FIAT MONEY IN DEATH THROES

Antal E. Fekete
San Francisco School of Economics
E-mail: aefekete@hotmail.com

"Banking was conceived in iniquity and born in sin. The Bankers own the earth. Take it away from them, but leave them the power to create deposits, and with the flick of the pen they will create enough deposits to buy it back again. However, take away that power, and all the great fortunes like mine will disappear — as they ought to in order to make this a happier and better world to live in. But, if you wish to remain the slaves of Bankers and pay the cost of your own slavery, then let them continue to create deposits."

Sir Joshua Stamp (1880-1941), one time governor of the Bank of England, in his Commencement Address at the University of Texas in 1927. Reportedly he was the second wealthiest individual in Britain.

Make no mistake about it: in this credit collapse we are witnessing the death throes of irredeemable currency. In vain have governments and their client banks tried, for hundreds of years, to graft this repulsive and degenerate bastard on the living organism of society. The result was always the same: the healthy organism rejected the unnatural implant in its own good time. The present episode is no different from earlier ones except, perhaps, in the degree of the conceitedness of the perpetrators, and in their contempt for the native intelligence of man.

When on August 15, 1971, Richard Nixon defaulted on the gold obligations of the United States and declared the irredeemable dollar the "ultimate" means of payments and liquidator of debt, he was relying on the expert advice of Chicago economist Milton Friedman. Five years later the world's oldest central bank, the Swedish Riksbank would bestow upon Friedman the prize it established in memory of Alfred Nobel. The reward would be in recognition of the brilliance of Friedman's idea that if a central bank robs the people piecemeal (read: it dilutes the currency at a fixed rate of, say, 3 percent per annum) then the victims would not cry "we wuz robbed!" They would never notice the robbery.

In all previous episodes shame and disgrace were part and parcel of the government's default on its promises to pay. Not so in 1971. In this latest experiment with irredeemable currency there was a new feature: far from being a disgrace, the default was presented as a scientific breakthrough; conquering "monetary superstition" epitomized by gold; a triumph of progress. Sycophant governments and central banks overseas that were victimized by it and had to swallow unprecedented losses due to the devaluation of the dollar were not even allowed to say "ouch!" They were forced to celebrate their own undoing and hail the advent of the New Age of synthetic credit, irredeemable currencies and irredeemable debts.

The regime of the irredeemable dollar was put to the test soon enough. In 1979 the genie escaped from the bottle. The price of oil, silver, and gold were quoted at twenty times that prior to 1971; in the case of sugar the rate of increase was more like forty times. Interest rates were quoted in double digits well past the teens. There was panic across the land and the globe. Hoarding of goods became a way of life. Everybody was expecting the worst.

It was at this time that the notion of "targeting inflation" was invented. Previously the claims of central bank power were rather modest. Central banks were supposed to target short-term interest rates. Later they graduated to targeting the money supply. Now they were claiming supernatural powers of micromanaging price increases. It was apparently working, and the genie was put back in the bottle.

In the intervening three decades policymakers and mainstream economists became ever more confident that in inflation-targeting they have found the holy grail of irredeemable currency. Professor Frederic Mishkin of Columbia University, a former governor of the Federal Reserve, published the gospel of inflation targeting with the title *Monetary Policy Strategy* in 2007. In his book he calls inflation targeting "an information-inclusive strategy for the conduct of monetary policy." Martin Wolf, the chief economic columnist of the Financial Times of London explains: inflation targeting makes allowance for all relevant variables — exchange rates, stock prices, housing prices and long-term bond prices — via their impact on activity and prospective inflation. This, then, is the new modified holy grail. Cast your net wide enough to catch all that you want to control. If you do it boldly, you will make people believe that the government can control everything it wants to control. It is amazing how much can be accomplished by piling prestidigitation upon prestidigitation.

