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A new golden age

"The designers of the good ship euro wanted to create the greatest liner of the age. But as everybody now knows, it was fit only for fair-weather sailing, with an anarchic crew and no lifeboat. Its rules of economic seamanship were rudimentary, and were broken anyway. When it struck a reef two years ago, the water flooded one compartment after another.. European officials now recognise the folly of creating the euro without preparing for trouble. It would be wise to be planning now for what to do if it sinks.. Even now, after decades of "European construction", many Eurocrats cannot conceive of the euro as a wreck. Those who have worked hardest to keep it afloat are exhausted and know it is not in their power to save it anyway."

- Charlemagne in 'The Economist', November 26th.

The business of investment for at least the past four years has been akin to conducting a detective inquiry: whodunit ? Just how did we end up in this mess ? To tackle one's enemy, one first needs to identify it. In the popular conception, a myth gleefully adopted by politicians, it is all down to corrupt American investment banks, poisoning the collective well of global capital with subprime mortgage filth – what Professor Robert Vambery in this week's Economist nicely if grimly refers to as adding three quarts of milk to a quart of sewage and creating four quarts of sewage in the process. And then the poison spread. It is a neat little tale but nowhere near sufficient to explain the extent of our current malaise. We can throw some mud in the direction of politicians, but that is a little like shooting the messenger; they have only been dispensing the bread and circuses and pension and welfare benefits on the never-never that everybody has been clamouring for. The culprit we find the most culpable, and which draws all these disparate threads of blame into one cohesive narrative, is a fundamentally corrupt money system.

At this point, Keynesians and other economically retarded or wilfully ignorant financial onlookers typically have their eyes glaze over. But the frequency of repetition of the Austrian perspective does not make it any less true. To have a properly sound economy, one needs sound money. Everyone is for the former, but few can see the essential requirement for the latter.

Jörg Guido Hülsmann in his masterful 'The Ethics of Money Production' lays out the historical facts. Money is useful because it replaces the messy inconvenience of barter.

"In the history of mankind, a great variety of commodities – cattle, shells, nails, tobacco, cotton, copper, silver, gold, and so on – have been used as media of exchange. In the most developed societies, the precious metals have eventually been preferred to all other goods because their physical characteristics (scarcity, durability, divisibility, distinct look and sound, homogeneity through space and time, malleability and beauty) make them particularly suitable to serve in this function.

"When a medium of exchange is ***generally accepted*** in society, it is called "money". How does a commodity such as gold or silver turn into money ? This happens through a gradual process, in the course of which more and more market participants, each for himself, decide to use gold and silver rather than other commodities in their indirect exchanges. Thus the historical selection of gold, silver and copper was not made through some sort of a social contract or convention. Rather, it resulted from the spontaneous convergence of many individual choices, a convergence that was prompted through the objective physical characteristics of the precious metals."

At this point, politicians and bankers should already be cringing. Precious metals have throughout history been adopted as money through free choice. Their adoption has never required the coercion of the state. Hülsmann points out that in no period of human history has unbacked paper money ***ever*** spontaneously emerged on the free market. "In all known historical cases, paper money has come into existence through government-sponsored breach of contract and other violations of private-property rights. It has never been a creature of the free market." Hülsmann also points out, ***and this could not be more topical***, that in a truly free market, paper money could not withstand the competition from the monetary metals; paper currency would ultimately be completely eradicated.

Of course we now operate under a fiat money system, in which money is given the dubious legitimacy it possesses by means of the power of the state. It is merely worth making the non-trivial observation that no unbacked paper currency has ever lasted. This observation is, of course, more poignant given current events in Europe.

The problem is made more acute, and global, by the fact that, as Chris Martenson points out, we operate with debt-backed money. At the local bank level, all new money is loaned into existence. At the central bank level, money is simply created out of thin air and then exchanged for interest-paying government debt. This next sentence should be read aloud, in an ominous tone:

Perpetual economic expansion is a requirement of modern banking.

Not least, so that existing debts can continue to be serviced.

The problem of our age is that the level of global accumulated debt is so huge that it can never be paid back. Certainly, the austerity now being pursued in varying degrees across the western economies ensures that we will have insufficient economic growth to maintain debt service costs. The only question now is in what form much of the unpayable debt is repudiated – explicitly by outright default, or implicitly, by further money printing that is likely to spiral out of control.

The adjective 'iatrogenic' comes from the Greek 'iatro' (healer) and 'genic' (caused by): it refers to an illness caused by the doctor himself. And this is surely the way to describe the current policy prescriptions of our current monetary Doctors Frankenstein: the best way to "cure" an ailing economy is simply to pump more money in. This prescription ended up killing the Weimar patient and there is no reason to believe the experience will be any less painful this time around. Unfortunately, in the mythology of our current overly politicised economy, there can be no hard choices, so a series of soft options continues to be pursued until – like now – we are left with the hardest choices of all.

Fund manager Doug Noland of the Federated Prudent Bear Fund summarises the situation well:

“The global credit crisis took giant leaps forward this week. With even the euro region’s depleted “core” succumbing, crisis dynamics are now anything but isolated to “periphery” markets and economies.. Problems at Europe’s “periphery” will not be easily resolved by German and French guarantees, Eurobonds, a leveraged bailout fund, the ECB, or the Chinese. The markets recognize there will be no quick fix, while worries mount that global finance and economies may be much less sound than earlier believed.. I don’t believe that the expanding nature of global market illiquidity is garnering the attention it deserves. And it’s difficult to envisage a scenario where the liquidity backdrop doesn’t continue to deteriorate. European banks are likely still in the early innings of their historic retrenchment. With financial implosion risk seemingly growing by the day, I fear an escalating crisis of confidence with respect to derivatives and counterparty issues. This is a major issue for global financial institutions and the vulnerable global leveraged speculating community.. I would not be surprised by some announcement of concerted international policymaker measures to bolster confidence in global market liquidity. The financial breakdown scenario is no longer outrageous. The global crisis has afflicted the core, with literally tens of trillions of sovereign debt and banking system liabilities now in the markets’ bad graces."

All of which should serve to remind us that money is far too important to be left to politicians. As the financial world edges ever closer to the brink, desperate investors are fleeing to all sorts of things in a crazy delusion of apparent safety. That US Treasury bonds (issued by a country with a national debt of $15 trillion) are among those ‘safe havens’ is a sign of just how far down the rabbit hole we have fallen. In the short term, the last true safe haven will see even its price, as expressed in unbacked paper money, oscillate uncomfortably. But given the perhaps existential severity of the global challenge, the one true money is now the only logical choice. And given the role of the banks as global plague-carriers, and politicians as their wing-men, it should offer particular comfort to investors that physical gold comes with zero counterparty or political risk.

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