Toward a Stable Currency

Restoring Commerce when Central Banking Fails

Wm E Rhodes

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Toward a Stable Currency

to Doug Morin and Jim Sully,
honest craftsmen and tradesmen,
my friends

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Synopsis

Dear Doug and Jim,

Since I cannot sit and visit with either of you, please receive this book in lieu of a long discussion over pints of beer, and enjoy a pint or two for me as you read it.

A Synopsis is never a substitute for reading the text. It's like reading Cliff Notes for *Lord of the Rings*. You get the gist of the story, but you never know the whole story, any of the details, or have the fun of reading it.

Your wealth is being taken away by inflation. This inflation is embedded by design into the money system we use, and is implemented through the Federal Reserve. It isn't that the Fed doesn't provide useful services, but you must understand that its first and foremost purpose is to act as fiscal agent of the United States Treasury.

A corollary result is that because banks distribute Treasury debt, officers of some of these banks have been able to get away with indiscretions that would put other folks in jail. Some of these financial institutions have been propped up with government money.

Savings, the most ancient way to amass financial wealth, part of any basis in a financial system, are eaten away by inflation. The inflated wealth is transferred to debtors, the largest of whom is the Treasury.

Every country has a central bank. The selling pitch for central banking is to create a "lender of last resort" to lend when banks face temporary shortages. Central banks create this money out of thin air: the money they lend is always new debt. The same is true of all other banks using this system: New money is always new debt, whatever its source. The central bank always lends on the credit of the government, which means that in every national financial crisis in which a central bank intervenes, its government takes on more debt and more risk.

This creates a condition called “moral hazard”. Moral hazard develops when banks take on more risk because they believe the government will bail them out if they get into trouble. This is a world-wide problem that exists in both “capitalist” and socialist countries, including all the communist countries.

Modern central banks developed beginning in the late 1600s so that governments could expand their military power. Central banks borrow on their own terms because they set interest rates. They eventually took possession of the gold reserves of private banks and the gold of private citizens, giving them in its place money issued by the central bank. This greatly enhanced the power and wealth of governments, and increased their control over their citizens, because without central bank money, citizens cannot conduct any business.

Governments use the financial control over citizens they get from central banks to force the people into policies the people don’t like. In the European Union, the European Central Bank has been used to force national governments to kowtow to the wishes of an autocratic government in Brussels, impoverishing whole nations in the process.

Through central banks, governments control interest rates and create inflation. Central banks allow them to borrow the enormous sums of money needed for modern military machines, and to expand the welfare state. They cannot be eliminated because without its central bank, a government could not maintain its military power, and its enemies would quickly conquer both that government and the nation it rules.

There is a movement to get rid of currency, that is paper money, and replace it with electronic money. Every transaction would be conducted electronically, by bank card, with a cell phone or computer, but never by handing “money” from one person to another.

There have been some attempts to circumvent central banks. Bitcoin, using the clever invention blockchain, has been the most successful. Blockchain is a useful invention. But electronic-only funds transfer, including Bitcoin, also gives government unprecedented power over citizens, allowing the state to monitor every single purchase or sale everyone makes, blocking purchases and sales it doesn't approve, and seizing financial assets at any time for any reason.

Moreover, governments have, through their central banks, imposed negative interest rates in some countries: that is, the lender must pay the borrower for the privilege of lending. In this case, the borrowers are either governments or select borrowers chosen by governments. This is also a way of confiscating wealth.

Ultimately, governments are moving toward integrating biometrics into electronic funds transfer. The excuse they will use is that it will make financial assets more secure, less likely to be stolen. At that point, every person with a biometric marker will be under constant surveillance by the government, even in their most intimate and private moments. But because they will be able to control all funds transfers thanks to their central banks, governments will enforce the implementation of these markers, effectively enslaving their populations by allowing or denying their access to wealth.

But regardless of how much wealth governments take from people, it will never be enough to satisfy their demand. Eventually, a money system built on debt and fuelled by more and more debt must topple. The problem has been understood for many decades, and though various schemes have been used to stave it off, it will ultimately catch up with everyone. All money based upon debt must eventually become worthless.

