ALCHEMY

or

HUMAN RIGHTS IN THE CONTEMPORARY MONETARY LANDSCAPE

HOW FIAT CURRENCIES AND FRACTIONAL-RESERVE BANKING PROMOTE GLOBAL INEQUALITY AND UNSUSTAINABLE CONSUMERISM

AN AUSTRIAN SCHOOL PERSPECTIVE ON THE ETHICS OF MONEY-PRODUCTION IN A GLOBALIZED ECONOMY

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Deadline of submission: 05/15/2010

Number of words: 19,936 (max. 20,000)

25.05.2010

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HOW FIAT CURRENCIES AND FRACTIONAL-RESERVE BANKING PROMOTE GLOBAL INEQUALITY AND UNSUSTAINABLE CONSUMERISM

The issues of global poverty and inequality cannot be properly addressed without thoroughly taking into account the financial super-structures of the world. This essay presents a deductive line of reasoning that aims to convey how the reigning international regimes of fiat monies combined with fractional-reserve banking promote economic inequality, both in and between nations, while simultaneously enabling a culture of consumerism that is both economically and environmentally unsustainable. It is argued that the inequitable conditions within the globalized economy are an implied result of the inflationary nature of the contemporary financial-system, and that these structural tendencies should be addressed by returning to full-reserve banking, while simultaneously abandoning fiat-currencies. While full-reserve banking does not necessitate a metallic monetary standard, it is shown that the recognized goals of financial stability and politically insulated money are most properly ensured by returning to an internationally recognized commodity-standard. The broader argument presented is implied in the above: Through accepting and upholding the contemporary financial structures, modern nations cannot be seen as acting in compliance with their obligations under the UN Charter to promote the economic and social advancement of all peoples. Through investigating our contemporary institutions of money and banking, this essay is an attempt at exposing the monetary aspects of *how* global wealth-disparities occur and *why* they necessarily do so.

Table of contents

1. Introduction

1.1 International monetary policy and human rights

1.1.1 Brief justification of topic

It is held as obvious that the issues of global poverty and inequality cannot be properly addressed without thoroughly taking into account the financial super-structures of the world. This is the simple yet crucial premise which justifies bringing the questions of monetary policy into the realm of human rights.

Debraj Ray opens his impressive book *Development Economics* by inviting us to study 'what is surely the most important and perhaps the most complex of all economic issues: the economic transformation of those countries known as the developing world.'[1] Truly, the science of economics is most troublesome, and most fascinating, when the immense importance of its questions is recognized in light of the apparent futility in which they're asked. What and how should we produce - and how should we distribute the fruits of our labour? While it can safely be held as uncontroversial that our way of organizing the international economy is fundamental to its distribution of wealth, it is by no means clear *how* our current system relates to widespread poverty: Economists often provide different and diametrically opposed answers to the begging question of which measures we can take, in order to decrease the unacceptable gap between the worlds rich and poor. Needless to say, they cannot all be right. In spite of an endless amount of economic controversy, there are however some uncontroversial premises which might serve as a common starting point for further discussion. The most basic one has already been addressed and its acceptance has been taken for granted; the phenomenon of global poverty and inequality is morally undesirable and the science of economics has *something* to do with it. On this basic acknowledgement this essay problematizes our contemporary monetary regime as a fundamental cause of global inequality and thus as an obvious *human rights matter*.

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[1] *Development Economics (*1998): 3

It is proposed that a structural propensity towards inequality and poverty is a central feature of the international financial architecture itself. If one acknowledges the imperative connection between our economic structures and global welfare, the importance of the implication suggested should need no further elaboration: If indeed it is the case that our very way of organizing the global economy is counter-productive to the general human-rights project, then our international declarations, our benevolent intent and our humanitarian organizations will indeed have a Sisyphean task ahead.

1.1.2 The central thesis

The gap between the worlds richest and poorest populations is arguably increasing - simply put, the rich get richer and the poor stay poor. While there are those who contest the issue of growing wealth disparities, an interesting debate in itself, it is here held to be the case that global inequality *is* on the rise, both within and between nations.[2] Naturally, the next step is to ask *why* these inequalities persist; an important question itself, and all the more so as reigning theories of economic growth suggest that the 'global gap' should be decreasing. An obvious example is the theory of economic convergence, the 'catch-up effect', whose core proposition states that poor economies with low per capita income will tend to grow faster than rich economies, as the marginal return on capital invested is higher in capital scarce regions. The notable implication being that in the long run, *regardless* of the nations initial capital stock, countries in general will converge towards *the same standard of living*. Moreover, the dynamic of economic convergence, will also tend towards leveling out per capita income *within* countries.[3] This is seemingly not what is happening out in 'the real economy', neither internationally nor domestically. The simple question is then - why not?

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[2] On this matter see *UN Finds Global Inequality Rising* (BBC News 25.08.05) (URL). Also, in 2008 the OECD (Organization for Co-operation and Development) concluded that '[t]he gap between rich and poor has grown in more than three-quarters of OECD countries over the past two decades, see *Income Inequality and Poverty Rising in Most OECD Countries (OECD 21.10.08) (URL).* See also *infra* note 3.

[3] Economic convergence is a commonly explored theme in development economics; for a thorough review of growth models and convergence in theory and practice, see *Development Economics (1998)*: 47-90

What is presented is a deductive line of reasoning that aims to convey how the reigning international regimes of fiat monies combined with fractional-reserve banking promote economic inequality, both in and between nations, while simultaneously enabling a culture of consumerism that is both economically and environmentally unsustainable. It is argued that the inequitable conditions within the globalized economy are an implied result of the inflationary nature of the contemporary financial-system, and that these structural tendencies should be addressed by returning to full-reserve banking, while simultaneously abandoning fiat-currencies. While full-reserve banking does not necessitate a metallic monetary standard, it is shown that the recognized goals of financial stability and politically insulated money are most properly ensured by returning to an internationally recognized commodity-standard. The broader argument presented is implied in the above: Through accepting and upholding the contemporary financial structures, modern nations cannot be seen as acting in compliance with their obligations under the UN Charter to promote the economic and social advancement of all peoples.

1.1.3 Presenting an Austrian perspective on money and human rights

It is beyond argument that money and credit are fundamentally important in our daily lives. Few things are in fact more central to the general welfare of individuals and nations alike. Most of us hold mortgages, prioritize our expenditures and overall spend a considerable part of life making sure our personal finances are viable. Great wars have been waged over wealth, and within nations themselves, few things stir up as much political controversy as the issue of what exactly the state should do with *its* money. In fact, the political enterprise itself can be seen as pertaining to the question of how the state ought to collect and spend its revenue. Upon acknowledging the monetary phenomena as permeating most practical aspects of human life, it is clear that our monetary regime may be described from innumerable angles. Furthermore, the inevitable complexities of the issue tend to conflate the descriptive and the prescriptive aspects of any thorough evaluation; this is natural, even unavoidable, as our currency regimes and monetary institutions are more than technical creatures of mathematics, they are also highly politicized phenomena. Any honest analysis of the subject will therefore, to some degree, acknowledge its conclusions to be ideological as well as technical in nature. This does not necessarily make the reasoning biased to the point of being unsound, rather it is because our choice and evaluation of any monetary regime is *inextricably* political and thus ideological in nature. It is no coincidence that many of the great classical economists such as David Hume (1711-1776), Adam Smith (1723-1790) and John Stuart Mill (1806-1873), the founders of the economic sciences, were also moral philosophers; our organization of economic life is very much a matter of ethics. With this in mind it is found appropriate that the wider purpose and ideological framework of what is to follow is addressed in a brief manner. Through presenting this account of the connection between our international financial structure and the growing wealth-disparities it is intended that three interrelated goals are reached:

Firstly, it will hopefully be made clear that that our medium of exchange*, our money,* is an obvious human rights matter. We should here recall that paper-monies has historically been fiercely debated. 'Hard currencies' was in fact deemed so important that special mention was given to it in the first Article of US Constitution: "No State shall […] make any Thing but gold and silver Coin a Tender in Payment of Debts".[4] Needless to say, the road from metallic monies to electronic money was both long and highly controversial, and the way in which money relates to basic civil liberties and economic freedoms should not be forgotten. As the life blood of our economies, it should be understood that the institution of monetary currency is highly central not only to the attainability of the goals and rights enshrined in the 2nd Article of the UN Covenant on Economic Social and Cultural Rights[5], but *also* that our medium of exchange is a matter properly addressed within the interrelated and interdependent civil liberties. Whether we bring into mind the recent hyperinflation in Zimbabwe, the bank-triggered downfall of the Icelandic economy, the talk of a possible break-up in the European monetary union or any other historical monetary crisis; it should be clear that we all want and need our currencies to be of a certain *quality* - in a general sense, we

[4] Article 1, Section 10 in *US Constitution* (URL)

[5] CESCR in *Global and European Treaties (2007).*

want *sound money.* As the Austrian economist Ludwig von Mises (1881-1973) put it: 'It is impossible to grasp the meaning of the idea of sound money if one does not realize that it was devised as an instrument for the protection of civil liberties against despotic inroads on the part of governments. Ideologically it belongs in the same class with political constitutions and bills of rights. The demand for constitutional guarantees and for bills of rights was a reaction against arbitrary rule and the non-observance of old customs by kings.'[6] We shall in due time return to the Austrian conception of 'sound money', as it is most central to the main propositions of this paper, but for now we simply recognize that there are important matters of civil liberty pertaining to a nations monetary regime: Does the state protect and guarantee for our money, or threaten its integrity? Should the government adjust the money-supply? Do we need government to alleviate the harmful effects of business-cycles? In short, what is the proper role of the state in the monetary landscape? It is simply regrettable, that the fierce historical debates over the adequacy of our money have become generally forgotten over the last decades. While it has become economically unfashionable to advocate changing the current international regime of fiat-currencies and fractional-reserve banking, we are not 'flat-earthers' when we question our financial and monetary structures. The fundamentals of our monetary regimes are by no means beyond debate.

Secondly, it is within in the scope of this paper to provide a contribution towards generally re-introducing the somewhat marginalized perspectives of what has been termed 'the Austrian School of Economics' and, most importantly, to make the Austrian perspective accessible to the human rights community. It is believed that the issues at hand are of fundamental importance to the wider human-rights project, and furthermore, that the qualitative approach and the verbal formalism of the Austrian school might help to alleviate the alienation often experienced when one is faced with the unintuitive complexities of mainstream, quantitative 'macroeconomics'. An overarching intention will be to present Austrian theory as thankfully lacking what is deemed to be crucial deficiencies in the theoretical foundation of mainstream economic orthodoxy, and to expose some overlooked aspects of international finance that might serve as a starting

[6] *The Theory of Money and Credit* (2009): 414

point for further problematizing modern finance within the framework of international human rights.[7]

Thirdly, it is hoped that this essay might do something towards vindicating capitalism as part of the solution, not the problem. Trade in the form of mutually beneficial exchange is by all standards more desirable than empire, and while alternatives to largely private ownership exist, both the theory and historical practice of these systems leave it hard to be convinced of their superiority. It is not by this held that the forces of trade and private ownership should operate unchecked, so the question to keep in mind is *what kind* of measures are most appropriate towards achieving what we want, namely a domestic and international framework for economic life that is fair and conducive towards the benefit of all. At times it seems apparent that the human rights community is ridden by a hopelessly emotionalist disdain for capitalism in general, and 'big corporations' and globalization in particular - but metaphorically speaking, it must be considered wrong-headed to criticize the house itself for not having a roof. By true capitalist standards; no bank, however large, is too big too fail. While it is unequivocally acknowledged by this author that capitalism in its current form is malfunctioning severely, it is argued and emphasized that free-market capitalism as a system is not yet ready for the ideological landfill.

1.2 Methodological issues

1.2.1 The methodology of the Austrian school of economics

Throughout, any reference to 'Austrians' shall be understood as referring to adherents of Austrian economic theory, not as Austrian nationals. Since the 1960s the most active theorists have been found within the US, but today there are also smaller communities of Austrian scholars within some of the European universities. As most people today are

[7] 'Mainstream economics' shall here be understood as what is commonly referred to as the 'neo-classical synthesis', generally consisting of a neoclassical approach to microeconomics, a Keynesian approach to macroeconomics and a general emphasis on mathematical models as most suitable to describe and understand economic life. The terms 'mainstream', 'contemporary', 'orthodox', 'quantified' and 'Keynesian' will be used interchangeably.

largely unfamiliar with the Austrian tenets, it might be prudent at this point to briefly point out just a few of the distinguishable features of the Austrian paradigm compared to contemporary economic orthodoxy.

Firstly, it is worth noticing that the Austrians conceive of the economic science as a general *theory of action*, rather than a *theory of decision* concerned merely with allocating and economizing. The concept of human action includes and far exceeds in scope that of individual decision-making. In the words of political economist Jesús Huerta de Soto, the mainstream conception of economic action 'implicitly presupposes a given knowledge of ends and means and reduces the economic problem to a problem of mere allocation, maximization or optimization, subject to certain restrictions which are also assumed to be known'.[8] In other words, while the hypothetical rationalizations of *homo economicus* is included in the Austrian paradigm, what is also taken into account is the very perception of the ends-means framework, within which our attempts at rational choice takes place. We do not so much *decide* within a given framework of ends and means, as we through learning and imagination *create and discover* the decision-making framework itself.[9]

Secondly, one should be aware that Austrians disagree with contemporary orthodoxy on the adequacy of mathematical modeling as a tool of economic analysis, and instead prefer a verbal approach of aprioristic deductive reasoning. Mainstream economists prefer a mathematical formalism to reveal economic truths and make predictions: By idealizing, quantifying and combining economic aggregates (e.g. *price-level*, *gross national product, money-supply*) in equilibrium-models they seek to simplify and thereby understand the infinitely complex dynamics of individuals in economic interaction. Austrians hold that there is a crucial fiction at the heart of mathematical equilibrium-theories, as they in a *static* manner investigate the *non-static* state of economic affairs: Economic chains of events are dynamic and generative processes

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[8] *The Austrian School* (2008)*:* 5

[9] It is broadly speaking this recognition that *behavioral economics* try to take into account; the simple fact that the rationalizing 'homo economicus' oftentimes is neither rational nor economical, but instead controlled by the notoriously mis-calculating 'animal spirits'.

comprised of causally related but non-synchronized events. In other words, the separate components of economic processes relate to each other but are 'heterogeneous in time'. Of course, mainstream economists do not argue the fact that they use highly simplified and static models to describe complex non-static reality; rather the disagreement is about whether the quantitative approach is clarifying rather than disruptive to our economic understanding. In short, Austrians see the focus on hypothetical equilibrium states as confusing rather than clarifying the dynamic, non-static nature of economic phenomena. Instead of looking for circular, functional relationships between aggregates of macroeconomic formulas, and in turn using these as a foundation for Keynesian social engineering, economists should concern themselves with discovering unidirectional *laws of tendency* pertaining to the observed economic phenomena. While mathematical models are great auxiliary intellectual tools, that can and do yield valid conclusions, Austrians simply point out that their validity is by no means guaranteed, and that one have reason to be critical of their theoretical foundations. In brief, oftentimes a dynamic, non-mathematical approach is better at capturing the essence of complex economic processes.

Thirdly, in relation to the aforementioned equilibrium-models, one should notice that Austrian theorists see no sense in maintaining the radical division between micro and macroeconomics. On the contrary, they insist on studying economic problems as interrelated issues, without establishing the separate micro and macro-aspect that is so prevalent in the mainstream orthodoxy. Such a separation is considered highly unfortunate as it has resulted in the practice (referred to above) of "examining the supposed mechanical relationships between macroeconomic aggregates, while the connection of these with human action is very difficult, if not impossible to comprehend."[10] Their main objection to the macro-focus is that "it pays attention only to the effects and changes in the quantity of money on the general price-level and not to the effects on the structure of relative prices. In consequence, it tends to disregard [...]

[10] *The Austrian School (2008)*: 10

the most harmful effects of inflation: The misdirection of resources it causes and the unemployment which ultimately results from it.”[11]

1.2.2 The Austrian definition of inflation

Mainstream economics define inflation as ‘a sustained rise in the general level of prices in the economy’.[12] However, as prolonged and general price-inflation is impossible unless accompanied by an increase in the money-supply,[13] Austrian theorists tend to define inflation as an increase in the money-supply, not as rising prices.[14] In other words, they see rising prices as a *symptom* of inflation, not as inflation in itself. While definitions in themselves do not carry any intrinsic merit, they can be more or less helpful as we strive to investigate and understand complex reality. Thus, what might seem like knit-picking, is held to be conceptually important as it promotes a proper understanding of what is reasonably considered *the* most important phenomena in the economic and monetary landscape. Macroeconomic equilibrium-models leaves it clear *that* prices will rise as the money-supply is increased, but they do little to reveal much else. Which prices tend to rise? In what ways are the productive structures disturbed? Who gains and suffers from inflation? Importantly, within Austrian theory it is not then a necessity that prices actually rise in order for there to be inflation, only that the monetary-base is expanded. The expansion in the money-supply provides a fundament from which prices *tend* to rise, but equally important, some prices will simply fail to adjust downwards. The crucial point to be made about inflation in Austrian theory is

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[11] Friedrich Hayek in *The Austrian School (2008)*: 83

[12] *Macroeconomics* (2006): 31

[13] In an economy with a stable monetary supply, prolonged inflation is not possible: Prices for *some* goods might rise as a result of increased demand or decreased supply, but *only* if prices of others goods fall. If *all* prices rise, then the purchasing-power of money falls and the related increased demand for cash will in turn lower prices. Austrian theorists therefore agrees on this point (although they disagree on many others) with the monetarists of the Chicago School who hold that ‘inflation is always and everywhere a monetary phenomenon’. (The quote is a famous assertion of the Chicago school, made famous by and generally attributed to Milton Friedman.)

[14] E.g. *Deflation and Liberty* (2008): 10, *What Has Government Done To Our Money* (2005)*:* 55-56 or the useful elaboration in *The Inflation Crisis and How to Resolve It* (2009): 11-16.

thus not that prices tend to rise, but that it distorts prices and thereby alters the structural patterns of consumption and production.

1.2.3 The Austrian criticism of macro-economic aggregates

Macroeconomic models work as ‘black boxes’; if one changes one input, then all the other components changes instantly, while leaving the actual, and arguably important, economic processes unseen. Keeping in mind the black-box nature of these models, one must also understand that their input-components, the macroeconomic aggregates, are highly imperfect entities. *Exempli gratia,* it has in modern times become excruciatingly hard to understand just *which* financial-assets should be included in the total money-supply,[15] and the all-important price-level can only be measured theoretically through more or less arbitrary indexing: The various measurements of price-inflation[16] do not keep up with the ever-changing preferences of consumers, nor with the ever-changing supply of products. Moreover, is it clarifying or obfuscating to use seasonally adjusted numbers, or even to exclude say oil-prices and food-prices, because ‘these prices are so volatile’? Arguably it is not - consumers have to heat their homes and eat food in both September and May. When one also notices that changes in the preferred methodology for measuring macroeconomic aggregates consistently seem to work in the favor of the government (Figure 1 and 2), one has ample reason to believe that the macroeconomic models do indeed yield highly inaccurate indications of what goes on out there in ‘the real economy’.

