What Has Government Done to Our Money?

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PART 3

10. Going off the Gold Standard

There still is the check on credit expansion in the form of the amount of gold that the CB itself has to have. Citizens could make a CB run or, more likely, foreign governments will want redemption in gold.

One way to solve this problem is inter-CB cooperation. If they all agree to inflate at the same rate, no inter-country redemption problems will take place and they could inflate without end.

Another way to solve it is by just going off the gold standard altogether when confronted with redemption demands. Often this was a temporary measure, but even then it in essence undermines the general gold standard, it makes it a mockery.

Another step was the 'gold bullion standard' which meant that gold could only be redeemed in large quantities (not coins or nothing) which limits gold redemption to handful of specialists in foreign trade.

A final step is to go off the gold standard completely (often under indignant patriotic jingoism) and with government paper becoming the *fiat* standard money.

11. Fiat Money and the Gold Problem

When a country goes off the gold standard and onto the fiat standard it adds to the number of moneys in existence. Besides gold and silver there now is e.g. the dollar and the Pound. The market will determine the exchange rates between these moneys. Since government is inherently inflationary its fiat money will keep depreciating. If it is more inflationary than other government's fiat moneys and these circulate as well then it will depreciate vis-à-vis them.

Such depreciation is highly embarrassing for governments and hurts citizens who import goods. So governments will outlaw payment in gold and silver or even other fiat currencies.

12. Fiat Money and Gresham's Law

With fiat money established and gold outlawed there is only one check left: hyperinflation and the chaos it creates. But within that limit governments can inflate at will, provided that the risk of embarrassment due to depreciation vis-à-vis foreign currencies is nil. To make sure that it is governments have tended to abolish freely-fluctuating exchange rates. Instead they fixed arbitrary exchange rates. Gresham's Law will tell us what the result of this will be. Governments tend to over-value their currency for reasons of prestige and because then their currency will dominate. Currently, foreign governments tend to undervalue the dollar vis-à-vis their own currency which results in the famous 'dollar-shortage' (who'd want dollars if they can't get the full price for them?). Foreign governments may do this so they can:

1. ask for American dollar aid to relieve dollar shortage in the world
2. start to ration imports from America (cuz these will be artificially expensive which results in trade deficit and dollar drain) This usually occurs through license systems for importers and planning of imports and by confiscating (nationalizing) foreign exchange holdings by people, giving them less money than what they would get on free market

The world currently is enmeshed in a chaotic welter of exchange controls, currency blocs, convertibility restrictions, multiple systems of rate and so on. Almost all nations are on a fiat standard though they may not be frank about it, but gold *is* still used between governments so that they can 1) compare different currencies in terms of gold and 2) and as payment (which is necessary because exchange rates are fixed but "realistic" payments still have to be made)

The inflationist's dream is world paper money manipulated by world government and CB. We are not there yet, but are moving towards it. The IMF for example is basically an institution designed to bolster national exchange control in general and foreign undervaluation of the dollar in particular.

The IMF requires each member to fix echange rate and to pool gold and dollars to lend to countries in need of hard currency.

13. Government and Money

The market can handle money, the government cannot and will use it for its own devices. Over the past centuries governments have step-by-step invaded the free market and seized complete control over the monetary system. Each new control begets further controls. The goal is to inflate at a pace decided by the government and bring about socialist direction of the economy. Government control of money has brought chaos and not order, and has fragmented the peaceful, productive world market and shattered it into a thousand pieces, with all sorts of restrictions and obstacles for trade, and so among other things has brought about war.

IV. The Monetary Breakdown of the West

The 20th century history of the world monetary order can be divided into nine phases. We can show how each set of inflationist intervention collapsed under its own inherent problems only to beget more interventions.

1. *Phase I: The Classical Gold Standard, 1815-1914*

The 19th century saw the benefits of one money throughout the civilized world. One money facilitated freedom of trade, investment and travel with the consequent growth of specialization and the international division of labor. The classical gold standard functioned as an automatic market mechanism for checking gov't's inflationary power and kept the balance of payments of each country in equilibrium. Countries would still try to inflate but were forced to contract when other demanded redemption.

2. *Phase II: World War I and After*

The classical gold standard broke down because governments were entrusted with the task of keeping their monetary promises. It was the latter, not the gold standard itself, that failed. Because WWI caused governments to inflate heavily, they could no longer redeem, which hailed in ('cept for the US) a brief era of freely-fluctuating exchange rates.

3. *Phase III: The Gold-Exchange Standard (Britain and the United States) 1926-1931*

Overvaluing one's currency leads to lower exports. GB did exactly that (against gold, without contracting the money supply) out of patriotic concerns. The result was a great depression. But GB tried to pull it off by establishing a new international monetary order that would induce or coerce other governments into inflating or overvaluing (vis-à-vis gold) their own currencies, thereby crippling their own exports and subsidizing imports from GB.