Money has to provide three things:

1. a Unit of Account,
2. a Medium of Exchange, and
3. a Store of Value.

Though they have been used in various places at various times for a thousand years, all paper currencies fail. The traditional means of transacting business and storing wealth is by using gold, silver, or copper. These are "real" money, money that is not debt owed by someone else. Central banks are technically and legally in debt to the people and institutions that use their money, but the debt is never extinguished. Instead it is inflated away. As a result, central bank money fails as a Store of Value. As electronic money, it can be seized at any time for any reason. It is vulnerable to collapse by over-indebtedness.

We have confused credit and real money because we have used credit instead of real money for the past century. Using gold, silver, and copper as money means government can no longer control transactions or confiscate wealth as it pleases; at least, it makes this much more difficult. Credit is vulnerable to arbitrary confiscation and collapse. Real money is not.

For most of the past 2500 years, sovereigns have set fixed exchange rates between gold, silver, and copper for taxes and to govern financial and commercial and transactions. This fundamental error of fixed exchange rates causes instability by creating arbitrage opportunities between the fixed official exchange rate and the market exchange rate. Allowing exchange rates between gold, silver, and copper to float makes the money system flexible, preventing arbitrage.

Governments must not be allowed to mint money because they always debase it. Debasing money is the same thing as inflation: it makes the money worth less than it is supposed to be. Instead, governments should enforce minting rules on private minters, punishing those that break the rules and collecting a fee for enforcing those rules. Governments are very good at enforcing rules when they collect money for doing it.

Real money – gold, silver, and copper – has proved stable for thousands of years. The credit currency system we use is inherently unstable.

I hope you enjoy the book and the beer – Bill

Conclusion

If your asset is someone else’s liability, you do not have money: you have credit. Credit may be withdrawn or defaulted upon at any time at the borrower’s decision. Money can be stolen – so can credit – but it cannot be withdrawn or defaulted upon. In the most extreme circumstances, it will not serve, but that is only because money cannot replace life; once the existential crisis passes, money functions once again. In an existential crisis, credit may collapse entirely, and must be slowly rebuilt either from someone else’s credit or from money.

A debtor who never repays all his debt – all of it at one time, so that he owes no debt at all – will eventually default. This is not a guess, but a mathematical certainty: Debt always carries a probability of default in any period. While the chance of default in any given period may be small, the probability of default is cumulative: that is, the chance of not defaulting period after period is the product of the probability of not defaulting in all the previous periods leading up to it. No matter how small the risk of default at any given instance, the cumulative risk of default over long periods is so great that it eventually becomes all but certain that the borrower who never clears all his debts will at last fail to repay on time or not at all: he will default.[284]

Central banks are bankers to the finance ministry of the government. So long as the treasury borrows only in its own currency, and the central bank deals only in the currency of the treasury, then in theory, neither the treasury nor the central bank can become insolvent using a credit-based currency, because the central bank can always create more currency at will; however, in practice both central banks and treasuries must borrow and deal in other currencies besides their own, so that they become indebted to foreigners using other currencies.

Central banks hold out the hope of acting as lender of last resort to commercial and investment banks. But in order to perform this function, the central bank must have the backing of its treasury, so that the credit it uses to backstop the banks is ultimately the liability of the sovereign, who can and will extract the wealth needed to provide backing as lender of last resort from the citizenry.

Moreover, over-extending credit leads to inflation in the prices of goods and services purchased with credit.[285] Modern economies everywhere use debt currencies, and governments over-extend credit as part of their political maneuverings. Even though there may not be system-wide inflation in food and fuel, for instance, manipulation of credit can drive up the prices of financial assets, real estate, and other investment goods, creating gross disparities in the distribution of wealth, effectively impoverishing a significant portion of society.