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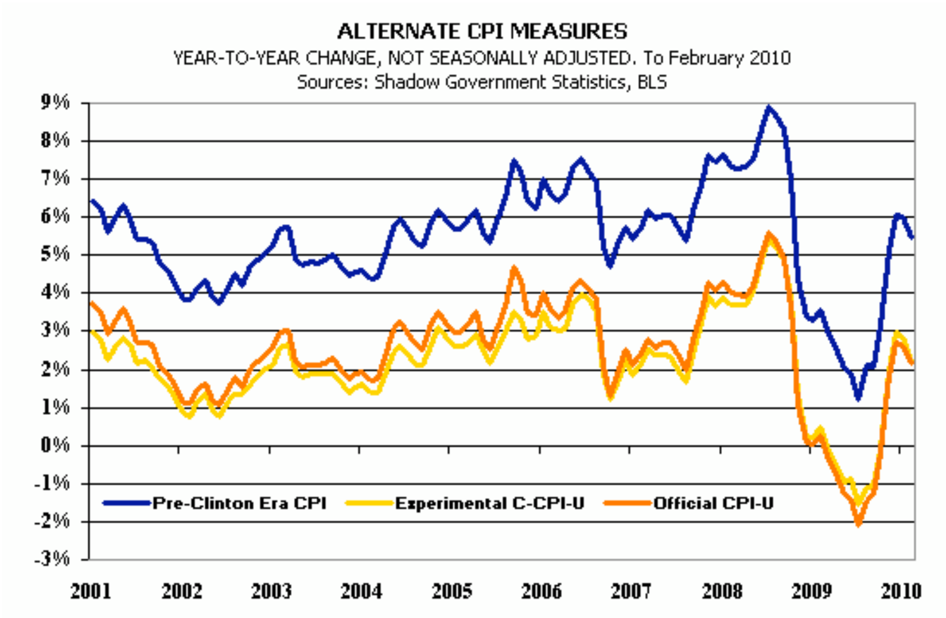
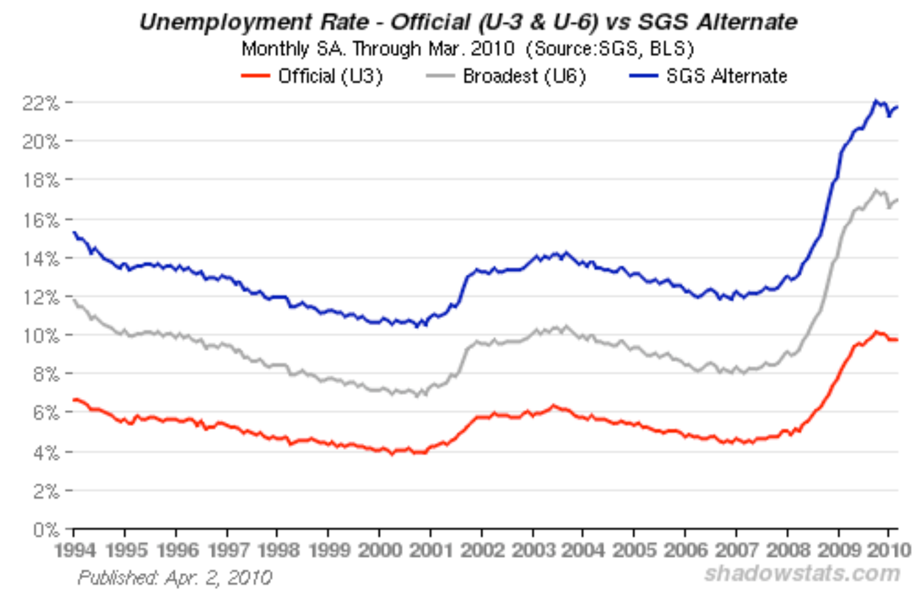
[15] For useful elaboration, see *The Mystery of Banking* (2008): 252-261

[16] Terms like ‘price-inflation’ or ‘inflation in prices’ refers to increases in the overall price-level, i.e. to the *effects or symptoms* that result from an inflation of the money-supply. It is important however to keep in mind that the term ‘inflation’ should in general be conceptualized and understood as the phenomenon of monetary expansion.

Figure 1 and 2: Measuring Macroeconomic Aggregates



Changing the methodology when measuring prices yield vast differences in results: Is price-inflation 6%, as with pre-Clinton indexing, or 2% as in present indexing?



“The SGS Alternate Unemployment Rate reflects current unemployment reporting methodology adjusted for SGS-estimated long-term discouraged workers, who were defined out of official existence in 1994. That estimate is added to the BLS estimate of U-6 unemployment, which includes short-term discouraged workers.” *(Both charts: Willams/Shadow Government Statistics 2010)*

John Williams’ Shadowstats.com aim to track important macroeconomic aggregates using both discarded and present government methodologies. The charts are intended simply to illustrate a general Austrian point concerning the inherent inaccuracy of many macroeconomic aggregates.

1.3 General approach

1.3.1 General approach

This essay is intended to address some overlooked, but important aspects of the international financial structure that are believed to be of fundamental importance to the wider human-rights community. It focuses on economic aspects that are deemed relevant to human rights in general, not on human-rights law in itself. Legal elaboration on 'black text' international law will therefore form only a minimum part of this essay. Hopefully the reader can accept and acknowledge the initial premise: "[T]he human-rights issues of global poverty and inequality cannot be properly addressed without thoroughly taking into account the financial super-structures of the world." If so, it should readily be understood that implied in this statement lies an acknowledgement of economic life as fundamental to the realization of a wide variety of interdependent and interrelated human rights.

It is proper to stress the holistic approach taken - the multifaceted complexities of political economy in general and monetary-regimes in particular require a wide search for understanding. The conclusions drawn in the latter part of this essay will not appear sensible unless their historical foundation is properly understood. It is intended that each relevant aspect shall be duly addressed, but dispensable elaboration will have to be restricted. This essay is not intended as a comprehensive defense of Austrian theory, so economically curious readers are highly encouraged to dive into the readily available Austrian literature, and investigate for themselves the vast arsenal of deductive reasoning which problematizes and questions reigning economic theory.[17] (Those who say that economics make for a boring read are usually not acquainted with the likes of Henry Hazlitt and Murray Rothbard.) This *is* however an essay aiming to re-introduce some important monetary matters into the human-rights field: Austrian theory has a long tradition of linking the monetary-system and financial stability to issues of basic civil liberties. As the UN now recognizes the need for major monetary reform I think it

[17] One such source is Henry Hazlitt's *The Failure of the New Economics* (2007), which is a line-by-line refutation of John Maynard Keynes *General Theory*.

is crucial that Austrian theory is revisited, and that human-rights advocates do not leave this debate to mainstream macroeconomists.

As implicated by the above, the verbal formalism adhered to is very much a fundamental methodological preference, which it is hoped will be appreciated by the larger 'non-economist' human rights community. Illustrative charts are however included as a supplement, as they are informative and serve to drive home the general points found within the text. All charts should be considered as parts of the web-based public domain, and none originate with the author of this essay. If successful, this essay will clarify some important economic tendencies within our global financial structures, and might thus serve as a useful starting point for more legal-oriented human-rights scholars who wish to further investigate and problematize the general standing of our economic organization within the international human-rights framework. What is presented is a line of reasoning that aims to expose fundamental aspects of the financial and monetary-system that cannot be seen as existing in accordance with the generally recognized principles of human-rights law. Through investigating our contemporary institutions of money and banking, this essay is an attempt at exposing the monetary aspects of *how* global wealth-disparities occur and *why* they necessarily do so.

2. The Austrian perspective on money and banking

> *You might say that he hath the secret of alchemy in perfection. The Khan causes every year to be made such a vast quantity of this money, which costs him nothing, that it must equal in amount all the treasure of the world.*[18]
>
> Marco Polo (1254-1324) on Kublai Khan.

2.1 Money at the speed of light

At no times do the debates over 'tight or easy' money seem fiercer or more important, than when the financial architecture itself seem to be crumbling around us. While it is generally understood that too much easy money will have some detrimental effects, the prospect of an impending deflationary collapse weighs heavy on the monetary caretakers, and thus they often and understandably conclude that the market needs a helping hand: Disaster will strike unless *something* is done, and that something generally entails giving the economy a monetary boost.

Following the collapse of the Lehman Brothers banking-group in 2008, the US Congress found itself discussing 'the possibility of a breakdown in law and order and the logistics of feeding US citizens' in the event of a possible widespread collapse in commerce and banking.[19] The consequences of *not* acting was seen as disastrous, and Congress therefore heeded the warnings of US Secretary of Treasury Hank Paulson and reluctantly conceded to an unprecedented $700 billion Wall Street bailout. Emphasizing the urgency of the situation, Paulson later pointed out that in the information age, money move with the speed of light electronically - in other words, he considered the ripple effects: "[W]hen a financial system fails, a whole country's economic system can

[18] Attributed in various forms. For context, see *Marco Needs a Wallet* (Power Magazine, January 2009) (URL).

[19] *Paulson Reveals US Concerns of Breakdown in Law and Order* (The Independent 17.07.09) (URL).

fail [...] I believe we could have gone back to the sorts of situations we saw in the Depression."[20]

How did we get here, to a world in which money moves with the speed of light, and where the power to save or endanger vast economic systems lies in the hands of such a small number of individuals? Moreover, is the centralizing of monetary-power with governments, central-banks or financial-firms reconcilable with our democratic ideals, and our need for a financial-system that promotes economic convergence? Hopefully, by investigating monetary history and the vast changes in the *form* of our money, we might reach some clarity in regards to why our financial-system fails to deliver on its promise of spreading the wealth. [21]

2.1.1 The origin of money

Money fulfills our need for a common *medium of exchange*. The importance of exchange should be clear to anybody who have tried the self-sufficient life for any significant length of time. Considering the vast differences in personal skills and available resources, it simply makes no sense for each and everyone of us to make for ourselves everything we need to prosper. Simply put, without exchange we would not only have no need for money, we would have nothing like a modern society at all. Voluntary exchange occurs as both parties expect to benefit from the trade, and it is worth noticing just *why* such exchange increases general welfare. If for example Aristotle accepts Marx' offer of two fish for a bucket of berries, this is *not* because these goods are 'equal in value' to the two men, it is in fact because they value them *differently.* Aristotle values Marx' fish higher than his own berries, and vice versa - it is precisely because they value the products in different order that the exchange takes

[20] Ibid.

[21] The following account of the evolution of money is by and large the one shared by mainstream and Austrian theorists alike, and the economic principles presented are the same in kind as those available in most basic textbooks of economics. While due credit will be given were appropriate, it is not possible to attribute the basic economic reasoning involved to any one single author or school, neither mainstream nor Austrian. There will however be an Austrian emphasis throughout, and it is proper to acknowledge the foundational inspiration drawn from the works of prominent economists such as Henry Hazlitt, Ludwig von Mises, Murray Rothbard, Hans Sennholz et al.

place. The desirable result is that both men, without any increase in available goods, are that much better off.

What is it then about money that makes exchange easier - why not trade goods and services directly? Barter, or *direct exchange*, have indeed been used for centuries. In practice however, barter is only a little better than self-sufficiency. Firstly, there is the problem of *indivisibility;* if Aristotle owns a horse and wishes to trade it in for a pair of shoes, Marx' collected works and a straw-hat (objects with assumed separate owners), he will have trouble paying for the goods, as his horse is *indivisible*. All parties might agree on the horse as being many times more valuable than the other goods, but neither has any use for a third of it, and therefore the exchange does not take place. Secondly, there is the issue of *coincidence in wants*. Assume that Marx still has a surplus of fish that he wishes to sell for a pair of shoes. The shoemaker however, suffering from fish-allergies, does not need the fish - he wants knowledge and will therefore only trade his shoes for some philosophical insights. Without coincidence of want in other words, direct exchange is not possible, even though both have surplus product. Obviously, Marx ventures to ask Aristotle if he will accept the fish in exchange for some Greek philosophy, thinking he might in turn be able to exchange the philosophical writings for the shoemaker's shoes. However, chances are that Aristotle does not want to accept the offer (he already has fish) and furthermore, the shoemaker might only be interested in *Humeian* philosophy. Coincidence of wants, as we understand, is the exception rather than the norm in society, and direct exchange will not suffice in advanced economies. What is needed is a generally accepted medium of exchange - some sort of *money*.

2.1.2 The medium of exchange

Marx attempted to indirectly exchange his fish for a pair of shoes. *Indirect exchange* entails trading some product, not for the good that is actually sought, but for a good that *subsequently* can be exchanged for the product actually wanted. While this might seem cumbersome in a world without recognized money, it is precisely this type of exchange that has permitted society as we know it to develop. What we questioned in Marx' case was not his technique, but the *marketability* of his chosen intermediary good; Greek philosophy might simply not be in high enough demand to function adequately as money. For something to function well as an exchange-medium it is secondary what the chosen medium actually *is* - first and foremost it needs to be *marketable*, as this is the only solution to overcoming the mentioned need for coincidence of wants. It is important to notice that once a commodity is found to facilitate exchange, demand for that product increases, and thus its marketability becomes even higher. High marketability or *liquidity*, causes more demand, causes higher marketability, and so forth - this reinforcing spiral strengthens the monetary status of the selected medium, and eventually one or two media are left as the generally accepted *money*. Over the centuries, two distinct commodities emerged as the ultimate money, namely gold and silver. Among the many monetary candidates, these excel in most necessary qualities: They are divisible without loss of value, they are highly portable as their scarcity make them valuable in small quantities, and they are durable and thus excellent stores of value. The important thing to notice is that for *whatever reason* the free markets have found gold and silver as the most efficient monies.

The benefits of using money should be obvious; not only were the issues of indivisibility and coincidental wants solved, money also solved the pricing problem that is so characteristic in barter economies. When all exchange-ratios are expressed in the chosen monetary commodity, the *market worth* of each good becomes easily comparable to that of all other goods. If three pounds of fish exchanges for a quarter ounce of gold, four pounds of apples exchanges for a half ounce, and a bushel of wheat for two ounces, then everybody can tell that the market value of a bushel of wheat is 24 pounds of fish or 16 pounds of apples. These exchange-ratios are *prices,* and the chosen medium of exchange serves as the common denominator for all. Instead of remembering the innumerable exchange-ratios between each and every product, the introduction of money enables all actors to consider only the money-price of each product. In this way entrepreneurs and producers can easily make business-calculations, and thereby efficiently allocate available resources to where they best satisfy consumer-demand. Money then, does not *measure* prices or value, rather money is the common denominator in which prices and value are *expressed*.

Austrian theorists point out two things in regards to the origin of money: Firstly, they stress that money cannot *originate* in any other way than through this free-market cumulative development of the exchange-medium. Under no circumstances can money be created *ex novo*. Secondly, they emphasize that money is *a commodity,* always with its own supply and demand - not an abstract unit of account, nor a claim on society. Money is the commodity chosen as the generally accepted medium of exchange, and therefore it *functions* well as an accounting-unit, a measure of value and so forth. As the prominent Austrian theorist Murray Rothbard stated: 'Money is a commodity. Learning this simple lesson is one of the world's most important tasks.'[22]

2.1.3 Money through a process of cumulative development

Austrians emphasize that money must originate as a commodity chosen through cumulative development in a free-market setting, as they see this as the only logically possible route to creating a *monetary demand*. This is because knowledge of the prices of the immediate past is embedded in the current demand for money: As opposed to demand for other goods, monetary demand *must* be grounded upon pre-existing money-prices. This can only happen by beginning with a useful commodity under barter, and then gradually increasing its general demand through adding to it a *monetary* demand as the preferred medium of exchange.[23] One is therefore putting the cart in front of the horse, if one holds that "the chosen metal became the universal equivalent after, as opposed to before, it was incorporated into money."[24] Gold and silver were by no means turned into money as a result of a sovereign 'intervention that defined the commodity that would be used as to mark value'[25], rather these metals were chosen for sovereign standardization and monopolization precisely because they *were* money - defined as such by the people through a process of cumulative development. While a government

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22 *What Has Government Done To Our Money* (2005): 27

23 This is what is entailed in Ludwig von Mises' *regression theorem.* For elaboration, see *Human Action* (1998)*:* 405-413, *The Theory of Money and Credit* (2009): 76-77 or *The Austrian School (2008)*: 64-65

24 ()*Coin Reconsidered* (2010): 371

25 *Ibid.* 372. (For similar views, see *The Jurisprudence of Global Money* (2010).)

preference for gold as money obviously improved its liquidity, it is contrived to say that government thereby *defined* the monetary commodity. Rather, by turning the preferred metal into sovereign coin, government *enhanced* its monetary efficiency. Much like people trust a Mercedes as being of a certain quality*,* individuals receiving a trusted coin could feel safer in regards to *its* actual composition. Liquidity then is not the unique quality 'that set money apart from a commodity'[26], rather excellent liquidity is a sine qua non of any *monetary commodity*: If it's not liquid, it cannot serve as money.

'Strong' state-theories of money are therefore inherently fallacious, simply because it is theoretically impossible for any state to introduce money into a society *ex novo.*[27] Whatever monetary commodity they choose, be it metal or paper, their declared currency must be linked to an existing price-system. 'Weak' state-theories of money are however fully plausible; if the society has adopted some kind of democratic money, the government can impose fiat-paper by latching it onto the existing price-system. The introduction of unbacked fiat-monies is a case in point: Fiat-notes were initially gold-receipts, with each government-currency redeemable into gold.[28] Only over time, gradually and through a long series of legislative measures, could the 'fiat-tie' to the natural money be severed altogether.

Misconceptions about the origin of money, what money is and its historical relationship with government, inevitably leads to the kinds of economic reasoning that Austrians consider as both unsustainable and detrimental to economic life. The fact that money early on was *politicized*, and later digitalized so that it 'moves with the speed of light', changes nothing in regards to the appropriate conception of money as a commodity in general monetary demand according to its specific supply.

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[26] *Ibid.* 372

[27] *Supra* 2.1.3

[28] *Supra* 2.1.4

2.1.4 The standardization of money: Sovereign or private coinage

As with other commodities, it fell natural that the preferred money-commodity was measured in units of *weight.* The standardization of gold and silver into coin did initially little to change this, and it must be understood that the monetary-units emerging (franc, dollars, pounds, etc) were only different names for weight-units of gold and silver: The British 'pound sterling' started off as exactly that, one pound of sterling silver.[29] Under the gold-standard before 1933 it was therefore misleading when people said that the price of gold was *fixed* at twenty US dollars an ounce - rather one dollar was *defined* as 1/20 of an ounce of gold.[30] It was not the price of gold that was fixed, it was the price of dollars, measured *in* gold. The gold-price itself floated, but with the dollar being being directly redeemable into gold, it naturally did not venture far off the $20 an ounce mark.

The *name* of the monetary-unit makes absolutely no economic difference on a commodity-standard, although it causes significant confusion as opposed to simply using a plain measure of *weight*. Under a gold-standard for instance it is of course the definition of each currency's *weight* that set the exchange-rates between them. As noticed, the very raison d'être of money was to escape having to deal with a plethora of exchange-rates. It therefore makes no more sense to talk about 'francs for marks' and 'dollars for pounds', than it makes to talk about 'fish for berries' or 'apples for bushels', all the while they all exchange into a single monetary medium.

When the right 'money-stuff' is chosen, it follows that the *entire* stock of it may serve as money. If gold is the preferred exchange-medium, then *all* the available gold constitutes the global money-supply. It does not matter whether the metal is coined or kept in the form of bars or other kinds of bullion. Even gold dust can and have

[29] At the time of writing (12th of March 2010), one pound of silver trades at £164.

[30] This is a commonly used approximation. The actual definition agreed upon in the United States Gold Standard Act of 1900 was one troy once of gold as $20.67. For comparison, on the 18th of March 2010 one troy ounce of gold trades at $1 125. The term 'troy ounce' (a precious-metals unit of weight) shall hereinafter be replaced with the more convenient 'ounce'.

functioned as money, even in modern times.[31] When money is gold, then all gold is money. This said, coins do indeed trade at a premium compared to the same commodity in pure metallic form. This however do not stem from coin as being 'more money' than pure gold, but from the simple fact that the standardization of pure metal into coin always requires labor. This premium is outweighed by the increased liquidity the metal offers when coined - with trusted coins people do not have to ensure the weight and purity of the metal. Some *shapes* of money are simply more practical than others.

The logical conclusion to the above often seem foreign to non-Austrians: On a pure commodity-standard, there is no need for government to be involved in the production of money. Private minters can guarantee the uniformity and fineness of coin just as well as any government-mint, and the market-participants will simply prefer coin from minters with well-recognized quality of product. Opponents of private coinage often object by saying that private minting would lead to fraud and tempering with the monetary-standard, but this objection seems odd if properly investigated. As our legal regimes prohibit criminal behavior, anybody involved in fraudulent counterfeiting would be prosecuted just like other individuals or companies who are engaged in fraud or theft. If one accepts the idea of state-monopolized coinage in order to avoid fraud, one must also by the same logic entrust government with the production of computer-processors, half-gallon bottles of milk or any other standardized product - this simply makes little sense. Under private coinage, one would obviously not trust *any* odd character offering a freshly minted coin, rather consumers and businesses would converge around those minters with solid track-records and a reputation for quality. Modern business is in fact based upon recognized standards - minting companies, like any other producer of goods or services, would be out of business on the spot, and eligible for prosecution, if they conspired against their customers. In short, under hard currency regimes there is no reason for considering the monetary standard as essentially different from any other standard. Government involvement is therefore not a necessity

[31] For a modern account, see *Zimbabwe - Gold for Bread* (Guardian 11.02.09) (URL). This is not to imply that Zimbabwe turned to a *de jure* gold-standard when their currency collapsed, but simply to illustrate that the people of Zimbabwe turned to gold, and that grains were as good as coin.

for a functional monetary-regime, and standards of *weight* might be handled just as well as any other standard by the free market.[32]

While the origin and standardization of money did therefore *not* depend upon government intervention, it is clear that sovereign powers quickly saw the benefits of acquiring monetary control. One can reasonably say that the justification for state-intervention in the monetary sphere was to release individuals from the necessary and strenuous task of testing weight and fineness,[33] but it quickly became clear that the monetary weight-standards were less secure than other standards in government hands.

