle Ages in Europe was akin to the debasement of coinage a thousand years earlier, culminating in the collapse of the Roman Empire in 480, followed by a breakdown of law and order lasting for centuries. Had the Great Debasement of the Middle Ages been allowed to continue, history would have repeated itself, and another breakdown of law and order lasting for centuries would have followed.

Also, there was an incessant drain of silver from Europe to Asia, especially to India, Indonesia, and the Far East, representing payments for exotic Oriental goods such as spices, porcelain, silk, and other fine fabric and cloth. The word „consumerism” could be applied to this period as well, meaning the „conspicuous consumption” of the aristocracy. Just as today, the one-way trade from Asia was sapping the resources and threatened the prosperity of Europe.

The demand for reliable and uniform silver coinage to finance expanding trade was met by the currency reform of Archduke Sigismund. As more silver was coming from the mines due to improved mining technology, minting technology was also changed to make large mintages possible. Mass production methods in striking silver coins were introduced. Previously, coins had been struck individually by hand from single blanks. No wonder that issues were small. In 1486 the Mint in Hall introduced silver strips to replace silver blanks, and installed machinery to strike silver coins serially from the strips. The machinery was made of wood and was powered by hydraulics, but was still strong enough to allow doubling the size of the silver coin from 30 to 60 Kreuzers (from 5 to 10 Groschens). Thus was the historic Guldengroschen coin, nicknamed the guldiner of Hall born. It served as prototype of the other historic coin 30 years later, the thaler.

In 1490 Archduke Sigismund ceded his control of Tirol, rich in salt and silver (both having monetary importance) to his cousin, the future Holy Roman Emperor Maximilian I (1459-1519), a towering historical figure, recognized as the second founder of the House of Habsburgs. Their names are shining in the monetary history of the world. History books assert that the Modern Age started with the discovery of America by Columbus in 1492. They got it wrong. The Modern Age started with the opening of the Mint to silver in 1487 by Sigismund and Maximilian.

The father of Maximilian, Emperor of the Holy Roman Empire, Frederick III, suffered a great setback in his fortunes when the king of Hungary, Mathias Corvinus occupied the Habsburg capital Vienna in 1485. He had to pay for his defeat a second time as well: next year the electors forced him to give up his title as the King of the Romans and elected Maximilian in his stead (while he could retain his title as Emperor until his death in 1493).

Maximilian I was crowned in Aachen on April 9, 1486. This important event was followed by the first issue of the Guldengroschen, struck from silver found in Schwaz near Hall, in 1487. The new coin was an instant and unqualified success. Indeed, it was a landmark in the monetary history of the

world. The silver coin soon reached world-class status as its mintage beat all earlier records, and its circulation spread all over Europe. Naturally, the success of the guldiner soon attracted imitators in every dukedom of Europe with a silver mine.

The winner among these imitators was the Joachimsthaler nicknamed “thaler” (from which the English word “dollar” was derived). The silver came from the rich mines of Joachimsthal, or Joachim’s Valley, in Bohemia (today, the Czech Republic). Saint Joachim, the husband of Saint Anne and the father of the Blessed Virgin Mary, is commemorated by the first thaler struck 30 years after the inauguration of the guldiner in 1518. It was of similar physical size but had slightly lower fineness. It became the standard for silver coinage for almost four hundred years in Europe and, later, in America.

The market dropped the guldiner and embraced the thaler. The Mint in Hall had to turn to the production of thalers of which it struck 17 million specimens during the 20-year period from 1748 through 1768 alone.

Burg Hasegg was built in the late 13<sup>th</sup> century. It housed the Mint from 1477 through 1806 when coin production ceased partly because of the Napoleonic wars, partly because of the exhaustion of nearby silver mines. The Mint in Burg Hasegg is a museum now, open to the general public. It displays minting presses at their various stages of development, including (a replica of) the first mass-producing minting press utilizing silver strips instead of silver blanks. Demonstrations of historical printing techniques are given from time to time. The castle itself is an example of early Gothic era Tirolean fortress architecture, with an impressive watchtower, the Münzerturm.

On June 9, 2010, I climbed the 204 steps leading to the top observation deck of Münzerturm. It offers an unparalleled view of the valley of the River Inn and the mountains enclosing it. There was a guestbook, in which I wrote the following sentence:

*Open the Mint to Gold Again!*

Let us hope that world leaders will have the wisdom of Archduke Sigismund and Emperor Maximilian I who opened the Mint to silver, thus saving European civilization from further decay, ushering in the “Silver Age” of prosperity.