This came in the form of the gold-exchange standard: the US remained on the gold standard. GB and other Western countries returned to a pseudo-gold standard, only redeeming large quantities of gold. GB redeemed not just in gold, but also in dollars, while other countries redeemed their currencies in Pounds (and they were induced by GB to overvalue their currencies vis-à-vis gold). The result was a pyramiding of the US onto gold, of British pounds on dollars and of other currencies on Pounds.

Now GB could inflate more because other countries did not ask GB to redeem in gold, but piled up Pounds and GB induced the US to inflate dollars so as not to lose many dollar reserves or gold to the US.

This couldn't last and in 1931 confidence was lost and 'hard-money' France tried to redeem gold for its pounds led GB to go off the gold standard completely.

4. *Phase IV: Fluctuating Fiat Currencies, 1931-1945*

This brought the world back to the monetary chaos of WWI except that now there was little hope for a restoration of gold. International trade suffered greatly. The US got off the gold standard in 1933-34 supposedly to solve the Great Depression. Citizens could no longer redeem the dollar in gold or even own gold except for jewelry or industrial use etc. Foreign governments and CB's could still redeem their dollars in gold though. This in an important sense is e.g. Milton Friedman's ideal, freely fluctuating currencies with the addition that governments promise not to inflate too much. But no government can be trusted with such awesome power.

5. *Phase V: Bretton Woods and the New Gold Exchange Standard (the United States) 1945-1968*

The Bretton Woods system worked far better than the previous system, but was still inflationary just like the gold-exchange standard of the 1920s had been. The main differences were 1) that now *only* the dollar was the key currency 2) the dollar was no longer redeemable in gold by the US citizen.

Since the dollar was strongly undervalued and most other currencies overvalued (vis-à-vis the dollar and gold) the dollar became scarce, causing the 'dollar-shortage' which American taxpayers had to pay for in the form of foreign aid. With the gold-standard check gone, with other currencies being overvalued, and with quite a bit of gold in the US CB the US government was able to inflate merrily for quite some time, till gradually, because Western European countries became less inflationary, the dollar became *overvalued* which caused other countries not to be too happy at being forced to pile up ever less valuable dollars.

So they started to redeem their dollars causing gold to flow out of the US and showing the irredeemability of the dollar for gold at the agreed upon rate of $35 (agreed in the sense that the US was supposed to keep the dollar at that level on the gold market) an ounce on the free gold market. Moreover, private foreign citizens could sell their dollars for gold (at $35 an ounce) on the free gold market, so dollars were sold more and more, threatening the very currency. So this system too had to go.

6. *Phase VI: The Unraveling of Bretton Woods, 1968-1971*

Because the free gold market threatened the monetary system the US sought to insulate the flow of gold between governments and CB from the free market in gold. Governments and CB would not buy or sell to the other market anymore, and rather than trying to keep the ratio of $35 an ounce the US government simply declared that on the government and CB 'market' an ounce of gold *was* worth $35. So basically a new separate system was set up.

Along with this the US pushed hard to create a new kind of world paper reserve which would supposedly replace gold altogether. But this never really transpired. All pro-paper economists thought that now the ties between the free gold market and money had been severed gold would become less and less valuable on the free gold market. Of course the exact opposite happened.

This new system only lasted a couple of years as US inflation and deficits continued, Eurodollars accumulated and gold continued to flow outward. Confidence in the dollar decreased significantly.

7. *Phase VII: The End of Bretton Woods: Fluctuating Fiat Currencies, August-December 1971*

On August 15, 1971 Nixon cut off all ties of the dollar with gold. The dollar no longer was redeemable in gold by foreign gov't's and CB's. So we once again had freely fluctuating currencies, this time though without any ties to gold (through the dollar). Chaos loomed.

8. *Phase VIII: The Smithsonian Agreement, December 1971-February 1973*

Countries pledged to maintain fixed exchange rates, like before, but now without gold or a world currency to give it any backing. US inflation continued, the supply of Eurodollars increased causing the free market gold price to increase drastically. The overvaluation of the dollar vis-à-vis gold *and* other 'hard-money' currencies became more and more evident. Early 1973 the dollar as a result broke apart on the world market.

9. *Phase IX: Fluctuating Fiat Currencies, March 1973-?*

The dollar had now lost its overvaluation and because exchange rates could now freely fluctuate currencies were priced more realistically. US inflation in general and its bad consequences as described above went on unchecked. But hard-money countries don't like to see their currencies become more and more expensive vis-à-vis inflationary currencies, hurting their exports for the benefit of their American competitors. Also, these gains come at the expense of American consumers whose imports are now more expensive. Moreover, because fiat money is to a significant extent based on politics, not gold, the currency exchange rates can be highly volatile.

The most obvious future plan to solve these problems associated with fluctuating fiat currencies is a worldwide fiat paper standard with its endless possibilities for continued and intense inflation directed by (world)-government. The only *real* solution though is a return to the classical gold standard, getting government out of the money market.