While it is pointless for any government to suddenly declare the meter as being 90 as opposed to 100 centimeters, debasing the monetary-unit quickly became a profitable government enterprise. Through monopolizing the minting of coin, kings and government profited vastly, and systematically they turned out to be poor guardians of the monetary weight-standard: By calling in coins for renewal, the nominal value of coins would be returned, but each coin would have less gold or silver in it (Figure 3). Debasement then, is understood as the arbitrary redefining of a currency, practiced by sovereign powers in order to generate income.[34] Because the public had gotten used to exchanging money in *name-units* (e.g. pound, franc, mark), as opposed to *weight-units*, the debasement of currencies increased the money-supply, and as a result prices in the debased currency tended to rise. Importantly, had the money-unit remained as a measure of weight, this practice would have been near impossible - an ounce forever and always remains an ounce.

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32 Notably, as late as in 1848 privately manufactured gold-coins circulated in California. It is also worth noticing that as government sought to monopolize money, the first royal coins came with the guarantee of private bankers, whom the public apparently trusted more. (*What Has Government Done To Our Money* (2005): 37)

33 *The Theory of Money and Credit* (2009): 66-67.

34 *The Mystery of Banking* (2008): 11

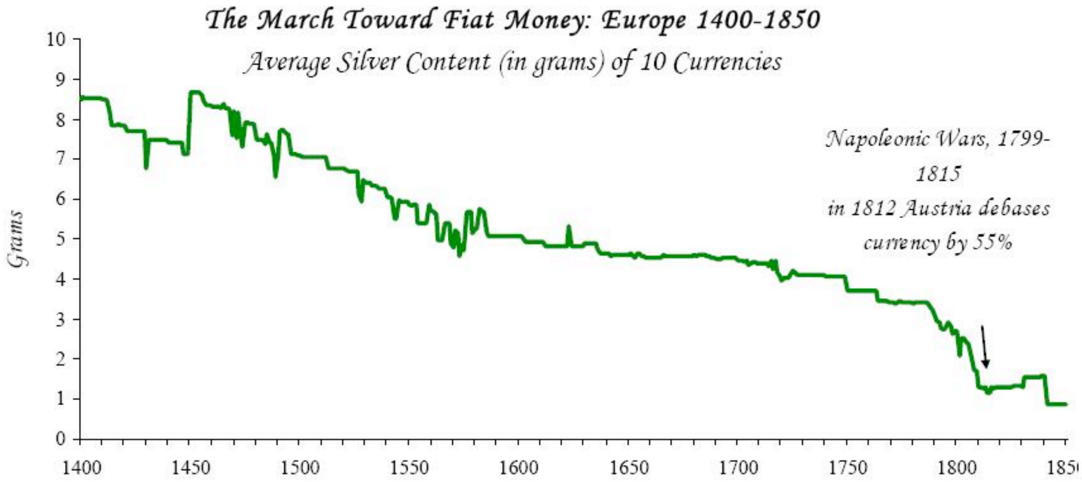

Figure 3: Illustrating the historically decreasing amount of silver in various European currencies. *(Source: Allen and Unger/Seeking Alpha 2010)*

2.2 The optimum quantity of money

The perceived royal prerogative of currency-debasement generated handsome profits, and the monarchs also received income by charging high seignorage-prices for the princely service of minting coin. We shall return to the process of how and why money-production was monopolized and politicized, but first we must understand the Austrian solution to a problem that needs solving by anybody aspiring to control a nation's money: How much of it should be produced?

2.2.1 Money as a non-economic good

Because economic goods (as opposed to 'free goods' such as air) are never absolutely abundant, there is always somebody who would be happy to receive more of that good than they at current prices are able to acquire. Therefore, increases in the quantity of such goods and services always confer a *net benefit* on society. This does not mean that *all* individuals are better off, but general welfare is always increased: An astonishing wheat-harvest resulting in lower prices for wheat, might not be great for the wheat-farmer who has calculated with high prices for his product, but it is a boon for the vast group of consumers and producers who suddenly have access to cheap wheat. They can now get the wheat they want in exchange for less of what they themselves produce (labour, apples, fish).[35] With economic goods therefore, there can never be absolute overproduction, only relative overproduction. An alleged oversupply of wheat, only makes sense insofar as there is a relative undersupply of some other good, say apples or fish. The outcome is a change in the exchange-ratio between wheat and the goods that find themselves in relatively higher demand. The miscalculating farmer who has overrated the markets desire for his wheat must correct his mistake (e.g. by going into the apple business), or accept lower profitability and the possibility of being run out of business. To the particular farmer this is a misfortune that should not be overlooked, but the market still has no use for his overpriced wheat, and welcome the opportunity of getting it cheaper elsewhere.

Increases in money however, do not benefit society as a whole. This is so as money is only useful for its *exchange-value*. If we all woke up with doubled bank-accounts, we would only feel twice as rich momentarily - as we all ran out to spend the 'new wealth', prices would very roughly double and society as a whole would be no better off.[36] Similarly, if for some reasons our bank-accounts were halved, we would arguably feel that much poorer, but as money prices would adjust downwards to roughly the half of their initial level, the overall effects would leave us no worse off than we were to begin with. The above is overly simplified, but it suffices for now and allows us to expose an important insight: It does not really matter what the money-supply is: Any monetary-

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[35] They use money as the intermediary medium of exchange, but are really exchanging their own produce for wheat. This is somewhat simplified, as some might have e.g. *inherited* the money they spend, but this is not really relevant, as even inherited money has been acquired by somebody producing something. (See Mises, Ludwig von, *Lord Keynes and Say's Law* or Say, Jean-Baptiste, *Of the Demand or Market for Products* both in *The Critics of Keynesian Economics* (2009).)

[36] The proposition that prices would actually double along with a doubling in money-supply is overly simplified, but serves to convey the important relation between prices and the monetary-base. Mainstream economists recognize and refer to this when they say that 'monetary policies are neutral in the medium and long run', see *Macroeconomics* (2006): *533-552*. For a thorough Austrian investigation of the 'quantity theory of money' see *The Theory of Money and Credit* (2009): Part II §6-10.

base is as optimal - if not as practical - as any other. This is not intended to say that changes in the money-supply do not have important implications in the broader economy. Changes in the monetary-base do indeed change the economic structure, and exploring this process will form a crucial part of the remainder of this essay.

2.2.2 The supply of money and prices

Sustained price-inflation can only stem from a persistent fall in the supply of most goods and services *or* from an increased money-supply. Since we know that productivity in modern times has grown tremendously, the sustained increases in overall prices experienced over the same period can only stem from an increase in the monetary-base. It is therefore uncontroversial in both mainstream and Austrian economics to leave the supply of goods behind, as we go on to explore the inflationary nature of our our financial-system. Governments worldwide have adopted monetary-policies that gradually has increased the money-supply and driven prices higher - it is precisely these policies that will be explored in more detail in the following (Figure 4).

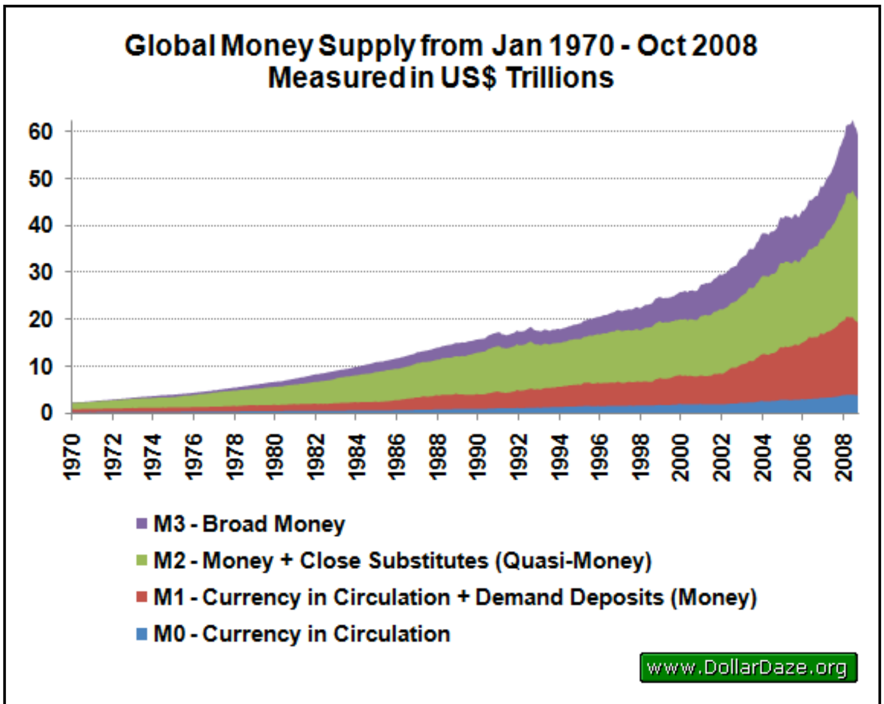

Figure 4: Global Money-Supply 1970-2008
(Source: Hewitt/Dollardaze.org 2009)

We concluded above that from an economic viewpoint the quantity of money (M) is fundamentally unimportant, and that every M is as good as any other for performing its cash-balance exchange-function. The economy seen as a whole does not get richer by increasing its money-supply, all that happens is that the purchasing-power of its money is diluted. For our later analysis of real-world inflation-processes however, it is important to notice that *some* individuals benefit from an increase in circulating money. As the individuals in our example woke up to doubled cash-balances, some of them went out and spent their money *before* prices had a chance to rise - *these* people certainly benefitted. Those more cautious spender who decided to save their money actually lost out in absolute terms. With doubled cash-balances and doubled prices, their purchasing-power is roughly left intact, but importantly, as they refrained from increasing their consumption they did not benefit from the actual spending-spree that made prices rise: The early spenders therefore benefited *at the expense* of the more cautious and thrifty late-comers.

2.2.3 Private inflation and the 'Cantillon-effect'

In order to better illustrate the redistributive effects of inflation, it will at this point be useful to consider the less honest enterprise of *counterfeiting.* Counterfeiting money is of course fraudulent and illegal - it is irrelevant that the counterfeit money is made so well that people accept them as real money. But if the fake money, for instance coins, are indistinguishable from the real thing, what are the effects of counterfeiting?

Firstly we notice that the counterfeiter is effectively increasing the money-supply: Counterfeiting is a private *inflationary* activity. Because nobody can spot the difference between fake and real coins, the counterfeiter dilutes the purchasing-power of already circulating money. The counterfeiter thereby swindles not only the receivers of the fake coins, but he injures and defrauds *all* legitimate existing money-holders. Secondly, we notice that the increased money-supply does not raise prices uniformly or increase individual cash-balances all at once. On the contrary, the new money are injected at very specific times and at very specific places in the economy: The culprit spends the money for instance by buying new furniture and kitchen-appliances. The storeowner, very much happy with the way her business is booming, in turn hires an extra assistant. The newly hired assistant will then spend his salary on whatever it is he desires, and so forth. As the money ripples through the economy, in ever-widening circles, the price-level in the general economy is raised.

Increases in the monetary-base do not affect the whole economy at once: The process through which money-production tends to increase the price-level is spread out in time, and thus it affects different prices at different points of time - there is no simultaneous increase of all prices. Furthermore, "there is no reason why prices should change uniformly or in some fixed proportion to the change in money-supply. Hence, money-production entails a tendency for prices to increase, but this increase occurs step by step in a process spread out through time and affects each price to a different extent."[37] In contemporary monetary analysis, these redistributive and structurally disruptive effects of changes in the money-supply are called 'Cantillon-effects', after the economist Richard Cantillon (1680-1734).[38] Crucially, increases in the money-supply benefit those who receive the money first, at the expense of those who receive it later. Some might not even receive any money at all, either because the 'trickle-down' has stopped, or simply because they are fixed-income individuals, living on unemployment-benefits, bond-yields, pensions, student-loans and so forth. In the case of counterfeiting, the new money definitely creates a dubious 'Keynesian boom' in the economy, but the benefits of this counterfeit boost are short-lived and unevenly distributed.

2.3 From commodity-money to fiat-currencies

We shall return to the redistributive effects of inflation, but before we do that it is natural to investigate just how the monetary supply can be increased. The following sections consider the potential for changing the money-supply under commodity-standards and under regimes of paper-monies.

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[37] *The Ethics of Money-Production* (2008): 44-45

[38] For an excellent account of Cantillon's research on changes in the money-supply, see *Cantillon on the Cause of the Business Cycle* (2006)*: 45-60*

2.3.1 The supply of gold and other 'democratic monies'

Under a strict gold-standard it is of course exceedingly hard to increase the money-supply, as one has to venture to actually dig it out of the ground. This process of *mining* for money is an extensive process that requires a significant input of labour and capital. The amount of gold that will be mined and supplied will then, like other products, depend upon the expected profit of the suppliers. As in other branches of industry, money-production will expand if the expected return on mining investments look attractive from the producers' point of view, and as gold *is* money, its supply will depend upon the cost of production. The cost of mining-equipment, labour and so forth, will in turn depend upon the overall price-level. Like other producers, miners and minters will expand production when the return on these investments are at least as high as the return from alternative investments. It is therefore the market-participants themselves, through their incessant market-place 'voting', who fundamentally decides upon the relative value of gold to other products, and thereby how attractive it is for producers to supply more money (gold) into the market. Curiously, some gold-critics consider this 'mining for money' to be a free-market failure: If any monetary-base is as good as any other, and if its increase is not beneficial to society as a whole, is it not then simply wasteful and inflationary to mine for gold? Absolutely not - for while it is true that there are no monetary gains and indeed a slight inflationary effect in an increased gold-supply, society benefits as gold also has *non-monetary* value. An increase in the supply of gold will also mean an increase in the gold available for such things as jewelry, dental-work and industrial purposes.[39] As with other goods, an increase in the gold-supply thereby benefits society *on net*. Gold-mining is therefore just as productive as producing shoes and shirts.

We may call the type of money that originate through a cumulative market-process for *natural* or *democratic* monies, and the free-market production of them may be called

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[39] The inflationary effect is insignificant compared to the limitless production of modern monies. When acknowledging the strenuous manner in which gold is brought into the economy, it is uncontroversial to point out that an economy using gold-money will tend to find itself in a *deflationary* environment. Population growth alone will tend to increase the monetary demand and thus drive prices down, and general increases in productivity will do the same.

the natural money-supply. Throughout we shall assume gold to be the money-commodity of choice, but it is worth noticing that one cannot through *a priori* reasoning tell what the natural monies of a society will be. Gold and silver are good historical bets, but the only way to find out is to let people freely associate, and converge on their preferred medium of exchange. As such, natural monies are a remarkably social and democratic institution: Not only because they are used in interpersonal exchange, all monies are, but in the sense that their existence is exclusively owed to the fact that they better than any other medium facilitate the human need for economic exchange. When this description no longer holds, market-participants will simply discard the commodity used and turn to other kinds of monetary media. In other words, natural monies can be seen as stemming from a democratic grass-root movement that is constantly choosing its money of preference.[40]

Importantly, the government will naturally be severely restricted should it wish to increase the money-supply. The occasional debasement through coin-dilution is one option, but this is indeed a rather cumbersome operation. For government to effectively control and debase the money, it needs non-metallic money - the following briefly investigates how paper money came about.

2.3.2 From warehouse-receipts to fiat-currencies

For modern-day individuals it can readily be acknowledged that carrying metal around, even in the shape of coins, is both cumbersome and unsafe, especially for larger transactions. The solution to this problem came naturally: Gold needed storage, and market-actors stood ready to provide this service. As is common for all storage-facilities, the gold-warehouses supplied the depositor with a receipt, which in turn could be used to release the deposited gold from storage. However, the depositors oftentimes did not show up to collect their gold. The peculiarity arose as money, unlike most products, is not 'used up' when utilized, but rather it is simply transferred between the cash-balances of economic agents. As a simple matter of convenience, instead of

[40] *The Ethics of Money Production* (2008): 26-27.

exchanging the physical gold, individuals exchanged paper-titles to gold that they had deposited in specialized warehouses - or *banks*. In this way warehouse-receipts for deposited money, or *bank-notes,* increasingly started to function as *money-substitutes*. Fewer and fewer transactions were made in actual metal, and paper-titles to gold or silver became the preferred monies. Eventually, customers chose to waive their right to paper-receipts altogether, preferring instead to keep their money-entitlements as open-book accounts, or *bank-deposits*. Clearly, there was no economic difference between a deposit-entry and a bank-note; they were both claims to ownership of stored gold, and it was up to each client to decide whether to use bank-notes or keep an open deposit-account.

Importantly, the above transactions do not increase the money-supply. The warehouse-receipts are simply money-substitutes, that for practical reasons function as *stand-ins* for gold. The metal that is handed in is effectively taken off the market and held as a *reserve* tied to its paper-receipt. In other words, while the money-supply changes into a more convenient form, it is by no means increased, neither by the mere practice of using paper instead of the actual commodity, nor by the enterprise of banking per se. However, the popularity of money-substitutes provided new and welcome opportunities for sovereign revenue. The early bankers had discovered a rather dubious but highly promising possibility for profit: By writing out unbacked *pseudo-receipts* that were indistinguishable from the actual gold-receipts, the bankers could profit from the fact that people would use them as money. Thus, the first fractional-reserve banks were invented. As people could not separate between backed and unbacked bank-notes, *both* functioned as money, and counterfeit receipts rippled through the economy, effectively increasing the money-supply and driving prices higher. Gradually, governments world-wide monopolized the printing of bank-notes, and like the bankers, they could then easily inflate the money-supply. Seemingly, they had discovered the secret of alchemy - in effect, they found themselves capable of creating gold.

2.3.3 Introducing irredeemable paper-monies on free markets

For as long as money was redeemable into precious metal, there existed natural limits to the amount of money that government could produce, and only gradually could the tie to gold be severed completely. Historically, people have been distrustful of pure paper-monies: If we turn to the empirical record, we must accept "the stark fact that, in no period of human history, has paper money emerged on the free market. [...] The idea arose only when paper certificates for gold gained circulation, especially in the context of large-scale government finance."[41] The reasons for this can be found in the fact that commodity-monies are both useful in themselves *and* they provide excellent monetary services.[42] Commodities always carries positive exchange-value, and they can therefore always be re-monetized. Pure paper-monies on the other hand provide *only* monetary services. The exchange-value of paper-monies can and historically do fall to zero, and when this happens, it is impossible for the market to re-monetize them.[43] It is this inherent risk of pure paper-monies that makes people unwilling to hold them in unhampered market-conditions: Absent significant government-intervention in the markets irredeemable paper-monies are unable to rise and survive - they can only be introduced and maintained *by fiat.* Fiat paper-currencies are thus *forced monies,* that can only be imposed if accompanied by significant amounts of legislative coercion.

When one then considers how paper-monies are totally foreign in a free-market setting, one must also acknowledge that the transition into pure paper-money can only take place if the government backs its currency by various types of legislation. These kinds of laws can roughly be divided into four main categories: *Legalized falsifications* in the form of debasement or fractional-reserve practices, *legal monopolies* of money-production (royal mint, central-banking cartels), *legal tender laws* that forces creditors

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41 *The Ethics of Money Production* (2008): 30

42 Recall 2.1.2-2.1.3

43 For an overview of the historic life-span of currencies, see *Fate of Paper Monies* (Market Oracle 29.06.09) (URL).

to accept paper on par with gold, and legalized *suspension of specie-redemption*.[44] *Exempli gratia*, it was in older times perfectly common for foreign coins to circulate freely within a country. Up until 1857, few people in the United States saw it necessary to go to the US Mint for coin. The coins generally used were Spanish, English and Austrian gold and silver coins, and this practice continued until Congress outlawed the use of foreign coin, thereby forcing holders of such coins to go to the US Mint and re-melt them into American coins.[45] The most notable examples of monetary coercion are perhaps the US gold-embargo of 1933, in which the Roosevelt-administration by and large made it illegal for the American people to own gold, and the final and permanent suspension of specie-redemption in 1971, in which the US effectively told the world that it would no longer honor its debts.[46]

2.4 The institution of banking

Fiat-currencies are only inflationary when governments actually increase the money-supply, as they of course have a consistent tendency of doing. Similarly, only when bankers are allowed to issue *unbacked* money-substitutes, can they be said to inflate the money-supply. Under a system of *full-reserve bankin*g, the issuance of unbacked receipts or account-entries is considered fraudulent, but somewhat surprisingly, under a system of *fractional-reserve banking*, this activity is fully legal. Fractional-reserve banks legally create money-substitutes by issuing bank-money - or *credit* - out of which only a fraction is backed by the bank's actual reserves. As bank-money from a consumer

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44 Suspension of bank specie-redemption allowed banks to legally operate when unable to provide customers with their deposited gold. Other companies are put under management when they cannot comply with their liabilities, and it is generally illegal for a company to knowingly operate at its creditors' expense. While briefly mentioned here, these historical and present forms of legal coercion are thoroughly treated in the Austrian literature. For elaborative accounts, see *The Ethics of Money Production* (2008): 109-157 or *The Mystery of Banking* (2008): *125-139*

45 *The Mystery of Banking* (2008)*:* 10

46 The commonly accepted explanation is that the US faced vast gold-withdrawals in part due to excessive deficit-spending related to the Vietnam-war. The US thereby suspended gold-redemption to halt specie-outflow, and foreign central-banks could no longer redeem their US-dollars into gold, as they had been able to do under the Bretton Woods system.

point of view is indistinguishable from money proper, the effective money-supply is increased. Fractional-reserve banks are therefore inherently inflationary institutions.