Ironically, disaster struck just at the time when the prophets of inflation-targeting became cocky beyond any measure of modesty. They actually had a whole debate going on in American journals, but also English ones. Ben Bernanke, who in the meantime was made the chairman of the Federal Reserve, contributed the keynote address and the title to the debate: "*The Great Moderation*". Their description, up to and including the beginning of 2007 of what was happening in the macro economy, was a reduction in the volatility in the trade cycle: more consistent growth, less bouts of inflation, more stability. The London Times published a jubilant piece as recently as early 2007 with the title "The Great Moderation" which began with the line: "History will marvel at the stability of our era." It was not meant to be a joke. It was meant to be believed. Complacency about the almighty nature of monetary policy reached its peak. They celebrated the success of inflation targeting just when it started to unravel. Policymakers, central bankers, and their lackeys in academia and journalism, felt inordinately proud of themselves. They thought they held the whole world in their hands.

The celebration and self-congratulation was premature. Bernanke & Co. did not know that they were about to be humbled by the markets. Blinded by the glare of their own glory, none of them foresaw the coming disaster.

Martin Wolf in his column on May 7 talks about "this unforeseen crisis" as an unmitigated disaster for monetary policy. It leaves fiat money with just one last chance to put its act together and save its hide. He says: "The holy grail turned out to be a mirage. If fiat money is not made to work better than it has, who knows what our children might decide to do in desperation. They might even decide to bring back and embrace gold". Oh horror of horrors! Wolf still considers the gold standard an absurdity.

It's kind of strange. It is not the regime of irredeemable currency, whereby governments are supposed to create wealth by sprinkling some ink on little scraps of paper, that is considered an absurdity. Of course, Mr. Wolf has the right of wanting to be pilfered and plundered. But he has no right to advocate that the rest of us be cheated through this crudest form of plunder forever and ever.

He is also mistaken when he assumes that Bernanke & Co. still has one more chance. The chance they just blew *was* the last. We are witnessing the closing of the regime of irredeemable currency and irredeemable debt. We may not know how long its death throes will take, but there will be no other chance. Financial journalists and mainstream economists, in their blind stupor acting as cheerleaders for the disastrous monetary policy of the government and the insane credit policy of the banks, have exhausted and destroyed their own credibility for once and all.

* * *

Martin Wolf, like most of his colleagues, is a victim of brainwashing inspired by Keynes that has been going on to discredit the gold standard for some 75 years, but which got a new lift after Friedman inspired Nixon to default. Yet here are the facts about the gold dollar that should be made available to the world through the opening of the Mint to gold, as demanded by the U.S. Constitution.

The gold standard is an indispensable prerequisite of freedom. Without it individuals are helpless in facing the constant and ongoing encroachment of their property rights by the government and the banks. The right to demand gold in exchange for bank notes and bank deposits far transcends the mere exchange of one form of money for another. It is the only way to check the unlimited power of the government manifested by the unlimited creation of bank deposits. The combination of governmental power and the power of the banks to create deposits is especially dangerous for the freedom of the individual, because of the double standard involved. The government exempts banks from the effects of contract law in exchange for the banks' special treatment accorded to government debt.

Gold hoarding is not a blemish on the gold standard; it is its main excellence. When a sufficient number of individuals are disturbed by the encroachment of this combination of powers, or disapprove the monetary policy of the government and the credit policy of the banks, they are not helpless under a gold standard. They can withdraw gold from the banking system, thereby putting the government and the banks on notice that unless they mend their ways, and stop their adventures in debt creation, they will find themselves insolvent and out of power. The gold standard gives people the upper hand.

It is no accident that all dictatorships set out by limiting the people's access to gold. It makes no difference whether they march under the banner of national or international socialism. All totalitarian regimes inflict irredeemable currency on the people as an instrument of servitude and bondage. Martin Wolf should know this. The ideal of limited government is meaningless unless reinforced by a gold standard denying to the government the power of issuing unlimited amounts of currency. There is no other way of doing this than making the promises of the government redeemable in something other than more promises of the same kind.