Finally, central banks fix the price of money, of interest rates. In order for economies to function properly, prices must be allowed to change with supply and demand. But central banks control the supply of credit, and fix the price of that credit.[286] The price of money, the interest rate, is a primary economic fundamental, and indicator of the vigor of an economy. But when it is artificially set, it not only loses its effectiveness as an indicator for investors, it causes investors to misallocate capital, investing when and where they ought not, and failing to invest when and where they should. Instead of improving the economic cycle, central banks dampen its short-term volatility by increasing its long-run volatility, so that booms are longer and higher while busts are longer and deeper.

Debt currencies presuppose steady inflation. Even when inflation is low, savings are eroded, so that debtors become wealthy at the expense of savers. This is a perversion of the natural order: savers should prosper while the profligate suffer, but in an inflationary environment, the profligate prosper at the expense of savers. Since the sovereign is generally the biggest borrower of all, the effect is that the government slowly but surely confiscates a little of the wealth of its citizens year after year through inflation. What is more, people begin to notice that savers are at a disadvantage, though they may not understand why, and tend to begin to borrow more of their income. If investment is decreased because savings are decreased[287] – and savings *are* decreased in the situation I am describing – then incomes will also decrease. Thus even those who would prefer to save find themselves obliged to borrow because they can no longer set aside income from savings lost to inflation.[288]

To overcome the problems of credit, our forebears used metal money as "real money" not subject to inflation or the manipulations of bankers or sovereigns. Three metals have been used as money for over three thousand years: gold, silver, and copper. They should be allowed to trade freely in exchange. One of the grave errors of the past has been to try to fix their exchange rates from one to the other, leading to arbitrage and financial displacements. It is important that these three metal currencies be allowed to float freely among themselves, so that inflations or distortions in one of them will not inordinately affect the other two. Fixing exchange rates allows sovereigns to manipulate real money just as they manipulate debt currencies. Sovereigns should be allowed neither to fix the exchange rates of gold, silver, or copper, nor should they be allowed to mint the coins; however, the sovereign must oversee the mints to ensure that the minters are not cheating in making coins as well as the money-traders to make certain they are honest in their exchange dealings.

"Money" is common term like "corn". *Corn* is the English word for the common cereal grain of a region. In North America, that cereal grain is maize; in England, Ireland, Australia and New Zealand, it is wheat, the traditional "corn" of literature; in Scotland, "corn" was traditionally oats (or barley), which is hardier and more resistant to cold.

"Money" has come to mean *credit* in our language and in most others. Credit and real money are hardly indistinguishable in day-to-day exchanges, but for savings and in crisis, real money is far superior to credit, which can be lost or withdrawn in an instant at the whim of the lender in the case of banks and their customers, or the borrower in the case of the government (or its central bank) and their currency holders.

Credit is extended at the behest of the powerful, who can default at any time to protect themselves. Money cannot be controlled. If you would be free, you must have money, not credit.

Conclusion Endnotes

[←284]

Mathematically, if r_t is the risk of default in any period *t* and $1 - r_t$ the probability of repayment, $\prod_{i=1}^{t}(1-r_i)$ is the probability that repayments will be made each and every time until then. No matter how small r may be, $\prod_{i=1}^{t}(1-r_i)$ will eventually fall below ½, inevitably declining until default is all but certainty. There is simply no other outcome.

[←285]

Milton Freidman was fond of saying, "Inflation is always and everywhere a monetary phenomenon." In fact, it is a phenomenon of credit; but his observation is sound. Note that general inflation may not rise, as has been the case in the United States following the massive injections of credit in the aftermath of the 2007-2009 Mortgage Meltdown, but the prices of financial assets of all sorts, as well as real estate, soared.

[←286]

Central banks also determine who can and cannot receive credit through their actions as banking regulators. The temptation for government to use this power to reward its partisans and punish its opponents is unquestionable, though governments and central bankers generally deny they do this.

[←287]

In macroeconomics, it is generally assumed that savings are equal to investments.

[←288]

Inflation is pernicious in many ways, but this effect – that it lowers future income, even nominal income, by reducing savings – has not been widely recognized. In this sense inflation is akin to abortion: You do not know what you have lost, because you have never been able to see it or know it.