While most Austrian theorists oppose the system of fractional-reserve banking as both ethically unsound and inherently unstable, they are not opposed to banking in itself. Banking can be just as fruitful to society as any other line of industry. It is however worth separating between the different kinds of banking, since modern banks can be seen as mixing and confusing to distinctly different banking-activities, namely *loan-banking* and *deposit-banking*.

2.4.1 Loan-banking

Loan-banking is the economically desirable activity that most people think banks are engaged in: Loan-banks channel surplus savings into productive loans and investments. More precisely, the bankers provide the useful service of connecting savers with idle resources and potential borrowers in need of funding - in return for this service they pocket the interest-rate differential between the money they receive and the money they lend out. Loan-banking is therefore a fully non-inflationary activity, and while there are virtually no limits to the potential size of a loan-bank, it can never become 'too large too fail', because the loan-bank always uses its existing money stock to lend out money - either its own money *or* that of depositors who wish to lend out *their* surplus savings in order to receive interest. It might be useful at this point to briefly consider the balance-sheet of such an institution.[47] When the Aristotle Loan-Banking Corporation opens business, its balance-sheet might look like this (Table 1):

[47] For simplicity we shall simply use dollars ($) as the relevant money through out this section. The purpose is to explore the institution of banking in general and fractional-reserve banking in particular - it is irrelevant for the argument what the actual money is.

Assets		Equity and Liabilities	
Cash	$ 10 000	*Equity* Aristotle (Shareholder)	 $ 10 000
		Liabilities	 $ 0
Total Assets	$ 10 000	Total Equity and Liabilities	$ 10 000

(Table 1)

As the recently established banking-company lend out money in order to receive interest their assets are turned into IOUs ('I owe you*'*) to be paid back on a future date with interest. If the bank lends out $ 9 000 of its money at 10% interest to Marx, their balance-sheet changes accordingly (Table 2):

Assets		Equity and Liabilities	
Cash IOU from Marx	$ 1 000 $ 9 900	*Equity* Aristotle (Shareholder)	 $ 10 900
		Liabilities	 $ 0
Total Assets	$ 10 900	Total Equity and Liabilities	$ 10 900

(Table 2)

In the above, the bank-lender chose to forego consumption or investment, and instead lend out its money to Marx, who will utilize the surplus funds for business or consumption purposes. In order to pay back the loan with interest, he must later renounce parts of his consumption or business-profit. In other words, the bank and Marx are at different times *foregoing consumption* or other investments, in order to instead transfer surplus cash-balances to each other through mutually beneficial transactions. When Marx later repays the loan, the loan-bank will cancel the IOU, and the balance-sheet will simply contain $ 10 900 in cash. If the bank chooses to expand from lending out its own money, it might do so by borrowing other peoples savings, for instance by issuing bonds and selling certificates of deposit (CDs). Assuming that Marx has repaid his loan in full and that the bank sells $5 000 worth of bonds and attracts $5 000 worth of deposits, the balance-sheet is expanded (Table 3):

Assets		**Equity and Liabilities**	
Cash	$ 20 900	*Equity* Aristotle (Shareholder)	 $ 10 900
		Liabilities *Bonds* *CD*	 $ 5 000 $ 5 000
Total Assets	$ 20 900	Total Equity and Liabilities	$ 20 900

(Table 3)

Both the CDs and the bonds are to be repaid *at a future date*; they are *time-deposits.* Neither the bond-holders or the certificate owners can reclaim their money before the agreed upon time-period has expired. The bank must in the meantime pay interest on its liabilities and its profit will come from lending out the acquired assets at a higher interest-rate.

There are a few important things to notice: Firstly, the total money-supply in the economy has not increased. The transactions transfer saved funds from lenders to borrowers, they do not result in the creation of new money. Loan-banking therefore provides a socially useful and fully non-inflationary service.[48] Secondly, in order for the transactions to happen, all parties must at some point *forego alternative spending.* Thirdly, there can be no 'run on the bank' - the bank's creditors know that they can only collect their money when the bonds and certificates expire, and it is the bank's responsibility to ensure that it has cash ready when that day arrives. Naturally, if the

[48] The fact that the CDs and bonds can subsequently be traded, does not change this fact. If A lends $10 to B, and A subsequently sells the $10 IOU to C, then A simply transfers a credit-claim to C, to whom B will eventually pay back the borrowed $10. These are simple credit-transactions, and transferring credit-claims do not increase the total money-supply.

bank makes too many unsound loans, it will eventually fail, but this will be a bankruptcy like any other: Unwise management and poor business-decisions will have caused harm to owners and creditors alike.

2.4.2 Deposit-banking

Where loan-banking, at a certain risk, ventures to channel surplus savings into productive loans, deposit-banks started out as money-warehouses, serving precious-metals holders that needed to conveniently store their savings at low risk.[49] The depositor left money *on deposit* in the trust of the bank, and for this service the banker charged a storage-fee. The depositor on their part received a ticket (warehouse-receipt, bank-note, gold-certificate), entitling them to immediately redeem their property on demand - the bank held the money as a *demand-deposit.* Because the bank simply provides a warehousing-service, the deposited money does not show up in the banks balance-sheet. The deposit-banks functioned like safe-deposit boxes do today. In essence, the transaction is a *bailment*, it is not a loan. As Murray Rothbard puts it: 'The hallmark of a loan, then, is that the money is due at some future date and that the debtor pays the creditor interest. But, the deposit, or *claim transaction*, is precisely the opposite. The money must be paid by the bank *at any time* the depositor presents the ticket, and not at some precise date in the future.'[50]

In England, deposit-banks arose in the mid-seventeenth century where merchants had acquired the habit of storing their gold in the king's mint in the Tower of London. However and somewhat unfortunate for the merchants, Charles I decided in 1638, shortly before the Civil War, to confiscate £200 000 worth of gold, calling it a 'loan'.[51] The merchants then turned to the city's goldsmiths, who were also accustomed to storing valuable items. The English goldsmiths welcomed the new business, and quickly

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[49] The deposit-bank could of course be robbed, or the banker could embezzle the money, but these are criminal activities - the service of the deposit-bank is to offer a safe storage facility for money.

[50] *The Mystery of Banking* (2008)*:* 87

[51] Ibid. 88

discovered that the specific nature of money-storage, gives rise to certain temptations: As people tended not to collect their gold, instead preferring to use the gold-receipts as money, the early bankers noticed that they could simply write out pseudo-receipts for 'deposited gold' and lend *these* out as money. What the banker needed to figure out was just how many depositors could be expected to collect their gold at any given time. By having the right fraction of stock available, they could profit enormously from lending out the remaining gold. What the banker had discovered came to be known and embraced as *fractional-reserve banking.*

2.4.3 Some lego-ethical considerations

The early banker's peculiar opportunity for profit arose not only because customers chose not to collect their gold, but also because gold, like many other commodities, is *fungible*. One ounce of gold is identical to any other, and most customers would not mind if they received another gold coin than the one that they themselves had deposited. In other businesses, it is naturally illegal to profit on the property of others without their explicit consent. This form of fraud is known as *embezzlement*, often defined as "to appropriate (as property entrusted to one's care) fraudulently to one's own use".[52] Strangely enough, banking-laws moved in the opposite direction of overall warehouse-laws.[53] Whereas the grain-warehouse under no circumstances could sell or lend out its depositors wheat (although it was fungible and often remained uncollected), the banker was allowed to lend out the depositors' money, while *simultaneously* promising to return the money *on demand.*

The banker might justify this by using the popular 'bridge-builder analogy' - an engineer building a bridge for a nearby city, does not calculate it to bear the weight of all citizens simultaneously. In the same way, the banker does not expect *all* depositors to collect their money at once. The flaw of the argument lies in the fact that the engineer has at no point promised all the citizens that they *can* cross the bridge at once. The

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52 (*Merriam-Webster Online 2010)* (URL)

53 *The Mystery of Banking* (2008): 90-94

banker however, promises to at all times return the depositors' money, if they so demand.[54]

In England this matter was first tested in courts in the 19th century, when in 1811 in *Carr v. Carr* the court decided that money that had been deposited, but not earmarked in a sealed bag, had become a *loan* rather than a *bailment*.[55] The landmark case came in 1848, when the House of Lords in *Foley v. Hill* decided that the bank's customer is its *creditor*, towards whom the bank has a 'superadded obligation arising out of the custom [...] of the bankers to honor the customer's cheques'.[56] Lord Cottenham fatally presented the following decision:

> Money, when paid into a bank, ceases altogether to be the money of the principal; it is then the money of the banker, who is bound to an equivalent by paying a similar sum to that deposited with him when he is asked for it. [...] The money placed in the custody of a banker is, to all intents and purposes, the money of the banker, to do with as he pleases; he is guilty of no breach of trust in employing it; he is not answerable to the principal if he puts it into jeopardy, if he engages in hazardous speculation; he is not bound to keep it or deal with it as the property of the principal; but he is, of course, answerable to the amount, because he has contracted.[57]

The deposit-banks that had developed, were thus given carte blanche, and the seemingly fraudulent activity of private inflation was fully legalized. Deposited money was now implicitly *loaned* to the bank, and the customer-bailee became a bank-creditor. The deposited money became an owned asset of the bank, to do with as it pleased*,* although curiously, *still* redeemable on demand. In physical reality however, this is not possible,

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[54] Interestingly, since 1st of April 2010, Citibank emphasizes that "[w]e reserve the right to require seven (7) days advance notice before permitting a withdrawal from all checking, savings and money market accounts. We currently do not exercise this right and have not exercised it in the past." *Citibank Client Manual* (URL) page 22. See also *Citigroup Warns Customers It May Refuse To Allow Withdrawals*, (Business Insider 19.02.10) (URL).

[55] Carr v. Carr (1811), 1 Mer. 541 as presented in *The Mystery of Banking* (2008): 91-92

[56] Ibid. 92

[57] Foley v. Hill and Others (1848) 2. H.L.C as presented in *The Mystery of Banking* (2008): 92

and accordingly there has been considerable legal confusion surrounding the matter:[58] Deposited money is *either* an investment *or* a bailment. The nature of an investment, entails *giving up a present good* in order to receive a *future* good at a profit. This is the nature of loan-banking, where the customer is making a time-deposit by buying a debenture, and thereby forfeiting access to the funds for an agreed upon time-period. The fractional-reserve bank customer is however not giving up anything. The money is available *and* invested to receive interest at the same time. A deposit-banker can of course not promise every depositor an interest-profit, and also keep every deposit available to be returned in cash on demand. Only by producing bank-money (credit), which all customers, although not simultaneously, can exchange into real money, can this be done. In mainstream economics, this is of course the best of all possible worlds - to the Austrian theorist it is a fraudulent disaster.

The relevant question to ask is whether most customers consider themselves to have made an investment, or if they consider themselves to have deposited their savings for safekeeping. The benefit of the doubt has obviously been granted in favor of the banker, but if the latter is the case, then the banker is passing off an object (*credit*) for something which it in fact is not (*money*). In effect, he is operating as a counterfeiter. Arguably, the vast majority of customers believe themselves to 'have money in the bank' - crucially and by law, this is the case for none of them.

[58] This debate is not within the scope of this essay - the Austrian viewpoint is however briefly defended: Logically, a demand-deposit of money can not be an investment - bailee, not creditor, is therefore correct status of a demand-depositor. For a more elaborative account and legal references to relevant jurisprudence, see *The Mystery of Banking* (2008): 90-94

2.4.4 Fractional-reserve banking

Give me control of a nation's money and I care not who makes her laws.[59]
Mayer Amschel Rothschild (International Banker, 1744 - 1812)

As modern-day banking is built squarely on the *Foley*-concept, and as the activities of fractional-reserve banks are of course legal, an understanding of this peculiar banking-privilege provides useful insight.

Firstly, as banks only keep a fraction of their deposits as available money, but simultaneously promise to return deposited money on demand, it should be clear that the bank at no times can live up to its promise. It holds only enough cash to make good on a fraction of its promises, and as puzzling as it seems, modern banks are *at all times inherently bankrupt.* This is only revealed however in situations like bank-runs, where customers show up *en masse* to empty their accounts. Secondly, and regardless of the perceived beneficial nature of the situation, as fractional-reserve banks are allowed to issue unbacked credit-money, and as credit-money from a consumer point of view are indistinguishable from real money, we have a situation in which relatively small groups of private individuals, called bankers, operate like legalized counterfeiters engaged in increasing the broader money-supply. Rothbard neatly sums up the peculiar nature of fractional banking: "No other business can be plunged into bankruptcy overnight simply because its customers decide to repossess their own property. No other business creates fictitious new money, which will evaporate when truly gauged."[60]

Unlike traditional loan-bankers, who transfer part of the existing money-supply from savers to borrowers, modern bank-loans are injected into the economy as credit-money. If the Aristotle Loan-Banking Corporation decide to operate as a fractional-reserve bank, with a starting-capital of $10 000 in cash, its initial balance-sheet may look like this (Table 4):

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[59] Attributed in various forms to the founder of the Rothschild banking-dynasty. Mayer Rothschild is by many considered to be the founding-father of international finance, *Rothschild* (Wikipedia 2010)(URL).

[60] *What Has Government Done To Our Money (2005): 57*

Assets		Equity and Liabilities	
Cash	$ 10 000	*Equity* Aristotle (Shareholder)	 $ 5 000
		Liabilities *Customer Accounts:* Initial Depositor's Account	 $ 5 000
Total Assets	$ 10 000	Total Equity and Liabilities	$ 10 000

(Table 4)

It is assumed that the bank has financed itself with its own money and that an equal amount has been deposited from a trusting customer. Furthermore, it is assumed that they are the only bank operating in the economy. (The latter assumption vastly simplifies the illustration of banks creating money, while leaving the argument conveyed intact. The fact that more banks operate, will only slow down the process of each bank reaching its preferred reserve-ratio, normally the Basel II ratio of approximately 10%. With only one bank in the economy, this process is instantaneous.[61])

The bankers can now start lending out money, and as they are now operate on fractional-reserves, they can lend out far more money than they have available. The bank operates in accordance with the international regulative-framework, and being somewhat conservative it decides to at all times keep a minimum capital-reserve of 10%. In accordance with relevant regulations, they decide to lend out $90 000. The bank's trusted customer Marx is again granted a loan of $10 000, and they also decides to lend out an additional $80 000 that will finance an amazing think-tank recently established by a certain Hume. The balance-sheet then looks like this (Table 5):

[61] For elaboration see *The Mystery of Banking* (2008): 111-139, 161-170. For elaboration on Basel II, see *Basel II: Revised International Capital Framework*, Bank for International Settlements (URL).

Assets		Equity and Liabilities	
Cash IOU from Marx IOU from Hume	$ 10 000 $ 10 000 $ 80 000	*Equity* Aristotle (Shareholder)	 $ 5 000
		Liabilities *Customer Accounts:* *Initial Depositor's Account* *Marx's Account* *Hume's Account*	 $ 5 000 $ 10 000 $ 80 000
Total Assets	$ 100 000	Total Equity and Liabilities	$ 100 000

(Table 5) The full amount of borrowed money ($90 000) comes into existence through mere accounting, credited to each borrower's newly opened account. Simultaneously, the bank adds the corresponding IOUs as part of its assets. The banks meager capital-reserve of $10 000 must now cover a full $95 000 worth of liabilities.

Based on its capital-base of $10 000, the bank created the $90 000 *out of thin air*: They simply opened a customer-account for each borrower, *credited* their accounts with the borrowed amount, and simultaneously, they listed each borrowers *debt* as an IOU-asset. A bank's main asset is of course the debt of its customers - all credit is also debt. In the words of the famous Harvard-economist John Kenneth Galbraith: "The process by which banks create money is so simple that the mind is repelled."[62]

As it makes no difference to the consumers whether they use credit-money or money proper, the effect of bank-credit is an inflationary and redistributive expansion of the money-supply: Both Hume and Marx now have plenty of 'money' (*credit money*) that they can spend on whatever they like. If Hume decides to pay $50 000 to Marx in exchange for a lucid account of the labor-theory of value, he simply goes online and transfers the appropriate amount from his own to Marx's bank-account. Thus, the balance-sheet changes (Table 6):

62 *Galbraith Quotes* (Wikiquote) (URL).

Assets		Equity and Liabilities	
Cash IOU from Marx IOU from Hume	$ 10 000 $ 10 000 $ 80 000	*Equity* Aristotle (Shareholder)	 $ 5 000
		Liabilities *Customer Accounts:* *Initial Depositor's Account* *Marx's Account* *Hume's Account*	 $ 5 000 $ 60 000 $ 30 000
Total Assets	$ 100 000	Total Equity and Liabilities	$ 100 000

(Table 6)

However, as Hume is well-versed in Austrian economic theory, he argues that the labour-theory of value is supremely non-sensical, and that Marx therefore has failed to deliver the promised product. As Marx is unable to meet the objections, he must return the $50 000 - the balance-sheet will then simply look the same as it did before the transaction was made (Table 5).

In this way Marx and Hume happily spend and exchange their recently acquired 'money'; the fact that the bank at all times is utterly unable to hand them their promised amounts *in cash,* is none of their concern. All three customers (the initial cash-depositor included), can withdraw small amounts of actual money, but if they at any point decide to withdraw more than $10 000, the bank will be unable to provide. Luckily for the bank, its customers prefer to use online-transfers, and business is booming as it now earns interest on a full $90 000 worth of money, that if demanded in cash, *does not exist*. If too many customers demand their money, the bank must borrow funds in the money-market, seek government help or attempt to raise cash by liquidating some of its assets. Whatever route it chooses, until the bank sorts out its cash-bind, the customers are left without access to their funds. Eventually, they might or might not get their money back, but for now they must simply wait.

Assets (millions)		Equity and Liabilities (millions)	
Cash / Central Bank Deposits	£ 81 483	*Equity*	
Trading Portfolio Assets	£ 151 344	Shareholders' Equity	£ 58 478
Financial Assets Designated at Fair Value	£ 42 568	Total Equity	£ 58 478
Derivative Financial Instruments	£ 416 815	*Liabilities*	
Loans to Banks	£ 41 135	Deposits from Banks	£ 76 446
Loans to Customers	£ 420 224	Customer Accounts	£ 322 429
Other Assets* (Goodwill, Deferred Tax, Properties, and so forth)	£ 225 360	Trading Portfolio Liabilities	£ 51 252
		Financial Liabilities Designated Fair Value	£ 86 202
		Derivative Financial Instruments	£ 403 416
		Debt Securities in Issue	£ 135 902
		Other Liabilities* (Repurchase Agreements, Collateral on Securities Lent, Tax, and so forth)	£ 244 804
		Total Liabilities	£ 1 320 451
Total Assets	£ 1 378 929	Total Equity and Liabilities	£ 1 378 929

(Table 7) A large portion of both assets and liabilities consist of financial derivatives - notoriously risky assets. Note that a significant part of the derivative are 'designated fair value', and one can only speculate on the actual market-worth of these assets.) * *Consolidated*

Let us briefly consider the 2009 balance-sheet of one of the worlds largest banks, UK based Barclays PLC - for reasons of simplicity some entries are consolidated (Table 7):[63] The first thing we notice is that its regular customers have £m 322 429 '*on account*', whereas readily available cash amounts only to £m 81 483. The money the bank promises to redeem is obviously not available - what has the bank done with it? In order to generate profits the bankers have invested the money: Along with money and financial instruments borrowed from other banks and customers, some is loaned out to other customers (£m 420 224), some is traded on its own accounts (£151 344),]. Notably, a considerable portion (app. 35%) of the bank's assets and liabilities consist of derivatives, an interesting class of instruments that gained considerable notoriety when it in 2008 became clear that they had plunged the global economy into the worst economic times experienced since the Great Depression.

[63] Barclays PLC operated with capital ratios well beneath 10%: At year-end 2008 on a Basel II basis, Core Tier 1 ratio was 5.6% and Tier 1 ratio was 8.6%. In 2009 these ratios changed to about 10%. See *Barclays PLC 2009 Results (URL)*: Pages 15, 18.