Once the government makes the currency irredeemable, it puts itself in the position to curtail the rights and freedoms of the people as it sees fit. Constitutional government is effectively overthrown. Once the government usurps the public purse, its power becomes uncontrollable. Budget debate in Parliament or in Congress becomes an annual farce. Nothing stands in the way of unscrupulous politicians to undermine constitutional government. The purchasing power of the currency is constantly undermined year in, year out. The banks are freed from constraints on them exercised by the people under the gold standard. Pandora's box of corruption is opened and its contents contaminate the nation's economic, political, and social system.

Governments which employ irredeemable currency grab unconditional control over foreign trade, exchange rates, foreign investments and travel, even the amount of currency an individual can take in or out of the country. The more powerful governments will buy the allegiance of the less powerful. Out of this feudalistic web of allegiances financed by irredeemable currency come various adventures in fomenting and waging wars in far-away lands, spilling the blood of the young people of the nation for causes alien to them.

Under a gold standard prolonged budget deficits and prolonged unfavorable balance of payments cannot occur. There are forces limiting persistent losses of gold which tend to correct the underlying distortion. By contrast, under the regime of irredeemable currency economic distortions can persist indefinitely. They ultimately become destructive. This is so because government bureaucrats cannot possibly provide the same level of wisdom that a people free to act in their own interest can.

As problems in foreign trade mount, governments will find ever more excuses for ever more controls. There is no end to the expansion of government power over the individual until the nation regains the benefits of a gold standard, requiring that the government retire to its proper role of umpire and relinquish its role as dominant partner and dictator.

A government can take total control of the people either by the use of military force, or by the use of irredeemable currency. The former is readily understood, while the latter is a subtle national drug that is not generally recognized as such. Rather, it is readily embraced by its victims. For these and similar reasons irredeemable currency is the favorite device of modern governments that want to bring people under total control. Indeed, it enables the government to succeed in controlling the masses while, at the same time, earning their approval and even their enthusiastic support. Irredeemable currency must be seen as the habit-forming drug that the government uses to intoxicate people. Under this intoxication people will want more and more national spending, more and more government control, and more and more debt.

This intoxication obscures the sad end that arrives when the merry-go-round is coming to a jerky halt, when credit is exhausted or withdrawn, and the kitty is found empty. The nation is facing a most serious economic disaster followed by prolonged economic pain. Unfortunately government economists, university professors, and financial journalists have taken their share of the fun and they failed miserably in their duty to forewarn people of the coming disaster.

It is useless to expect a mass movement on behalf of a sound currency. The daily experiences of people provide them with a warped outlook. They confirm in their minds the alleged virtues and benefits of an infinitely inflatable currency. People lack sufficient understanding of monetary science to see that no currency can be made infinitely inflatable without inviting disaster. Like a drug addict, people exposed to irredeemable currency do not regard it as a dangerous and undermining narcotic agent. Even the loss of purchasing power does not disturb them to any great extent. Their response is to demand more money, and they take pride in the fact that the government listens sympathetically to their demand. They welcome the soaring stock indexes and real estate prices, and put great stores on them. Heavy taxes and burgeoning debt are not regarded with anxiety. A frequent and common agitation is for ever more government spending.

* * *

If we are to be saved from the ultimate evil consequences of the regime of irredeemable currency, needed action must come from the leadership of the opposition party when it is its turn to take over government. The new President and his Secretary of the Treasury, or the new Prime Minister and his Secretary of the Exchequer must be statesmen. They must act as informed and tough monetary surgeons, men who can and will persuade Congress or Parliament to reinstate redeemable currency.

Once that step is taken, the people should experience a breath of fresh air. Government would once more be subordinated to the Constitution, bringing greater freedom to the people. Optimism should be wide-spread, because the currency of the people would once more had integrity. Business should prosper, domestic and foreign trade expand. Imbalances in foreign trade should rectify themselves. Gold should start to circulate and flow in from abroad. The control of the public purse would be returned to the people where it belongs if human freedom is to be preserved and responsible government is to be obtained.