Once again, both civilization and prosperity are in grave danger as a result of spiraling monetary debasement and one-way trade from Asia to Europe, threatening the West with capital destruction and shrinking employment. This trend can be reversed only through a return to sound currency. Opening the Mint to gold would usher in a new “Golden Age” of prosperity.

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## The Great Financial Crisis

The present Great Financial Crisis is far from over. In fact, it is getting worse. It can be described as a debt crisis or, at its roots, a belated gold crisis. The landmark year was 1971, when the United States defaulted on its international gold obligations. Now there have been many defaults in history, but the one forty years ago was unique in that it exiled gold from the international monetary system; *thereby gold has been prevented from discharging its natural function as the ultimate extinguisher of debt ever since.*

When you pay a debt of \$100 by writing a cheque on your bank account, the debt is not *extinguished*, it is merely *transferred* to your bank. If you pay it by handing over a \$100 Federal Reserve note, the debt is not extinguished either but is transferred to the Federal Reserve bank that has issued the note. Ultimately the U.S. Treasury is responsible for all the liabilities of the Federal Reserve. Under these monetary arrangements the total dollar debt outstanding can only grow, never contract, even if there is a net reduction of debt in the economy. All debt presumed to have been extinguished will ultimately show up as an increase in the indebtedness of the U.S. government. No matter how you look at it, the desire to retire debt is frustrated by the lack of an ultimate extinguisher in the system. The consequences are frightening.

Let's draw a biological, nonetheless valid and convincing analogy by looking at the human metabolism. The elimination of toxic waste from the human body is of paramount importance. Bowel movement and passing water are the two main forms of excretion. If either of these processes is blocked permanently, death becomes inevitable. It is no different with the economy, albeit death may be longer in coming. The economy uses credit all the time, and some of it will turn out to be toxic even in the best of circumstances. If there is no way to eliminate this toxic waste from the system, that is to say, if there is no ultimate extinguisher of debt, then death is near. In the world economy, gold is the main agent of detoxification.

The tragedy is that the captains of the world economy refuse to realize that runaway debt is the logical consequence of their having exiled gold from the international monetary system in 1971. They try to cure the bad effects of too much debt, or the presence of toxic debt in the system by introducing more of it. They have no idea how total debt could be decisively reduced and toxic debt safely eliminated.

They are playing a very dangerous game with the welfare of the people. When credit collapse finally comes, production disappears, employment shrinks, law and order break down. We are running into an unprecedented crisis with our eyes blindfolded. Wishful thinking will not coax out "green shoots".

## **Open the Mint to Gold!**

The economic disaster staring us in the face will force the recognition that we have to change course. The present leadership will have to admit that its theories and practices have utterly failed. They will have to give up their position in disgrace, and the new leadership will have to see reality as it is. They must see that gold has a place in the body politic as well as in the body economic. They must return the world to the gold standard which is the only monetary arrangement that provides for an orderly retirement of debt, and is capable of doing justice between consumption and saving. The world needs a new financial system with stable exchange rates, stable interest rates, and stable bond prices. The architecture of this new financial system must involve three principles.

FIRST, the Mint must be opened to gold. What does this mean? It means that if people think that there is not enough money in circulation, they can do something about it. They can take their gold to the Mint and exchange it for the gold coin of the realm free of seigniorage charges, and with no limit imposed on the amount. In other words, they would get gold back in coined form, ounce for ounce, and the cost of minting would be absorbed by the government, the same way as it absorbs the cost of maintaining highways in good repair. Such a regime is mandated by the U.S. Constitution, and is referred to as “free and unlimited coinage of gold”.

Conversely, if people think that there is too much money in circulation, they should be able to do something about that, too. Owners of gold coins of the realm must have the right to hoard, melt down, or export them as they see fit. In this way the power to regulate the money supply will be vested in the people, rather than in representatives or unelected bureaucrats. When you look at it this way, you realize that the destruction of the gold standard in the 1930’s was a power-grab, pure and simple. The power to create money is *unlimited* power. As such, it must be reserved for the people. Take it away, and you have overturned constitutional order. Opening the Mint to gold simply means a return to limited government and to the principle of separation of powers. The world-wide regime of irredeemable currency will in retrospect appear as a brief reactionary period in history.

## **Abolish legal tender protection of paper money!**

SECOND, legal tender protection of fiat money must for once and all be declared unconstitutional. This measure is necessary to remove coercion whereby the government can force citizens to provide services against irredeemable promises to pay.