2.4.5 Fractional-reserve banking in a non-fiat monetary landscape

Having concluded that irredeemable paper-monies are totally foreign absent government-backing, one must also acknowledge that fractional-reserve banks would be fully unable to survive under a system of 'honest' currencies. Those who understand and tolerate fractional banking today do so *only* because they know that central-banks stand ready to bail the banks out by printing more paper-monies. Only under a fiat-monetary framework with limitless central-bank backing, can banks continuously operate with wafer-thin capital-ratios and mostly high-risk assets on their books - with physical unprintable monies the run on the bank would be instant.

The Austrian conclusion is unequivocal: As paper-monies would not exist in unhampered markets, *neither* would fractional-reserve banks. In the contemporary monetary landscape, fiat-money and central-bank cartelization has thus effectively *removed* the natural checks and balances that would exist under proper free-market conditions. The dire result is firstly limitless monetary expansion, and secondly, that when modern banks *do* collapse, they do so at lightning-speed on a global scale.[64] In the end, the mistakes of the very few, are paid for by the very many.

2.5 Preliminary conclusions

This essay started out with a reminder of trade as a fundamental and benevolent aspect of human interaction. Money as an exchange-medium vastly increased the potential for trade, and through a process of cumulative development precious metals became the preferred monies. While functional monetary-systems originated in the absence of state-intervention, and while the free market is fully capable of supplying an economy with quality monies, sovereign powers quickly discovered the benefits of controlling the issuance of currency. Today, government-enforced fiat-monies and central-bank backed systems of fractional-reserve banks have effectively removed the checks and balances that would exist in the monetary landscape under a system of democratic monies.

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[64] Since the sub-prime crisis became clear in 2008 more than 200 American Banks have gone bankrupt, sending shock-waves world-wide. The Federal Deposit Insurance Corporation (FDIC) have depleted its resources and are now in dire need of funding. See *Bank Failures in Brief* (FDIC 14.05.10) (URL) and *FDIC in Trouble* (Financial Sense 04.08.09) (URL).

The nature of counterfeiting was investigated and we noticed that all forms of inflation of the money-supply implicitly and unevenly re-distributes wealth in the broader economy via Cantillon-effects. Fractional-reserve banking, albeit government-sanctioned, was shown to be analogous to counterfeiting, understood as private inflation through the issuance of pseudo-money. Austrians question this, as it arguably is the proper role of government to prevent fraudulent activities, not endorse them. To Austrian economists, free-market principles implies the democratic free-market production of whatever monies a society freely converges upon, normally precious metals - not an unlimited supply of forced monies. [65]

Democracy is a hailed principle in every corner of civilized society, but in the monetary landscape, the powers that be still prefer to reign alone. The modern-day dime-a-dozen 'free-market proponents' seemingly do not actually want *free markets.* Rather they want their undemocratic privileges expanded or upheld, and as such they are effectively *opposed* to actual free-market conditions. Governments do not wish to abandon *their* ability to create money, and the bankers will of course not explain *their* credit-money creation as unethical and harmful, simply because that would ruin their profits and force them to make honest money like everybody else. As wiser writers than this one have pointed out: One cannot make somebody understand something, if their income and social standing depend upon them not understanding it.[66]

[65] Recall 2.1.2 / 2.1.3 and 2.3.1 / 2.3.3

[66] Attributed to American author Upton Sinclair.

3. Human rights and the ethics of money-production

I am of the opinion that the main and final cause why the prince pretends to the power of altering the coinage is the profit or gain which he can get from it; it would otherwise be vain to make so many and so great changes [...] Besides, the amount of the prince's profit is necessarily that of the community's loss.[67]

Nicholas Oresme (1323 - 1382)

Inflation is the one form of taxation that can be imposed without legislation.[68]

Milton Friedman (Nobel Prize Winning Economist)

It is the simple attraction of a possible *gain* that makes money-production desirable. Counterfeiters, banks and government alike create money in order to increase their own well-being. It might be contended that governments *also* create money under the pretense of benefitting their national constituents, but in this instance one can say that the nation-state creates money to benefit itself. In short, economic agents decide to produce money for one simple reason: They benefit from it. The remainder of the essay explores the effects of Keynesian monetary policies within a framework of economic globalization.

3.1 The central Keynesian fallacy repeated

It is a contemporary desideratum that the modern paper-money regime is optimal in most economic respects. This view stems from two basic considerations: Firstly, there is the widespread idea that changes in the monetary supply can and should be imposed by

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67 *The Ethics of Money Production* (2008): 104

68 *Friedman Quotation* (Wikiquote) (URL).

government in order to improve the state of an economy and accommodate *growth*.[69] Acknowledgment of this idea is a sine qua non for any arguments in favor of Keynesian intervention. Secondly, there is virtually unison agreement in mainstream economics on the benefits of inflationary policies. The reasoning is that rising prices will more easily provide full employment, and that it will also serve as a 'margin of safety' towards a harmful deflationary economic environment.[70] In short, Keynesians turn to the creation of money as they believe they thereby can confer a *net benefit* upon a society. Austrian theorists disagree on this matter, claiming that the Keynesians fail to realize that it is their own attempts at stabilization that over time create the malignant business-cycles that monetary intervention ventures to cure.

3.1.1 The Austrian business-cycle in brief

The mathematical implication of growth in the money-supply at a constant rate of interest and lending is an exponentially growing graph (Figure 5). Furthermore, increases in the monetary-base is in practice inevitably followed by increases in bank-created money (credit), as banks look to maximize their profits. If the growth in money and credit reflects sustainable GDP-growth, this practice is not harmful per se, but problems arise because monetary expansion (and thus debt) tend to grow faster than sustainable economic activity. In the words of Ron Hera: "From a policy standpoint, restraining debt issuance by private, profit-oriented banks to sustainable levels is impossible in practice because sustainable growth in GDP is an unknown when the interest rates and reserve ratios that moderate lending activity are set."[71] The tendency is therefore for credit to outgrow GDP (Figure 6):

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[69] This view is concisely expressed by Richard Sylla: "The modern fiat money regime is optimal in most economic respects. Whatever amount of money needed to accommodate growth can be supplied at minimal costs." *Political Economy of Supplying Money to A Growing Economy* (2010)*: 1*

[70] "Some, even a few central-bankers who are supposedly the guardians of price-level stability, argue that moderate price-level inflation - a gradual decline in the value of money - is better for full employment and economic growth than is price-level stability. [...] In addition, a moderate level of inflation gives an economy a margin of safety in avoiding the possibility of deflation, which is assumed to impose substantial economic costs." *Political Economy of Supplying Money to A Growing Economy* (2010)*: 3*

[71] *Bernanke's Dilemma* (Seeking Alpha 10.03.10) (URL).

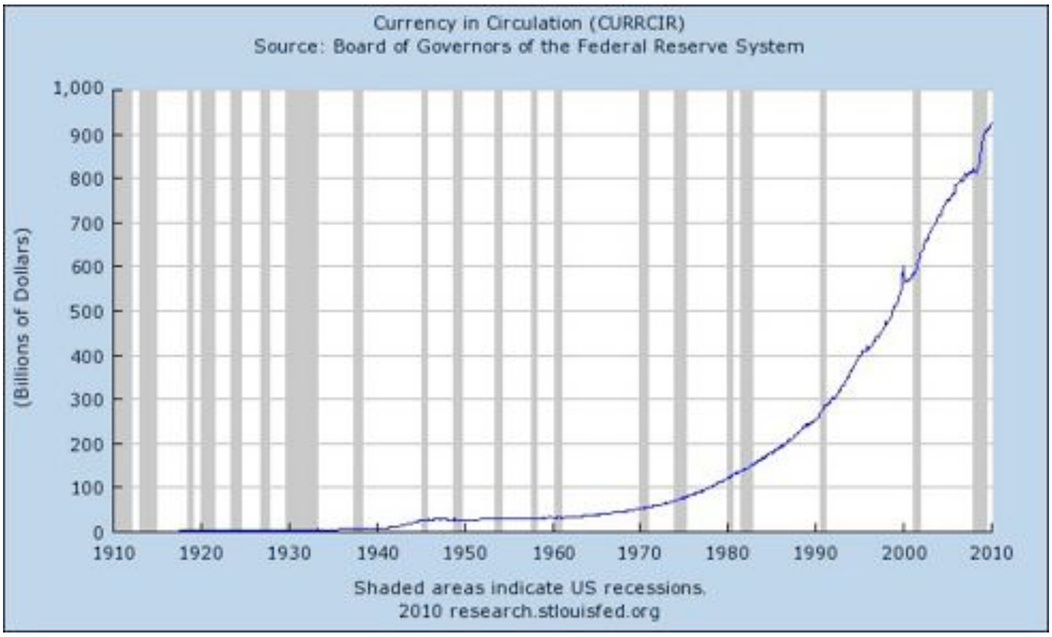


Figure 5: *US currency in Circulation 1910-2010:* Central-banks today usually injects (or withdraws) money electronically by buying (or selling) governments bonds in the bond-market, thereby implementing the government's monetary policy through controlling short-term interest-rates. The important thing to notice for the purpose of this essay, is simply that modern money can be created at will out of thin air, and that the total money-supply tends to rise exponentially. *(Source: Federal Reserve Bank of St. Louis)*

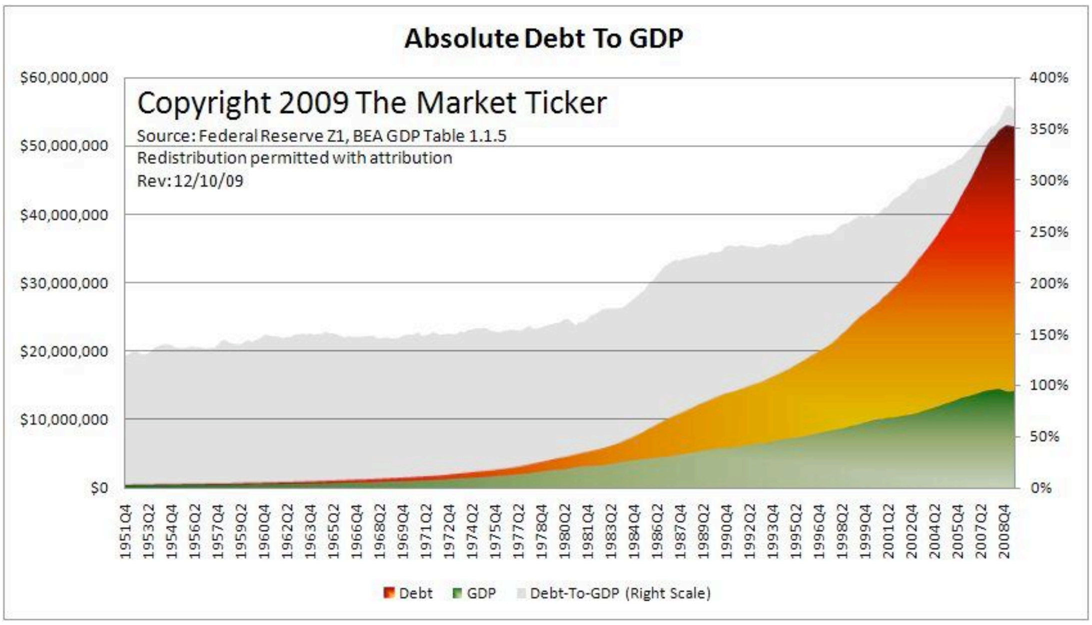


Figure 6: US historical absolute debt to GDP ratio: Debt also rises exponentially. (Lower darker area represents GDP.)

(Source: Carl Denninger/The Market Ticker)

The flip-side of monetary expansion is the loss of the monetary-unit's purchasing-power, that is debasement through inflation. As Ron Hera correctly points out, central-banks implicitly manage the decay in value of their respective currencies when they focus on interest-rates, reserve-ratios and price-inflation targets, but the occasional episodes of deflation and variations in monetary policy do not change the overall pattern of exponential currency-decay.

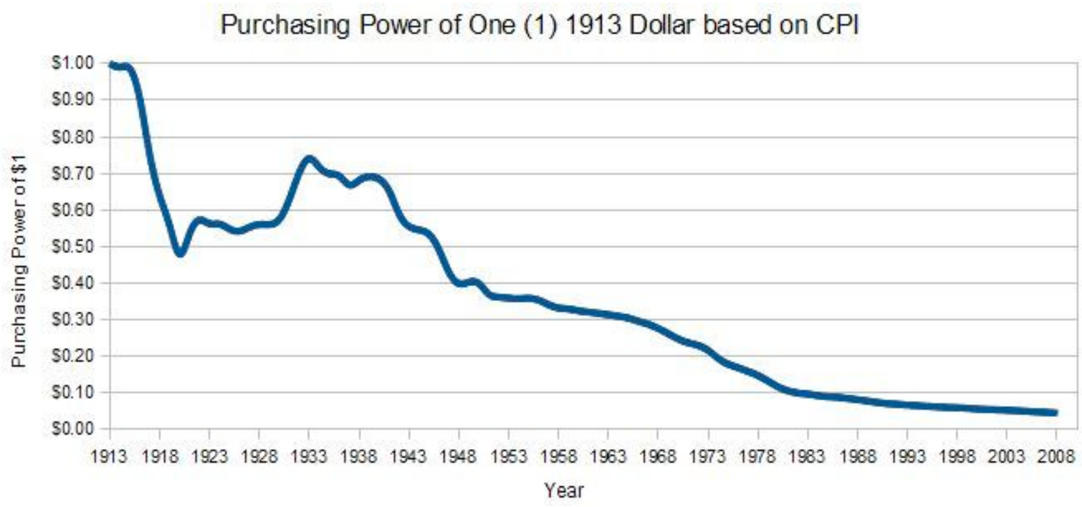


Figure 7: Purchasing-power of the US dollar since the inception of the Federal Reserve in 1913. *(Source: Hera/Seeking Alpha)*

Because it has little immediate impact and can have short-term benefits, the gradual decline in the value of a currency is generally accepted by economic agents, but "when debt increases disproportionately, a deflationary bust is inevitable and if it is postponed by further credit expansion systemic instability results."[72] This is staple Austrianism, and already in 1949 Ludwig von Mises pointed out that there are no means of avoiding the final collapse of a boom brought about via credit-expansion:

> The wavelike movement affecting the economic system, the recurrence of periods of boom which are followed by periods of depression, is the unavoidable outcome of the attempts, repeated again and again, to lower the gross market rate of interest by means of credit expansion. There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of

[72] Ibid.

> a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved.[73]

Policy-makers are in other words merely left capable of postponing the inevitable outcome of their policies, and they tend to do this by turning to excessive money-creation. To Austrian theorists "[t]he combination of fiat currency, where currency is created arbitrarily, and central banking, where money and credit are centrally controlled and where there is an inescapable inflationary bias, suggests that all such regimes have a limited lifespan, but this does not allow a hyper-inflationary outcome to be predicted."[74]

Thus it is for example not obvious *when* the US dollar will be rejected as the world's reserve-currency, but one is justified in predicting this as an inevitable outcome of current US monetary-policy. The alternative is a severe deflationary correction, which the current administration unsurprisingly has proven itself unwilling to let happen. The final outcome of the unprecedented US actions remains to be seen, but from an Austrian perspective the end-result of this reckless expansion is expected to be painful no matter which route is chosen.

3.2 The detrimental effects of the international financial architecture

The Austrian School of Economics has a long tradition for exposing and exploring the fundamental civil liberty aspects of monetary economics - vast sources of relevant literature are available for those interested. However, concrete tools for understanding modern globalization are for the most part only *implicit* in this literature. This can be explained by the fact that Austrian theory gradually became heterodox as the Keynesian Revolution took hold around the advent of World War II, and as a result Austrian theorizing suffered - it was simply no longer in demand. John Maynard Keynes had done something no recognized economist had done before him: He had argued that

[73] *Human Action* (1998): 570

[74] *Bernanke's Dilemma*, Seeking Alpha (URL).

small groups of social-engineers, politicians and central-bankers, *should* indeed create money at will, and thus steadily steer the productive structure by increasing or decreasing its money-supply. One should not overlook the lure this promise had on politicians, who suddenly had a full-fledged economic treatise which argued that they could spend their way into prosperity; and over time, this became staple economics.

Through the application of Austrian principles, the following aspires to identify the main economic tendencies that create poverty and inequality within and between nations. The United States is the preferred example-economy, as it is the privileged producer of the worlds reserve-currency, and also the world's largest debtor-nation in absolute terms. It does not matter for the essence of the arguments presented which economy is chosen, but the undesirable tendencies within the Keynesian paradigm are most easily noticed within debtor-nations whose currencies have traditionally been in high international demand. The important year to notice in the empirical material is 1971, the year in which US President Richard Nixon effectively took the world off the gold-standard, famously stating that 'we are all Keynesians now'.[75]

3.2.1 The mirage of inflation and inequality within nations

Aegrescit medendo.

Greek Proverb[76]

The key to understanding modern money lies in grasping the fact that the vast majority of currency-units in circulation are loaned into existence *at interest* by banks. This practice is sustained by allowing the monetary-base to grow *ad infinitum,* in other words, by adopting inflationary policies (Figure 8-9).

[75] Attributed, see *Nixon Quote* (URL). See also *supra* 2.3.3 esp. note 46.

[76] 'It becomes worse for the remedies employed.'

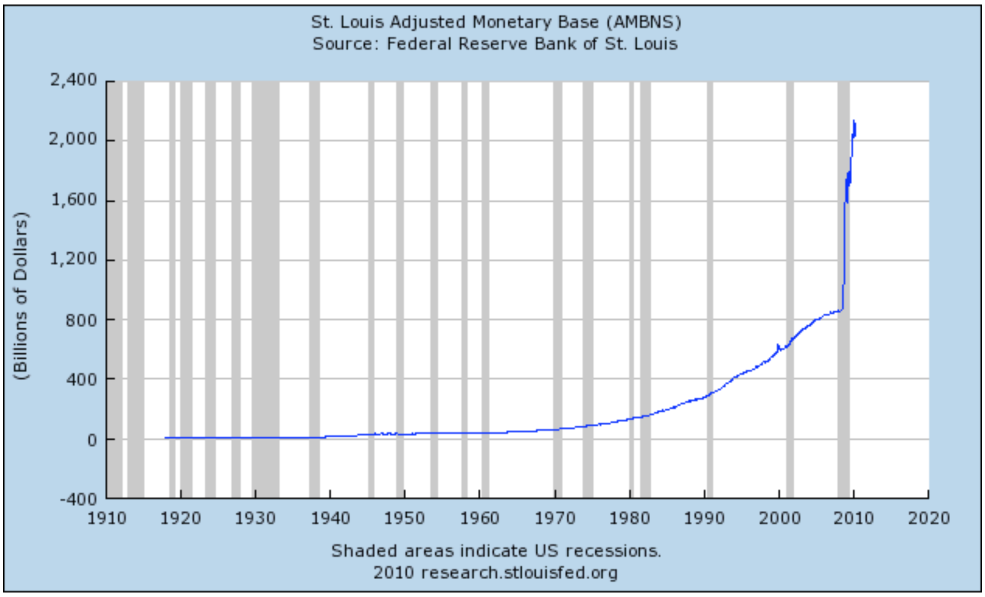


Figure 8: The life-span of fiat-money - exponential rise in base-money gaining speed post 1971, going vertical around 2009 in relation to widespread financial instability. Full-employment monetary-policies and the occasional deflationary shocks ensure constant growth in the money-supply. According to Austrian definitions, excessive inflation is already fact, however it fails to show up in consumer-prices because the stimulus money are currently held as central-bank reserves by financial institutions (Figure 9). *(Source: Federal Reserve Bank of St. Louis 2010)*

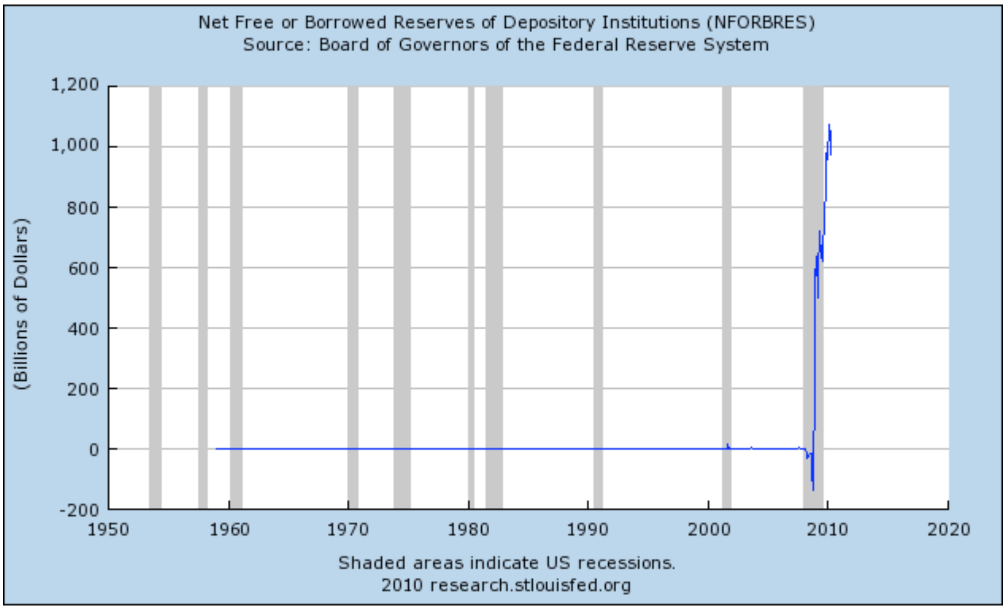
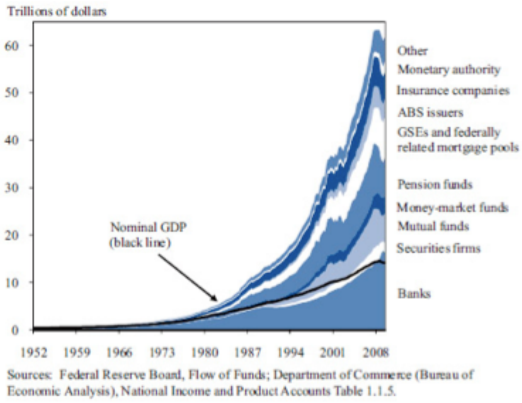


Figure 9: *The Great Quantitative Ease:* The vast increase in money created in the wake of the 2008 crisis is currently kept by banks as central-bank deposits. Draining this excess liquidity will prove excessively hard without causing a deflationary credit-debacle and chances are thus that quantitative easing is a one-way road, and that excessive price-inflation will eventually ensue. *(Source: Federal Reserve Bank of St. Louis 2010)*

In general, as the nations monetary-base expands, the debt-potential also increases; for reasons of self-interest commercial-banks use their 'fractional potential' to the fullest. Considering how the vast majority of the effective money-supply is bank-created credit (*debt)* the production of money implicitly consist of issuing-agents (banks) acquiring an asset and debtor-agents (borrowers) acquiring a debt. The moral hazard entailed in expected bailouts enforces the tendencies for reckless lending, and as the monetary expansion progresses, one would expect the banking-sector to grow larger and consumers to grow more indebted (Figures 10-13).