But as the last presidential election in the United States has shown, the needed leadership is lacking. The party of the opposition is just as much in thrall to the same toxic ideology as the governing party. The last change of guards took place in the middle of a financial and economic crisis involving the destruction of quantities of wealth unprecedented in all history, with more destruction coming. Yet when the new president appointed officials at the Treasury, confirmed others at the Federal Reserve, and named economic advisors, they turned out to be the same men who were responsible for the credit collapse in the first place. Not only do these officials continue the dangerous course of the previous administration; they increase the stakes by several orders of magnitude in announcing more government spending, more government debt, and more fiat money creation.

The situation is no better in the United Kingdom, another important country expecting a change of guards, which could take the initiative to put a peaceful end to the regime of irredeemable currency now in its death throes. Rather than initiating a national debate on the failure of the financial system which was supposed to end bank runs, deflations and depressions, serial bankruptcies and unemployment, and on the return to sound money and sound book-keeping, H.M. Loyal Opposition is plotting a course how to cure the collapse of bad debt with the injection of more bad debt.

What this means is that there is no hope for change through peaceful means. When change finally comes, it will be through violence. When the economic pain inflicted on the people reaches unbearable heights, anarchy and chaos will ensue. This is precisely what the great monetary tradition of the English-speaking countries, in ruling out irredeemable currency and mandating a metallic monetary standard, was designed to prevent.

June 10, 2009.

Acknowledgement

The author has drawn heavily on Walter E. Spahr's article in the quarterly *Modern Age*, Summer, 1960, under the title "The Significance of the Gold Standard", see also www.professorfekete.com, April 17.

Calendar of Events

Instituto Juan de Mariana: Madrid, Spain, June 12-14, 2009
Seminar with Prof. Fekete on Money, Credit, and the Revisionist Theory of Depressions
For information, contact: gcalzada@juandemariana.org

OroY Finanzas & Portal Oro: Madrid, Spain, June 18, 2009
Gold and Silver Meeting Madrid 2009
For information, contact: preukschat_alex@hotmail.com or
gcalzada@juandemariana.org or
http://www.portaloro.com/aemp.aspx or
info@portaloro.com

San Francisco School of Economics, San Francisco, California, July 25, August 1 & August 8, 2009
Investment Seminars: Trading Gold, Wealth Management
The Gold and Silver Basis; Backwardation; Trading Gold in the Present Environment; Wealth Management under the Regime of Irredeemable Currency. Given by Professor Fekete and Mr. Sandeep Jaitly of Soditic Ltd., London, U.K. Enrolment is limited, first come first served. For details, check: www.sfschoolofeconomics.com, contact: ibischoff@sfschoolofeconomics.com

San Francisco School of Economics, San Francisco, California, July 27-August 7, 2009
Two-week academic course: Money and Banking, taught in person by Professor Fekete
Enrolment is limited; first come, first served. The Syllabus for this course can be seen on the website: www.professorfekete.com,
For further details, check: www.sfschoolofeconomics.com
For enrolment contact: ibischoff@sfschoolofeconomics.com

San Francisco School of Economics, San Francisco, California, July 23-August 9, 2009
Private consultation with Professor Fekete available
contact: ibischoff@sfschoolofeconomics.com

University House, Australian National University, Canberra: first week of November, 2009

Peace and Progress through Prosperity: Gold Standard in the 21st Century

This is the first conference organized by the newly formed Gold Standard Institute.

For further information, e-mail: feketeaustralia@gmail.com ,

On the Gold Standard Institute, e-mail philipbarton@goldstandardinstitute.com

Professor Fekete on DVD: Professionally produced DVD recording of the address before the Economic Club of San Francisco on November 4, 2008, entitled *The Revisionist History of the Great Depression: Can It Happen Again?* plus an interview with Professor Fekete. It is available from www.Amazon.com and from the Club www.economicclubsf.com at $14.95 each.