Such coercion was first legalized in France and Germany in the year 1909, five years before the outbreak of World War I. These countries wanted to make sure that their military and civil service can be paid in chits, thus putting the

defense and labor force at the disposal of the government, independently of the state of budget and collection of taxes. In this way the electorate was denied its say in deciding whether the planned war is worth the blood and treasure to expend, or when to stop a war already in progress. World War I could have come to an early end but for the legal tender laws. As soon as treasuries had run out of gold, the belligerent governments would have been forced to make peace, unless the electorate agreed to pay for continuing the bloodshed and destruction of property in the form of higher taxes and sending more young men to their death in the trenches.

### **Bring back self-liquidating credit!**

THIRD, Adam Smith's Real Bills Doctrine should be rehabilitated. Bills of exchange, drawn on merchandise in urgent demand, maturing into gold coins in 91 days (the length of a quarter), must be allowed to enter into spontaneous monetary circulation. The credit represented by maturing bills of exchange — representing a mass of goods moving apace to the final consumer, also known as social circulating capital — is elastic and self-liquidating. It flows and ebbs with the variable need for goods and services. Most importantly, it is liquidated at the time when the ultimate gold-paying consumer withdraws merchandise from the market. For this reason it is *not* inflationary.

Our financial system lacks self-liquidating credit and, in consequence, the debt tower of Babel just keeps growing until it will topple and bury the world economy under the debris. Real bill circulation would bring back self-liquidating credit. This would guarantee the flexibility of the monetary system not through government coercion but through the voluntary cooperation of the producers and the consumers in satisfying human wants.

It can be seen that the market for real bills is nothing else but the clearing house of the gold standard. In 1918, at the end of World War I, the victorious powers in their wisdom decided not to allow the world to return to multilateral financing of international trade. To be sure, they were sincere in saying that they wished to return to the gold standard, witness Great Britain's 1925 decision to make the pound sterling once again convertible into gold at the pre-war exchange rate — but only bilateral trade was authorized. This was tantamount to the castration of the gold standard: once its clearing house was amputated, it could not perform.

The victorious powers did this out of spite and vengeance. They wanted to cripple Germany over and above the provisions of the Versailles peace treaty. Forcing bilateral trade upon Germany was equivalent to peacetime blockade whereby the Entente powers could monitor and control Germany's imports and exports. The measure backfired. The Great Depression and the 1931-36 collapse of the international gold standard was a direct consequence of the forcible elimination of multilateral financing of world trade through real bills.

The measure to eliminate real bills from circulation world-wide had another grave consequence that I have to mention. It destroyed the wage fund of society and became the cause of mass unemployment on a scale never before seen — as predicted by the German economist Heinrich Rittershausen. Real bills alone make it possible to pay workers for producing goods that the consumer cannot purchase before they reach the maturity of a finished good in 91 days. But workers have to eat in the meantime! A substantial part of the social circulating capital is spoken for by the wage fund. Disallowing real bill circulation destroys the wage fund and causes mass unemployment, forcing the government to pay dole to the unemployed. The architecture for a new world financial system may start dismantling the so-called welfare state since, with the return of real bills circulation, the wage fund will be replenished and full employment can be realized.

### **Outlawing open market operations**

The gold standard did not collapse because of its “contractionist tendencies” — as alleged by Keynes. It collapsed because of its clearing system, the bill market was blocked. Falling prices in 1930 were not the cause of the Great Depression: they were the effect. The cause was falling interest rates.

Falling interest rates were in turn caused by the illegal introduction of open market operations by the Federal Reserve of the United States in 1921, following the panic in the Treasury bond market. The Federal Reserve Act of 1913 did not authorize open market operations, quite the contrary. Treasury bonds were not on the list of “eligible paper” acceptable as collateral for issuing Federal Reserve notes and deposits. Federal Reserve credit was supposed to be backed by gold, or real bills maturing into gold. To the extent that Federal Reserve credit outstanding could be backed only by Treasury paper in lieu of real bills or gold, the Federal Reserve bank was found short of collateral and was to be penalized by fines on a progressive scale. Starting in 1921 the Treasury “forgot” to collect the penalty. It was a “sweetheart deal”: in turn, the Federal Reserve banks offered a cozy place in their portfolio to Treasury’s bonds, notes, and bills. Congress was presented with a *fait accompli*. It had no choice but to legalize the practice of open market operations *ex post facto* in 1935.