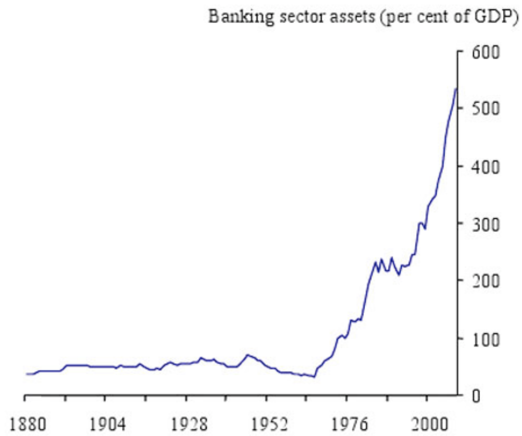
Figure 10: US Financial Sector Compared to GDP

1952-2008



Nominal GDP as black line in chart. *(Source: US Federal Reserve Board/Economic Report of the President February 2010)*

Figure 11: UK Financial Sector Compared to GDP



UK Chart included for clarity and general emphasis. Notice vast post-1971 expansion (Source: *Bank of England/Guardian UK 2010*)

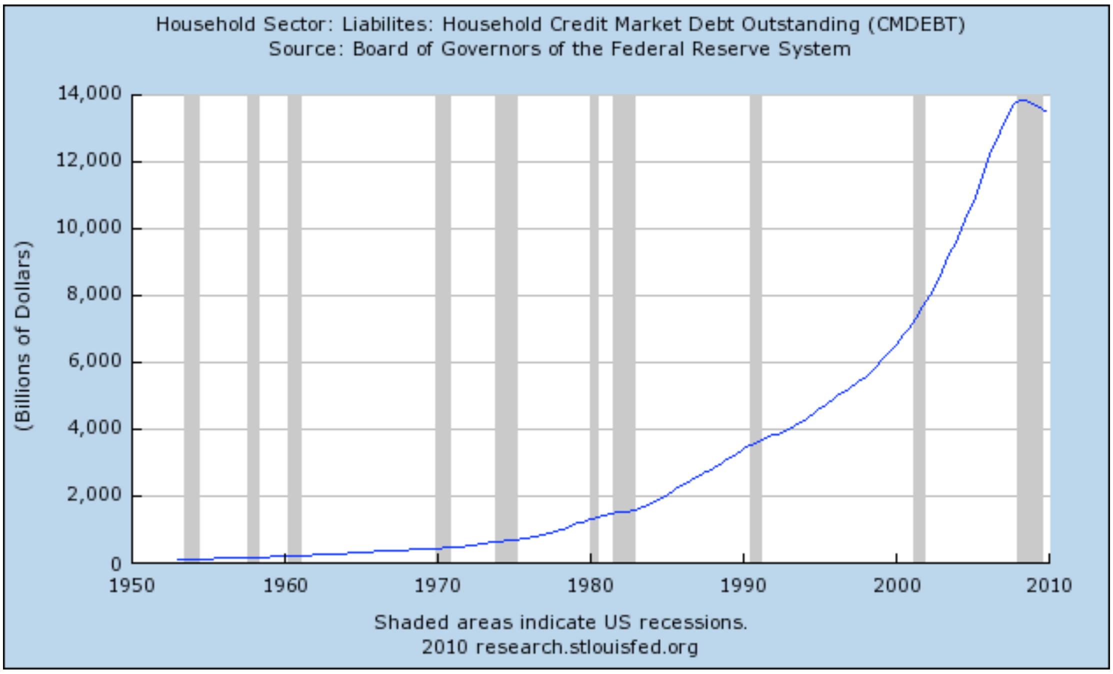


Figure 12: US consumers pile up debt in nominal terms... *(Source: Federal Reserve Bank of St. Louis 2010)*

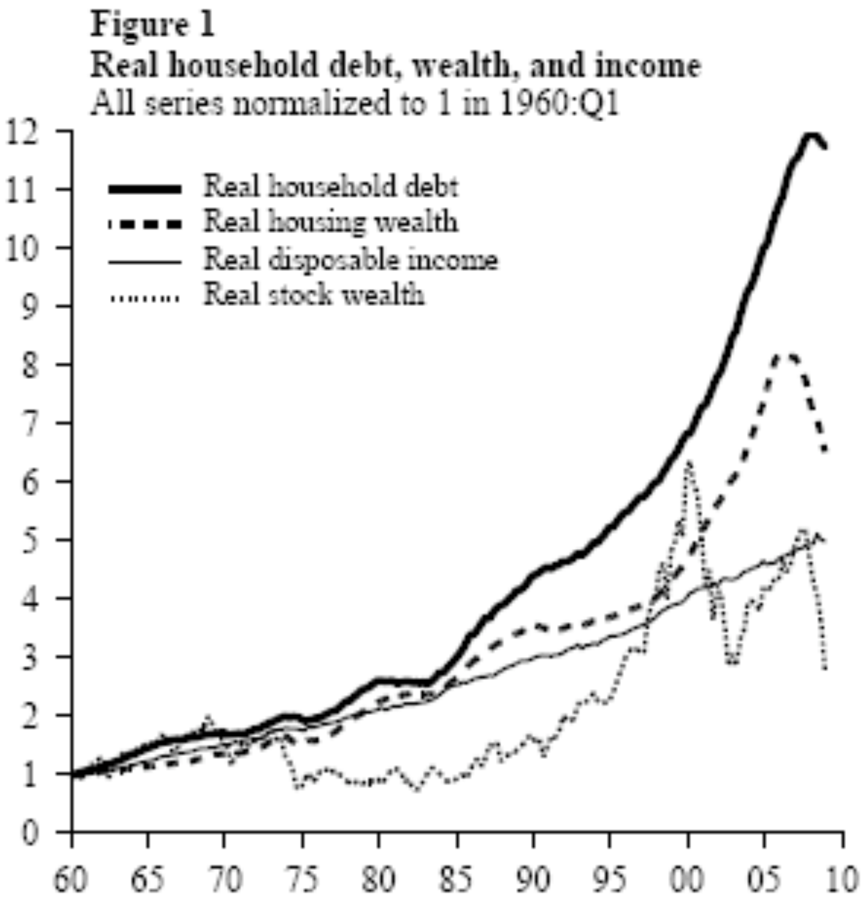


Figure 13: ... and real debt also rises far above real disposable income - collapse ensues. Notably, asset-wealth in the form of housing and stocks will be eroded while household-debt will remain intact. (Source: Federal Reserve Bank of San Francisco 2010)

As the money-supply grows, fractional-reserve banks create more credit, and the general populace (and often the government) tend to become increasingly indebted. Debt will be acquired in order to buy increasingly expensive assets (esp. housing) or simply because it is easily available (credit-card consumption). Not unlike a classic Ponzi-scheme, an increasing amount of money is required to pay the interest on the already created debt - thus, the monetary-base must keep on growing in order for the debt-based monetary system to remain solvent. The overall result is that the economy through inflationary policies progresses towards a significant and malignant deflationary collapse (or worse, towards hyper-inflation).

Throughout the business-cycle, when the laws of economic gravity become too annoying, more money is created. From a public-choice perspective one can understand why politicians find it easy to relax monetary policy, but nearly impossible to tighten it. Debt-deflation is politically undesirable, and moreover, governments have no mechanism for taxing *gains* in the value of the currency. Inflation, on the other hand, imposes a hidden tax on society.[77] If the government has also 'helped the economy' through fiscal-means, matters tend to get worse, as both public and private sector may become heavily indebted (Figure 14). As Henry Hazlitt pointed out, a culture of deficit-spending is notoriously difficult to change, simply because "[d]eficit spending, once embarked upon, creates powerful vested interests which demand its continuance under all conditions."[78]

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[77] Recall 2.2.3

[78] Hazlitt, Henry. *Economics in One Lesson* (1979): 175

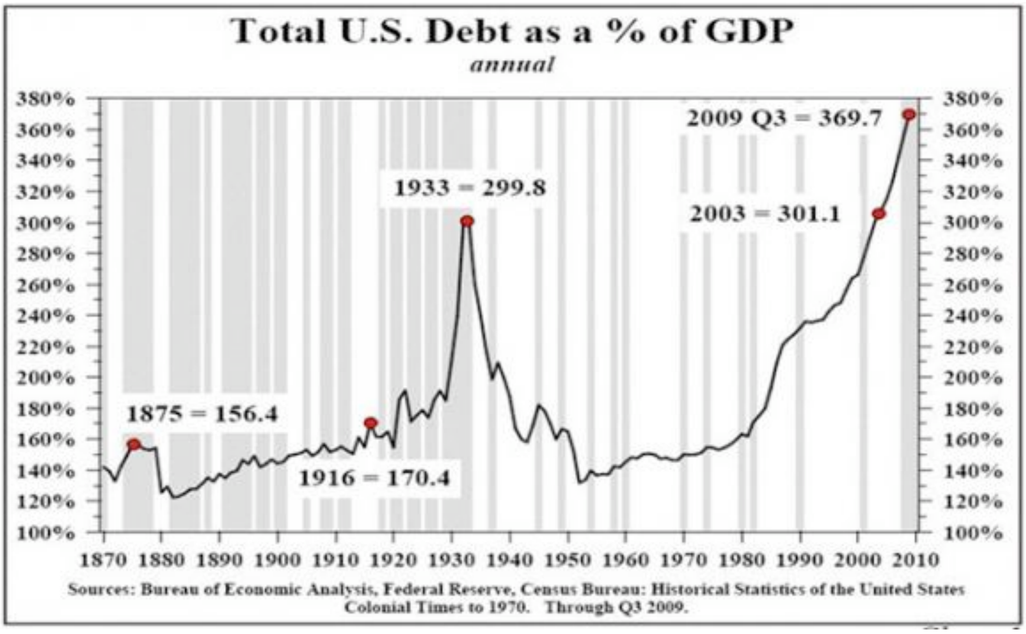

Figure 14: Policy-makers fail to reign in the debt expansion, and debt will tend to grow more than GDP. According to Austrians both the 2008 collapse and the Great Depression were the natural and unavoidable results of excessive credit creation.
(Source: Mauldin/Credit Writedown 2010)

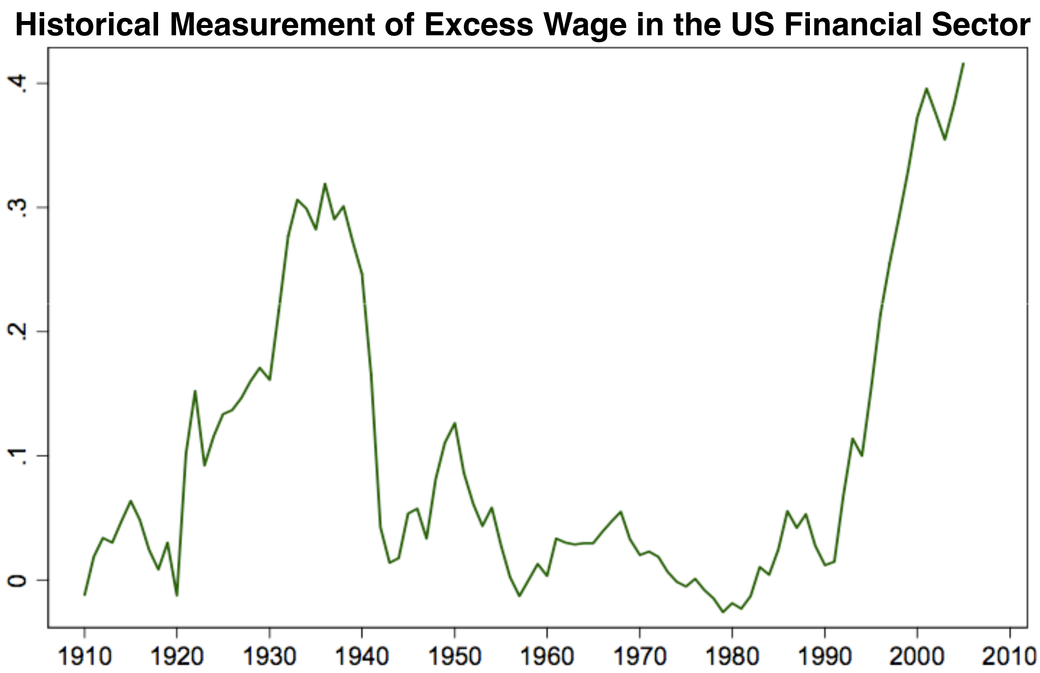

Figure 15: The above chart reflects excess wage in the financial sector, and as expected it matches the above debt to GDP chart: The classic beneficiaries of easy money are the banks - like all producers of money the bankers seek to gain.(Source: Philippon. Thomas et al. *Wages and Human Capital in the U.S. Financial Industry: 1909-2006* (URL Stern University 2008).

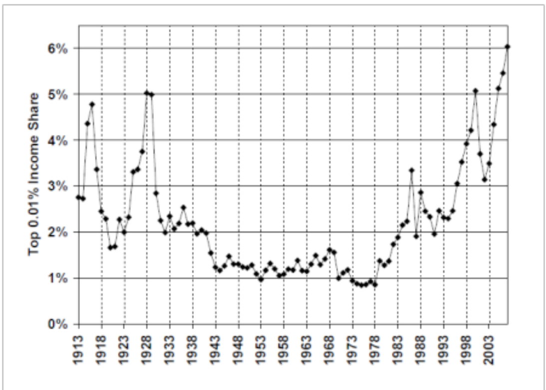

Fig. 16: Top 0.01% Income Share 1913 -2008

(Source: Saez/NY Times 2009)

Figure 17: Top 1% Income share (lighter column) is at its highest since the 'roaring twenties'.

US Numbers: Expansive monetary inflation increases overall inequality within national economies, as it benefits business-profits in general, not just banking-bonuses. Recall OECD statement, *supra* note 2.

The dynamic of economic convergence[79] is supposed to level out per capita income within countries, but seemingly it does not. In sum and as explained *supra*[80], Cantillon-effects ensure that the benefits of the inflationary environment are unevenly distributed. In particular, the inflationary boom will vastly increase *business-profit* in general: Business will be booming and there is plenty of 'growth', but structurally the economy is getting increasingly frail, while real wealth is accumulated among high net-worth individuals.

In sum, Austrians acknowledge that politicians tend to yield to the fact that the proverbial people *always* want bread and circus. The nutshell problem of Keynesian economics is thus found in the fact that people for a while tend to get too much circus and end up with too little bread - matters end up worse than they were to begin with. While the monetary game of musical chairs lasts, both politicians and central-bankers are hailed as outstanding social-engineers; when the music stops the indebted middle class is often wiped out.

[79] *Supra* 1.2

[80] *Supra* 2.2.2 / 2.2.3

3.2.2 Among fiat nations: The monetary cause of global inequalities

The theory of economic convergence states that economies with low per capita income will tend to grow faster than rich economies, and that in the long run, regardless of the nations initial capital-stock, countries will converge towards the same standard of living. Based on the following simple theorem, this section aims to explain why convergence will never arise under current monetary conditions:

> Among fiat nations (F_x), those nations with the most versatile and geo-politically effective apparatus of financial spin (S), shall be able to inflate more efficiently, and thus fraudulently expropriate some amount (R_x) of the globally traded resources (R).

'Financial spin' refers to the practice in which government-officials appear as 'talking heads', aiming to convince us of everything being alright, when the reality of the situation is that disaster has struck. It was prevalent in 2008 when sub-prime exploded, and it was also common throughout the Great Depression.[81] The credibility of national officials will be based partly on the underlying conditions in the economy, but also, and especially in the short-term, on the nations general geo-political standing. The presented theorem can naturally be attempted quantified, but what it states is simply that some nations are better at promoting their currency than others - and that these nations *benefit* from the process.

Because some nations are better at convincing other nations of their economic strength, they can inflate more effectively and with impunity. The prominent examples will be found amongst those nations whose currencies are desired as central-bank reserves throughout the world, with the number one example being the US dollar. A large fraction of the expected price-inflation from the US monetary expansion is simply exported to other nations, whose central-banks are willing to hold the currency. This is a privilege most national-currencies must operate without. (If for instance Sudan ventured to expand *its* monetary-base in order to finance a sub-prime lending feast, the world

[81] *The Great Crash 1929* (2009): 15-16

would shrug its shoulders. Sudanese money are simply not in high international demand, and overly expansive monetary policies on their behalf would have the effect of plummeting the Sudanese currency and raising prices within Sudanese borders.)

The US currently has the worlds largest economy: It is commonly stated to be 70% driven by consumption, the flip side of which is that most of its production has been outsourced to other nations. Moreover, the nation is currently financing two wars, and it is known to have military bases in approximately 135 countries. As the nation has largely dismantled its productive apparatus, and has become a 'service economy', these expensive activities (consumption and militarism) can only be financed through debt - and the US is indeed the worlds largest debtor. Arguably, the nation's ability of unprecedented monetary expansion has to do with the US dollar's status as the worlds reserve-currency. The US is currently granted the privilege of producing money for the entire international community, and it has thus been able to keep the cake and eat it too. The recognition of this privilege is based on deductive reasoning, not empiric studies, and its consequences were graspable right from the start. Roosevelt's Secretary of State Cordell Hull recognized this potential privilege already in 1942, when he concluded that the "leadership towards a new system of international relationships in trade and other economic affairs will devolve very largely upon the United States because of our great economic strength. We should assume this leadership, and the responsibility that goes with it, primarily for reasons of pure national self-interest."[82]

We must recall that inflation entails an implicit redistribution, that works in favor of the money-creator. The debt-driven consumption embarked upon by the West has driven up commodity prices globally (Figure 18), and we must acknowledge that these resources, in a counter-factual world, could have been used to improve living-standards in less privileged areas.

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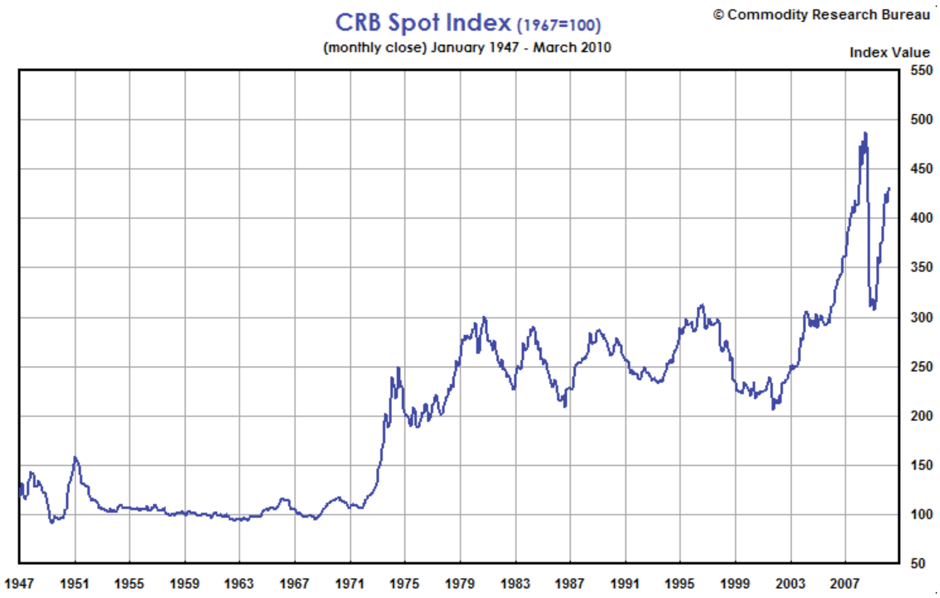
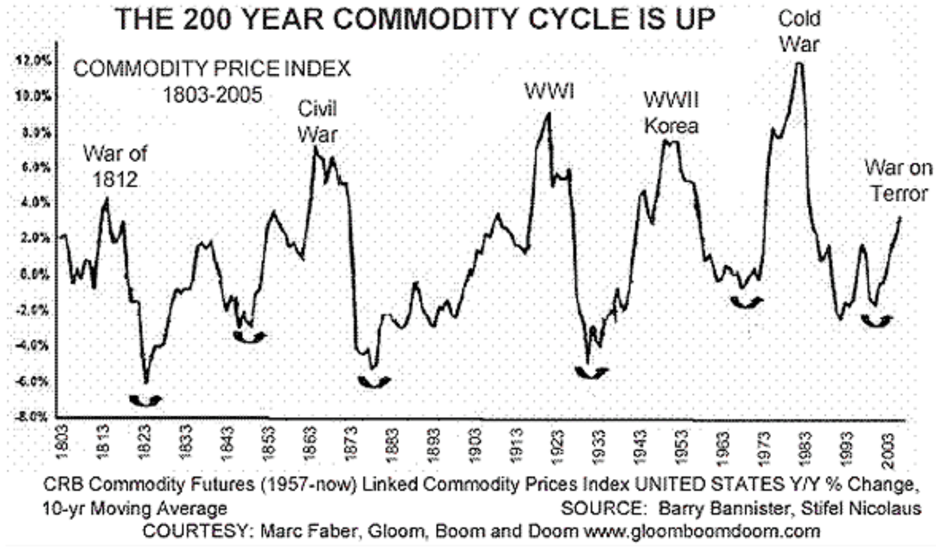
82 *The Mystery of Banking* (2008): 250



(Source: Commodity Research Bureau 2010)

Figure 18: Global commodity price-increases kicking in post 1971, as the world led by the US embarked upon its international fiat-paper experiment. Arguably, while third world countries will have provided vast quantities of the resources consumed over the last decades, their relative share of consumption have remained insignificant.

It is somewhat secondary to the argument made just what nations finance through expansionary monetary policies, be it excessive consumption or war, but one should acknowledge that nations turn to inflation in pursuit of their own interests, that, needless to say, are not always pure. The below chart is included to illustrate the notorious effect excessive money-creation has had on resource prices in the classic inflationary scenarios of warfare (Figure 19).



(Source: Aden/Moneyweek.com 2006)

Figure 19: The worlds reserve-currency currently finances vast military operations through US deficit spending. While a consumer debt-bubble is probably the main culprit, classic war inflation can arguably be considered to form part of the current increases in commodity prices.

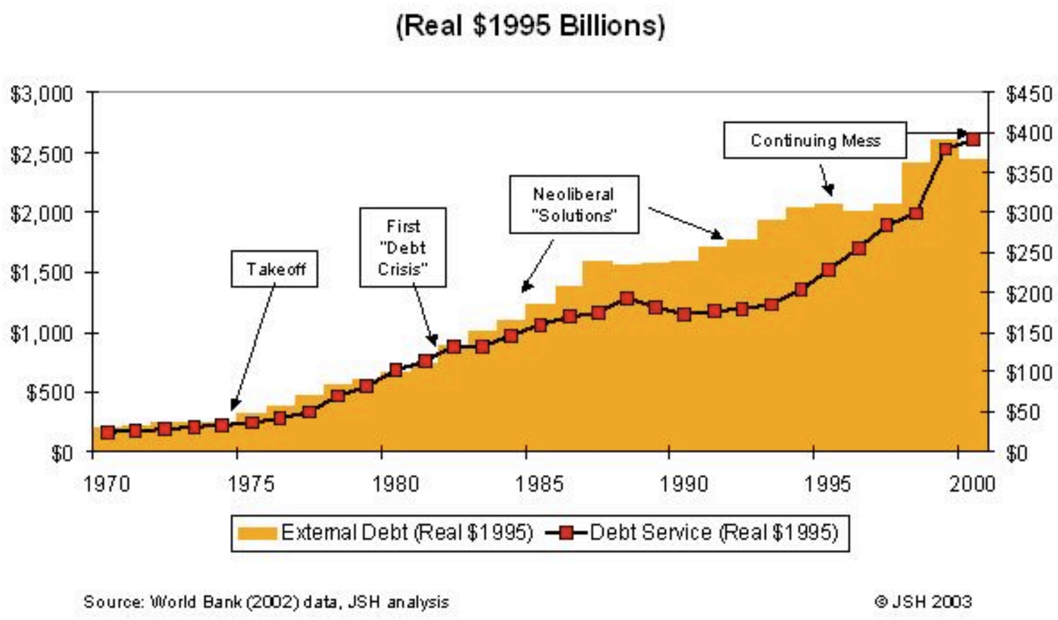
It is here held that an overlooked and important contributor to global poverty is the grand-scale Cantillon-effects that escape the macro-economic models. Through processes of inflation a hidden tax is imposed upon nations with less geo-political thrust. The theory of global convergence is in other words not flawed because of its mathematics, but because it fails to reveal or incorporate crucial aspects of dynamic real-world economic processes: In the long run, with all relevant factors being equal, living standards will indeed converge, but the realization is simply not useful. In the long run very little is equal, and much is effectively immeasurable.[83] Steps towards convergence will be taken every now and then: Industrious nations will increase their wealth, and reckless debt-expansion will eventually reach its natural end; but convergence implies stability, and stability is as shown to the full extent undermined by the Keynesian paradigm.

[83] Recall 1.2.2

3.2.3 The Lukas paradox and Western consumerism

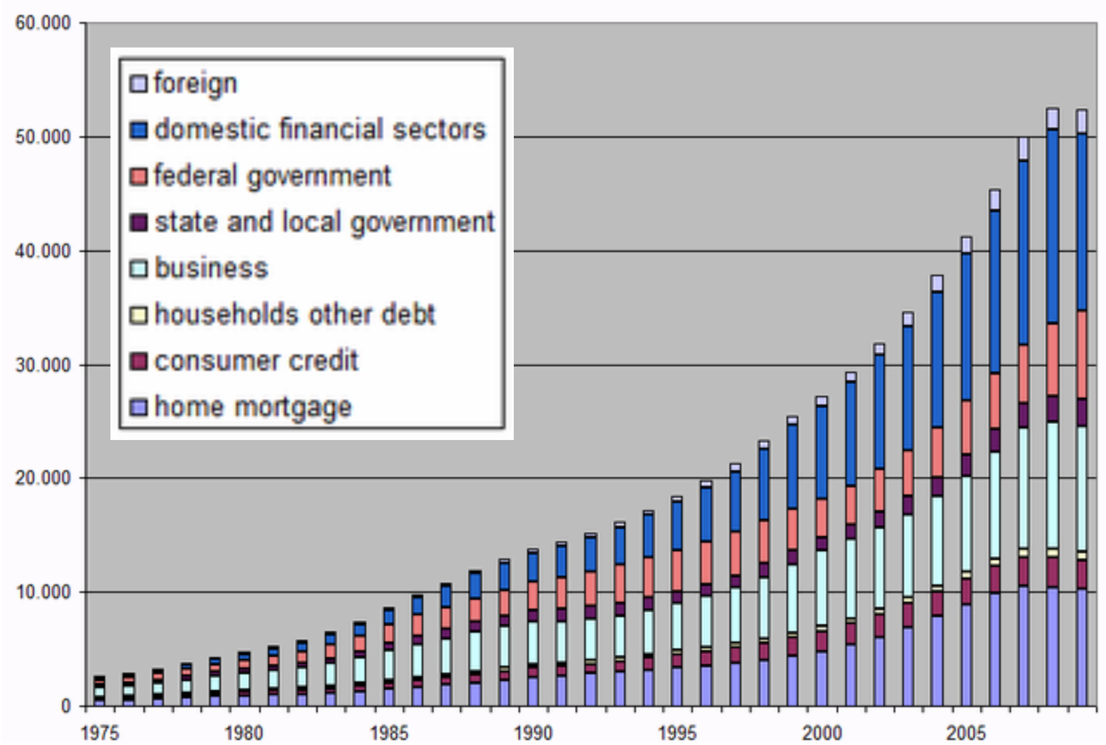
Interestingly, the increase in third-world debt seem to coincide with the world leaving gold and embarking upon an international fiat-system (Figure 20). In other words, the West seemingly had money to spare once it could create it at will. Arguably, had the world remained on a gold-standard, such a policy might have worked, as the marginal-return on invested capital is indeed higher in capital-scarce regions. Convergence failed to arise, however, because the Western world under the monetary stewardship of the US, instead embarked upon its own debt-bubble, financing excessive consumption with debt (Figure 21/22). Semi-metaphorically speaking, one does not promote economic convergence through giving away one dollar, and creating three for oneself.

Figure 20: Third World Foreign Debt and Debt Service 1970-2000

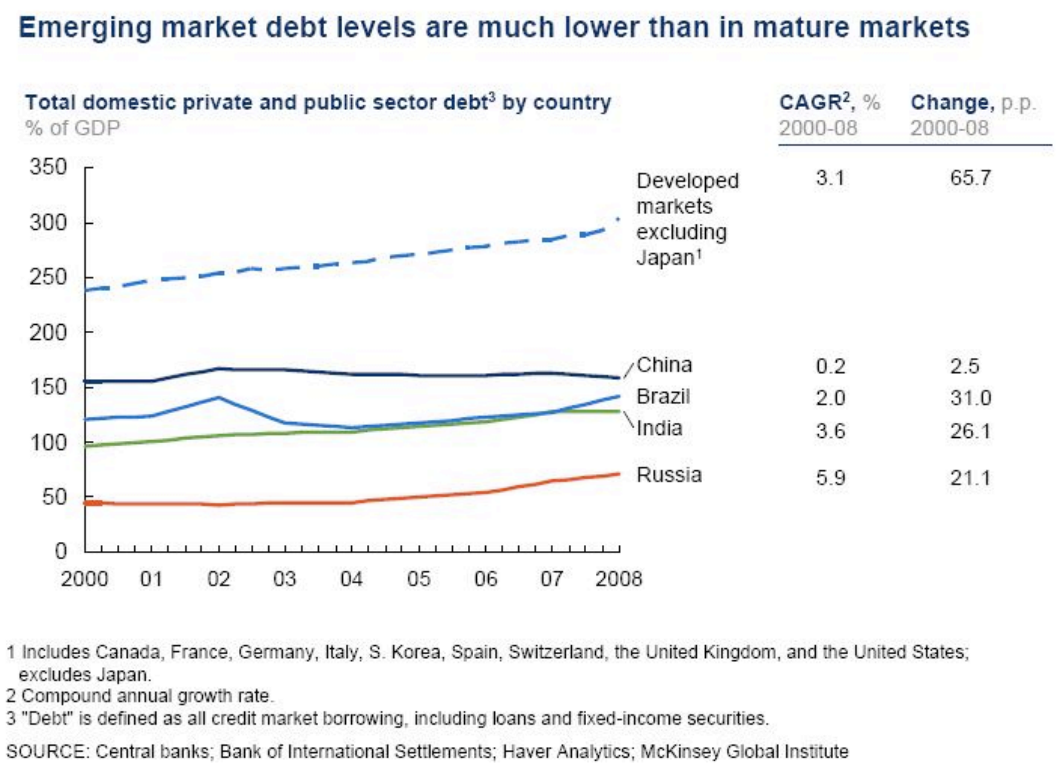


(Source: Henry, James/Submerging Markets 2003)

Figure 21/22: Western Consumption Fueled by Debt



US Debt Outstanding By Sector
(Source: Van Dalen/Wikimedia Commons 2010)



Debt Levels in Emerging vs. Developed Economies
(Source: Denninger/Seeking Alpha 2010)

One must acknowledge that the consumer-culture of the West could not have materialized in the absence of an unchecked and ever-expanding credit-bubble, and secondly, that this bubble could not have materialized in the absence of Keynesian policies enabled by a fiat monetary-system. The road to convergence might thus be found in a counterfactual world: Had the developed world had the economic sense to adjust its standard of living when it ran out of money (instead of turning money into mere paper), global resources would have found alternate uses. The troublesome 'Lucas Paradox' would then arguably not exist: If the marginal return on capital invested is higher in capital-scarce regions, then why do investors refrain from investing in these areas?[84] Arguably, it is because economic size matters. The velocity of money (the monetary exchange-frequency) is low in poor regions - people with no money simply buy less stuff, and investors do not invest in economic growth, they seek *profit.* It therefore frequently makes more sense to gain a small market-share in a big economy, than a big one in a small economy. From the self-interested investor's point of view only certain types of investment make sense in capital-scarce regions, with the number-one candidate being resource extraction. Vast riches are available, and labour-intensive extraction-processes are provided at low cost. It makes little sense however to sell finished goods in these markets. The big bucks is of course generated by bringing these resources to the Western credit-boom.

The credit-boom drives commodity prices up across the board, but Western consumers can handle this as their salaries are also driven up *and* because they have access to credit. Others are not so lucky - as the UN Conference of Trade and Developments points out, rising commodity-prices "had dramatic consequences for many developing countries. The greatest impact was on low-income countries, where poor households spend a large proportion of their income on food, and which are strongly dependent on food imports."[85] According to the UN the "combination of the high food prices and the global economic crisis has caused the number of hungry people in the world to soar by

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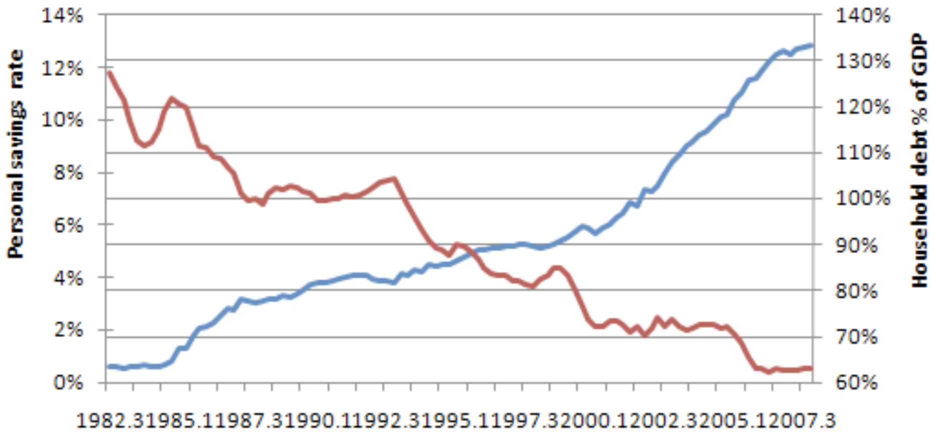
[84] After Robert Lucas.

[85] *UNCTAD Report* (2009): 47

100 million, resulting in more than one billion hungry people this year [...] and between 109 million and 126 million people may have fallen below the poverty line since 2006 due to higher food prices."[86]

One must notice that the ethically unsound aspects of debt-driven consumerism do not derive from the popular culprit known as the free-market capitalist. The trouble lies with policy-makers who believe that debt and money-creation together provide the obvious route towards growth and prosperity, and who refuse to let saturated consumer-economies adjust in accordance with common economic sense. 'Growth' they get indeed, but at what cost?

Figure 23: US Household Debt vs. Personal Savings



(Source: Harrison/Credit Writedowns 2008)

In the Keynesian monetary landscape, the gentle arts of moderate consumption and *saving* are under consistent government-attack. Fiat-inflation incentivizes a culture of instant gratification through debt-accumulation, and makes it economically unattractive to forego consumption (Figure 23). In this unfortunate manner important resources have been allocated to nations that in the end might prove themselves to be fully unable to afford the excessive living-standards that they have demanded. Amazingly, prominent economists and politicians frequently attempt to blame the shameful conditions in Western economies on a 'saving glut in developing economies' that has made money

[86] *Ibid.* 47

too accessible. This view is not only flawed and logically contrived, it is downright preposterous - what wrongs can these nations *possibly* have committed by foregoing their own consumption, and financing and producing goods for Western consumers?[87]

3.3 The contemporary monetary paradigm and 'black letter' IHL

> *By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some. [...] There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.*[88]
>
> John Maynard Keynes

It is beyond the scope of this essay to venture into the complex legal-elaboration that is required if one is to fully investigate the standing of the international monetary arrangements under 'black-letter' international human-rights law (IHL). Rather, this essay is an attempt at exploring those tendencies within our financial-system that needs to be understood and exposed in order for such a debate to take place.

It should suffice to say that under the UN Charter nations have set out to "establish conditions under which justice and respect for the obligations arising from treaties and

87 *Global Saving Glut* (Federal Reserve 2005) (URL). For elaboration on the attack on savings, see *Economics in One Lesson [2009]*: 177-190

88 *Keynes Quotes* (Wikiquote) (URL) The quotation illustrates that Keynes was fully aware of the dangers of inflation, and one must in fact give him credit for recommending his policies as restricted short-term interventions, that should be reigned in once the economy gained momentum. The fact that governments today *consistently* inflates the money-supply would arguably be problematic for Maynard Keynes himself.

other sources of international law can be maintained" and "to employ international machinery for the promotion of the economic and social advancement of all peoples".[89] If our current organization of the global economy is the best possible, then this essay will contribute little, as its arguments will obviously be flawed. But if the preceding arguments are sound, then internationally recognized human-rights law can not be seen as supporting the current monetary-system. Not domestically, because the inflationary policies in an inequitable manner tends to undermine the national economy, and not internationally, because these policies can only be understood as a modern form of empire.

3.3.1 Recognizing stable and equitable economic conditions as a basic human right

> [...] In no case may a people be deprived of its own means of subsistence.
>
> Article 1 (2) in the CCPR/CESCR

Article 1 (2) is most commonly understood as referring to resources, but it is reasonable to argue that a nation's financial structure today constitute a fundamental and indispensable part of a people's means of subsistence. While this might come across as a controversial legal-interpretation, it constitutes a useful starting point for conveying an understanding of how intricately modern life is connected to the financial-markets. Subsistence for individuals in modern society is tightly interconnected with functional markets. At no point in history has modern communities and individuals been more intertwined with and dependent on international financial-markets, and we have long since reached the point at which a melt-down in the credit-markets, or a major currency-collapse, would have unimaginable consequences. It is thus a questionable matter in regards to basic civil liberties that financial stability today can be derailed by one single 'too-big-to-fail' bank. We have if nothing else a major democratic problem when society cannot afford the cost of *not* bailing out its banks.

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[89] Preamble, UN Charter, *Global and European Treaties* (2007)

One has to acknowledge that a replay of the Great Depression would play itself out very differently in societies in which the majority of the population live in *cities,* an environment in which there is little to no room for self-reliance.[90] It is thus by no means clear that Congress was over-shooting when discussing the 'the possibility of a breakdown in law and order and the logistics of feeding US citizens' in the event of a possible widespread collapse in commerce and banking.[91] One should here recall that the modern media of exchange has the potential of reaching zero-value, and that a melt-down in a major currency such as the US dollar would be a global and devastating phenomenon that via electronic markets would take place in a matter of minutes, possibly leaving millions fully unable to provide and ensure for themselves, and thus effectively stripped of a wide variety of recognized rights pertaining to general subsistence and security.

The initial argument might indeed sound novel - if so, we should simply remind ourselves, that "in accordance with the Universal Declaration of Human Rights, the ideal of free human beings enjoying civil and political freedom and freedom from fear and want can only be achieved if conditions are created whereby everyone may enjoy his civil and political rights, as well as his economic, social and cultural rights".[92] Austrians hold that modern-day nations upholds and accepts an inequitable monetary and financial system that carries within it the seeds of its own destruction, thereby *undermining* recognized human rights.

When economies collapse, the basic right to life itself is threatened. Indeed, "[i]n the long run we are all dead"[93], but this can under no circumstances be seen as an excuse for embarking upon inherently inequitable policies that create short-term pleasures at

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90 Recall figure 15: Debt levels today are significantly higher than they were in the 'roaring twenties'.