The architecture for a new financial system must rule out such a conspiracy between the government and its central bank. Open market operations must be outlawed as they invite bond speculators to bid up bond prices by promising them risk-free profits. As a consequence, interest rates will have a downward bias. Falling interest rates not only falsify the natural rate of interest; they also cause capital destruction. The gold standard plus outlawing the practice of open market operations will stabilize interest rates at their natural level.

## **Outlawing the practice of borrowing short to lend long**

In addition to outlawing open market operations, the practice of commercial banks to borrow short in order to lend long must also be outlawed. Such a practice ignores the danger that the bank could be caught on the wrong foot when short-term interest rates rise while long term interest rates fall (i.e., the yield curve is “flattening”, let alone “inverting”). This means, in particular, that mortgages are ineligible as collateral to back commercial credit, and commercial banking must be separated from investment banking.

## **Eliminating double standard in applying the Criminal Code**

In drawing the blueprint for the architecture for a new financial system it must be remembered that double standard in jurisprudence is inadmissible. The government and its central bank must be subject to the same Criminal Code as everybody else. Ordinary citizens are not allowed to issue obligations which they have neither the intention nor the means to meet at maturity. If they do, they commit a crime dealt with by the Criminal Code under the heading “fraud”. There is no valid reason to allow the government and its central bank to issue obligations that they have neither the intention nor the means to pay.

## **Eliminating double standard in applying contract law**

In the same order of ideas I mention that no double standard ought to be tolerated in contract law either. In particular, banks should not be exempt from the provision of bankruptcy procedure in case of non-performance on contractual obligations. If a bank fails to pay its sight liabilities in gold as contracted, then it must not be allowed to promote its dishonored paper as money. Depositors ought to be able to press for liquidation of the bank or to avail themselves of any other remedies prescribed by contract law. There is no valid reason to treat banks and financial institutions any differently from other corporations in case they fail to perform on their contracts.

When the Mint in Hall was opened to silver in 1477, Archduke Sigismund and Emperor Maximilian I put the threat of a breakdown in law and order behind them. Their measure ushered in a new financial order promoting peace and prosperity.

In a latter-day replay of the medieval saga, an enlightened government in some part of the world may open its Mint to gold. The initiative would be widely followed, as was that of the Mint in Hall, and the world would be spared of a breakdown of law and order. The measure would usher in a new financial order promoting peace and prosperity.

June 22, 2010

## Calendar of Events

**ANNOUNCING THE ESTABLISHMENT OF THE AUSTRIAN SCHOOL OF ECONOMICS IN BUDAPEST.** The first ten-day, 20-lecture course offered is entitled: **Disorder and Coordination in Economics — *Has the world reached the ultimate economic and monetary disorder?*** The lecturer is Professor Fekete, with the cooperation of Mr. Rudy Fritsch (Canada), Peter van Copenolle (Belgium), and Mr. Sandeep Jaitly (United Kingdom). It will be held in Budapest, Hungary, from August 9-20, 2010. Participation is limited, early registration is advisable. For more information and registration, contact Dr. Judith Szepesvari at: [szepesvari17@gmail.com](mailto:szepesvari17@gmail.com). Inexpensive dorm-type accommodation is available for students (shared bathroom, shared kitchen); a three-star hotel is next door. Extra-curricular consulting with Professor Fekete can be arranged for an extra fee.

The school is meant for all students (including beginners) interested in the Austrian theory of money, credit, and banking. Its program plans to cover the whole spectrum of Austrian economics, with special emphasis on developments that took place after the death of the greatest 20th century economist, Ludwig von Mises, including the Real Bills doctrine and social circulating capital; the theory of money, credit and banking; and the theory of interest and discount.

Completion of this course will earn participants one credit towards a four-course, four-credit program that has been submitted for accreditation to the Adult Education Accreditation Board of Hungary. Participants will receive a certificate signed by Professor Fekete. The follow-up credit courses will cover these areas:

Adam Smith's Real Bills Doctrine and Social Circulating Capital.

The Austrian Theory of Interest and Discount.

The Austrian Theory of Money, Credit, and Banking.

Some of the future courses may be offered in Martineum Academy in Szombathely, Hungary, where we have had four successful conferences already in the past. A special cordial invitation is extended to all Martineum alumni and their family members and friends!

*It is not well-known that Budapest is one of the foremost spas in Central Europe with a dozen or so medicinal thermal springs. Participants of the course could stay on afterwards and savor the superb spa and cultural offerings in the city. Make it a family holiday! Eating and shopping facilities, as well as a swimming pool are nearby. Spectacular excursions can be arranged in the surrounding hills, and boat trips on the River Danube!*