91 *Supra* 2.1

92 Preamble CCPR.

93 Immortal Keynes citation: "The long run is a misleading guide to current affairs. In the long run we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is past the ocean is flat again." *Keynes Quotes* (Wikiquote) (URL).

the the cost of long-term stability and prosperity. Nations who steadily steer towards economic collapse can not be seen as acting in accordance with basic and generally recognized principles of human-rights law.[94]

3.3.2. Recognizing state-finances as giving rise to extra-territorial obligations under IHL

Arguably, the promotion of sustainable and fair economic conditions is not an obligation each government has towards its own citizens, it is an obligation all nations have *erga omnes.* As Richard Hustad suggests in ongoing research, nations might not only be responsible for poverty within their own borders, they might also be responsible in cases where domestic policy create poverty in *other* countries:

> While it may be settled law that states have numerous obligations domestically, obligations across borders to people in other countries remains disputed. By conceptualizing a global freedom from poverty, it does seem likely that existing legal norms protect all individuals in all countries from actions and policies by any country that may create poverty, even as a side effect to actions with another purpose.[95]

The fact that modern financial-calamities show very little concern for international borders thus raises new problems: Iceland threatened the well-being of both its own and other states' citizens, when it allowed reckless banking-practices to operate unchecked until the national economy was shattered. When the practice of US sub-prime mortgage-lending finally collapsed, it served an economic blow not only to US citizens, but to the entire global financial structure. Clearly, the potentially devastating cross-border impacts of nationally created financial crises, provide ample grounds for considering matters of domestic finance as giving rise to extra-territorial obligations under IHL.

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[94] Especially those found within the CESCRs - in general Article 2, and especially Article 9 and Article 11.

[95] *The Legalities of Poverty: Is Poverty a Violation of International Human Rights Law?* Norwegian Center for Human Rights 09.03.10) (URL)

The more subtle issue of inflation has traditionally been considered to be a sovereign matter, but increasing globalization make it reasonable to suggest that monetary expansion might be a national policy that is highly problematic under IHL. Keynesian monetary-policies focus implicitly on the benefit of *one* nation (or monetary-union), while they in some cases undermine basic human rights in less fortunate countries. Inflation of the money-supply *always* implies an effective and hidden redistribution that works in the favor of those who spend and consume. Thus, there exists an arguable aspect of international resource-expropriation in the monetary expansion of the West, made possible by their unique standing in the geo-political landscape. This is most obvious in the case of the IHL, where a single nation produces currency for the entire global market-place: While no country is legally obliged to hold dollars, it remains the chosen currency for international settlements, and in light of the preceding sections the problems entailed in using national paper-monies as international reserves should be clear.[96] Seemingly, we are left with a kind of capitalism that has largely forgotten its inherent ability to share and effectively utilize global resources. If Western nations have indeed embarked upon policies that effectively and unethically enables them to acquire more than their rightful share of scarce goods, then it is highly doubtful that such policies of ‘currency-empire’ can have any standing under the UN Charter.

3.4 Democratizing the international monetary landscape

Globalization is here to stay. Moreover, it offers endless possibilities in the promotion of global flourishing, but what seems to be lacking is a suitable global-economic infrastructure. The following section explores the potential for Austrian-style improvements to the globalized economy.

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[96] As to the intra-national alternative, the EURO, its problems are presently (May 2010) even clearer: Monetary-unions without political and fiscal union are wholly malfunctional, as uniformly implemented monetary-policies cannot accommodate each nations need.

3.4.1 Disarming the global banking-system

I believe that banking institutions are more dangerous to our liberties than standing armies. If the American people ever allow private banks to control the issue of their currency, first by inflation, then by deflation, the banks and corporations that will grow up around them will deprive the people of all property until their children wake-up homeless on the continent their fathers conquered. The issuing power should be taken from the banks and restored to the people, to whom it properly belongs.

Thomas Jefferson[97]
3rd president of the United States (1801 -1809)

The initial quote might indeed produce an aura of conspiracy, but banking-powers do not have to 'conspire against us' in order to be devastatingly harmful. In fact, a conspiracy would imply some sort of control, and it is precisely the complete lack of control that makes modern banking-institutions so dangerous. Specifically, it is the combinatory fact of them firstly, being allowed to take too much risk with other peoples savings, and secondly, that they err when it comes to understanding and assessing the risks they are in fact taking.[98] Human greed naturally plays part of this process, but it is irrelevant for the sake of our argument. The problem is that the financial structure itself, on its most fundamental level, incorporates and upholds the relevant detrimental tendencies, and that regulatory organs therefore fail to address these issues.

What needs to be understood is just *which* banking-practices are unhealthy, and secondly, what can be done to prevent them. Let us therefore re-examine Barclays' balance-sheet in order to recognize the most important and undesirable banking-practices - what did the banks do with its assets?[99]

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[97] Attributed in various forms, see *Jefferson Banking Quote* (URL).

[98] See *Citi's Management Say They Didn't Recognize CDO Risk*, Bloomberg (URL).

[99] *Supra 2.4.4.* The author wishes to stress that Barclays, like most investment banks and *probably* like Goldman Sachs, is managed by actual human beings.

A) It did not separate between its own and its customers money when it sought profit through issuing or investing in risky assets. Thus, when bankers miscalculate, the bank loses not only its own money, but also the money of its depositors. We notice that a re-introduction of a 'Glass-Steagall' type separation between commercial and investment banking will solve this problem.[100] (In regards to the depositors money, it is not the banks' risky investments in themselves that are dangerous, it is the fact that banks do not distinguish between their own and their customers' money when investing. However, derivatives quickly causes intra-bank contagion: Derivatives (betting-contracts) always have counter-parts - the failure of one bank therefore instantly spreads to other banks, who might in turn lose *their* customers money.)

B) It was allowed to operate with fractional reserves. Indeed, the practice enables it to supply the economy with vast amounts of debt (*credit*), but the long run effects are fundamentally detrimental, and the nature of such banking-privileges are inherently anti-social. A banking-system that as a rule operates with a ten-fold leverage is inherently unstable, and proper analysis reveal that there are no good reasons for endowing upon banks a privilege of practice that is considered fraudulent in every other line of business. Deposit-banks should be required to keep their short-term liabilities fully covered, and a *full-reserve* banking system is thereby advised (with or without a fiat-monies).

3.4.2 Dismantling the international dollar-regime

The world's reserve-currency, the US dollar, is presently the most important medium of exchange - it is managed by the Federal Open Market Committee (FOMC), who according to its own web-site "is the most important monetary policy-making body of the Federal Reserve System. It is responsible for formulation of a policy designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments."[101] As argued, a sustainable pattern of international

[100] For elaboration on 'Glass-Steagall' legislation and its effective repeal in 1999, see *Glass-Steagall Act* (Wikipedia 2010) (URL).

[101] *Structure of the US Fed* (Federal Reserve 2010)(URL)

trade has failed to materialize: Ethically, because rampant dollar-creation has undermined the potential for convergence in living-standards across nations, and financially because US debt-levels have reached the point at which an economic collapse is the most likely result. In the words of Chinese Premier Wen Jinbao: "We have lent a huge amount of money to the U.S. Of course we are concerned about the safety of our assets [...] To be honest, I am definitely a little worried."[102]

Peter Stella with the IMF notices that the Federal Reserve in relation to its crisis-management has been “transformed from a monetary authority with a minimal role in credit intermediation [...] to a size-able and fundamental quasi-investment bank role in financial markets. [...] The degree to which the Federal Reserve has explicitly intervened in the U.S. money and capital markets is historically unprecedented. The dramatic role reversal of the Fed’s balance-sheet from supporting average daily transactions of $25 billion in the fed funds market to the central linchpin and key to global financial market stability has raised concerns about its ability to exit once normality returns[.]”[103] He goes on to notice that “[c]ompared with its posture during the Great Depression, the Fed today is taking considerably more risk and the scope for possible profit and loss outcomes is much greater.”[104]

The Austrian critique is of course not aimed at US central-bankers for acting according to mandate - it is aimed at the fact that the international community has embarked upon a financial-system in which the actions of twelve individuals, who meet behind closed doors, can reasonably be considered to be ‘the central linchpin and key to global financial market stability’ - this is monetary madness. The FOMC should not have this power - no small group of people should. Global financial-market stability is simply too important to be left in the hands of individual actors. When one also recognizes “that each individual [Federal Reserve Bank] is a separate legal entity with distinct private

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102 *China Worried About U.S. Debt* (Washington Post 14.03.09) (URL).

103 *IMF Working Paper 09/120* (2009): 19, 49

104 Ibid. 55

shareholders”[105] this makes even less sense. Suffice it to say that it is rather questionable from a democratic perspective, that private banking-interests occupy the seats in the world’s most important monetary organization. Internationalized economies require international money, and the time is now ripe for a new global currency.

3.4.3 Discerning the cause of the present financial crisis

In a radical 2009 report, the UN Conference on Trade and Development (UNCTAD) argues that the system of currencies and capital-rules are working deficiently, and that it is these matters that are responsible for the financial and economic crises. According to UNCTAD, the present system, in which the dollar acts as the global reserve-currency, is a failure, and it thereby proposes the biggest monetary overhaul since the Second World War - including *a new global currency*.

The UNCTAD correctly notices that “further accumulation of external debt obligations by the United States would make the world economy even more fragile”[106], and that a new global reserve-currency is needed as a store of value. Thus far, the UNCTAD is in full accordance with the Austrian program. However, its presented solutions are diametrically opposed to those recommended by the Austrian School. UNCTAD considers enabling a “reformed IMF to issue an ‘artificial’ reserve currency, such as the ‘bancor’ suggested by Keynes in his Bretton Woods proposals for an International Clearing Union. The new global reserve system could be built on the existing system of SDRs [Special Drawing Rights].”[107] As to the rest of the worlds currencies, the UNCTAD suggests “a global monetary system with stable real exchange rates and symmetric intervention obligations”, justified in brief by them stating that “financial markets do not ‘get the prices right’.”[108] According to UNCTAD “[t]he crisis proves that free financial markets do not lead to optimal social and macroeconomic

105 Ibid. 26

106 UNCTAD Report (2009) : 130

107 Ibid. 123

108 Ibid. 127

outcomes."[109] Thus they hold that a regime of fixed exchange-rates, and a global fiat currency, is the natural solution - needless to say, to an Austrian economist this sounds like the perfect recipe for a global Keynesian disaster.

Firstly, a grand bureaucracy will *never* 'get the prices right' better than a free market will. In simple and direct terms, the utopia of the functioning market-place is *dwarfed* by the utopia of successful central-planning. Politicians must eventually come to terms with the fact of the matter: The major cause of the on-going financial debacles is *not* found in the free market - it is found in the fact that markets are *not* free: One, markets are not free under conditions in which government-elected bureaucrats change the value of money according to their own understanding of what will benefit their national economies. Two, markets are not free under conditions in which inherently fraudulent banking-privileges are allowed to exist and develop until the system inevitably explodes on a global scale. As shown above, both paper-monies and fractional-reserve banking are economic phenomena that are completely foreign to a free-market situation; they exist *only* as different forms of government-sanctioned counterfeiting-operations. From an Austrian point of view it is fully unreasonable to expect markets to function properly under current conditions, simply because the market's inherent potential for sensible economic calculation is so severely undermined when limitless amounts of money are created out of thin air. Again, the long-term effects of the consistently repeated short-term monetary interventions are that the economy's productive structure is distorted. These distortions grow ever larger under Keynesian supervision until they eventually correct themselves through unnecessarily painful processes of re-adjustment.

Secondly, paper-monies[110] form a crucial part of the problem, and there is very little reason to believe that they form part of the solution, even under supra-national surveillance.[111] It is simply not the proper role of government to manipulate the money-

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[109] Ibid. 115

[110] Note that Keynes' envisioned Bancor (like the early SDRs) was commodity-backed, whereas the SDRs today is paper-backed.

[111] Recall *supra* note 96.

supply. It is the role of government to collect taxes *openly*, in order to promote conditions in which free human-beings may enjoy civil and political freedom. Inflation on the other hand is a fraudulent hidden tax that impoverishes the many, while enriching the few, thereby undermining economic freedoms world-wide. Economies are hampered, not helped by monetary intervention and artificially set price-levels: For capitalism to function it is vital that prices are allowed to move both upwards and downwards in order for them to properly inform us of where and how to direct our resources. On the most basic level, money as a tool for economic calculation seizes to function when its supply becomes unlimited. Indeed, truly strange things happen when money comes free of charge: Suddenly it makes sense to throw mortgages after people with no savings and no income. It strangely becomes profitable to catch fish in the US, ship it to China for processing, and then ship the same fish back to the US for consumption - while the US government is *simultaneously* desperate to create jobs. Most mysteriously, when debt-levels become too problematic, the solution is not to curb spending, but to acquire even more debt and *increase* spending in order to 'stimulate aggregate demand'. Keynesianism and fiat inflation make these actions financially sensible, but under no circumstances are these practices *economic* in the true sense of the word.

3.4.4 Deciding upon the money of the future: Precious metals or SDRs

In 1943, in the April 8th issue of the *Paper of British Experts* one could read that credit-expansion performs the "miracle [...] of turning a stone into bread".[112] In 2010 we must ask ourselves whether the author, John Maynard Keynes, was in fact right. As UNCTAD notices, globalized money is needed - the relevant question to ask then is whether we should replace the 'petro-dollar regime' with an international fiat-project , *or* if we shall take the route of a global metallic standard.

We *left* the gold-standard because it presented natural limits to the growth in the money-supply; gold cannot be created in the printing-presses of central-banks. Austrian theory

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[112] Mises, Ludwig von. *Stones Into Bread* in *The Critics of Keynesian Economics* (2009): 306

considers this fact to be a major argument in favor of gold as money, while reigning orthodoxy considers it a deficiency. Richard Sylla eloquently summarizes the latter view when he states that "[a fiat monetary system] allows us to have whatever supply of money we need to grease the wheels of commerce and provide for both economic growth and a stable value of money".[113] From an Austrian viewpoint, that statement neatly summarizes the central Keynesian fallacies. Firstly, we should not venture to 'grease the wheels of commerce', as this promotes the short-term benefit of some groups at the expense of others, and as the long-term effect is that the productive structure becomes distorted and unsustainable. Overall, scarce global resources become inefficiently and unethically managed. Secondly, a 'stable value of money' is not what is important; stable and healthy productive structures are what matters, and these can only exist if prices, being the democratic language of supply and demand, are allowed to freely adjust and tell us how and where to make sound investments.

Austrians hold that the limitless credit-expansion enabled by fiat-systems, do not move us towards prosperous societies, nor towards globalized economic conditions that are equitable. In the words of Ludwig von Mises, "[i]nflation and credit expansion are the means to obfuscate the fact that there prevails a nature-given scarcity of the material things on which the satisfaction of human wants depends. The main concern of capitalist private enterprise is to remove this scarcity as much as possible and to provide a continuosly-improving standard of living for an increasing population."[114] The implication of continuous inflation, however, is that the capitalist system loses its inherent ability of effective resource-allocation. To the benefit of some, and to the detriment of others, rampant monetary expansion encourages a culture of instant gratification, and most importantly, unhealthy malinvestments are allowed to grow and develop until the necessary processes of re-adjustment become horrific.

When Austrians argue in favor of a metallic standard, such as gold, they do not suffer from some mysterious gold-fetish. They simply recognize that gold as a material

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113 *Political Economy of Supplying Money to A Growing Economy* (2010): 26

114 *The Theory of Money and Credit (2009):* 441

performs the necessary monetary services far better than paper. While the gold-standards of the past were far from perfect, one must simply acknowledge that this by and large was a failure of political stewardship, not one stemming from the nature of monetary metals. The failure of government to respect their chosen currency-standard in times of excessive spending, is political, not metallic in nature.[115]

Metallic monies are ‘honest monies’, that can not be tampered with in order to benefit one group or nation at the implicit expense of others. It does not matter whether gold or silver or copper is chosen, but societies should always make money out of something that has intrinsic value. The most obvious route to truly international monies would be to converge on two or three globally recognized commodities, thereby inviting *all* governments and individuals to produce money on equal terms. Two or three currencies in simple units of *weight* will function far better than the present multitude of nationalized money, and the day-to-day practical implications of a modern commodity-system would be unnoticeable: Card-swiping would still be the most obvious way to buy products, but the international monetary-unit will be fully backed up by physical metallic substance, stored in the vault of ones preferred bank. The systemic change of such a system, however, will indeed be Copernican.

Today most economist are critical of metallic currencies as they clearly implies a deflationary environment.[116] This is indeed so, and Austrian theory has done much research in regards to the implications of a deflation-biased system. There is ample reason to believe that a system of ‘mild and benign deflation’ will far outperform the current solution of ‘[so-called] mild and benign inflation’. Most importantly, sound money would encourage a culture of saving, as opposed to incentivizing consumption. Credit-markets would arguably look different than they do today, and it is not within the scope of this essay to explore this, but one assumption shall be made: There would be less indirect investment in the form of leveraged buy-outs and stock-speculation, and

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115 Recall 2.3.3.

116 Recall *supra* note 39. For mainstream-accounts of deflation, see *Political Economy of Supplying Money to a Growing Economy* (2010) or *Coin Reconsidered* (2010).

there would be more direct investment in the form of locally run small-businesses.[117] Needless to say, the environmental impact of such cultural changes will be vast. As to the international markets, a common metallic currency would level the playing field of international trade and incentivize nations to live within their means via balanced trade-accounts. Finally, and in light of the preceding paragraphs, one must acknowledge that the perils of the present globalized and debt-fueled financial-system would by and large be defused.

It would be prudent at this point in history to give more thought to this research. Nothing bad can come from at least investigating the claims of the Austrian theorists; as we presently aim to mend and re-organize international finance, we owe it to ourselves to at least understand their arguments. If the tenets of the Austrian School are flawed they should be discarded, as society has no use for unsound economic reasoning. No major problems arise from the Austrians being wrong - however, major problems will arise if they are right, and thus their arguments should not be dismissed without being properly investigated.

[117] The incentive for a culture of financial speculation under fiat-regimes is a commonly explored theme in Austrian theory.

4. Concluding remarks

The art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups.[118]

Henry Hazlitt

4.1 Economics in one lesson

This essay has ventured to show that modern money-production is the result of a failure to properly apply the art of economics to the globalized market-place. We readily see the benefits of fiat-monies for *some groups,* but we fail to grasp the consequences *for all groups*. The world would have been spared much suffering had it not fallen prey to the temptations of easy money, but sadly, 'the bad economists present their errors to the public better than the good economists present their truths'.[119]

4.1.1 Discarding the contemporary economic paradigm

The world is now faced with the task of deciding upon the money of the future. The transition to the next monetary-regime is likely to prove painful regardless of its eventual form. It is held that a new globalized fiat-system will eventually face the same issues that the international economy faces today, save for the fact that monetary power would then be even more centralized, and the consequences of the expected monetary mismanagement will thereby be even larger. Sound money in the form of precious metals are argued as the most suitable candidate for a modern globalized currency. Not because metal-backed monies are *necessarily* better than paper, but because paper-

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[118] *Economics in One Lesson* (1979): 17

[119] *Economics in One Lesson* (1979)*:* 18

monies are notoriously prone to being tampered with by special-interest groups. Commodity-monies form the only practical solution towards ensuring solid proofing between money and government. Independent central-banking has shown itself incapable of ensuring the necessary separation that *must* exist between money and the legislative branch. The needed currency-shift should be followed by a full-reserve regulative framework for banking, one that in effect will constitute the most effective way of imposing the needed checks and balances on the financial industry.

The Keynesian Revolution has abandoned us in a monetary landscape that is wholly incompatible with the ethics represented by international human-rights law. It has been argued, that the failures of the Keynesian social-engineers stem from their fundamentally flawed opening-position: They believe themselves to be economically insightful to the point where they can confer a net benefit on an economy, through tampering with its money. History and Austrian deductive reasoning combined, tell us that in the long-run they can not, and they should therefore not be trusted with a nation's money. The consequently repeated experiments of stabilization are as shown never beneficial on net. In the short-run, the practice is welcomed and hailed by its beneficiaries, in the process gross inequalities arise, and in the long-run it is left to the next generation to sort out the Keynesian chaos. In brief, monetary intervention is the disease, not the cure.

In a globalized world the nation-state is no longer the correct focus of economic life, and the widespread paradigm of monetary nationalism should therefore be abandoned. It is concluded that we need an international metallic currency that is accommodating towards the benefit of *all groups,* not idiosyncratic bureaucracies that seek gains through a monetary race to the bottom. The time and need has come for truly international economics - it is here simply held that the Austrian School of Economics reveals the most promising path forward, towards an international framework for economic life that is fair and conducive towards the benefit of all.

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