<u>Something useful to protest: a Treatise</u>

Introduction

In any sphere of activity, accomplishment is differentiated from movement by purpose. Phrased another way, showing up and getting things done are two different things.

Here is my suggestion to the Wall Street protesters: educate yourselves, and start by reading this set of essays to help you understand what money is, how it is created, how Capitalism is supposed to work, and what PRECISE failings of our system—which can in fact be located on Wall Street—are causing our financial troubles.

Since one must choose a goal, there is no compelling reason not to choose the largest and most inclusive goals possible, while understanding that their pursuit requires concrete planning, of the sort provided here.

My overarching goals are global peace, generalized prosperity, and a pervasive sense of meaning. We are at a stage in our history when I truly believe we have a choice between Goodness, as embodied in continuing freedom, and Evil, as embodied in the totalitarianism some of our thought leaders keep calling for.

To make some terms clear, Capitalism is in my view an economic system within which moral narratives operate. In its basis, it is people making things and selling them. People keep the results of their labor, which is how it should be. It doesn't matter what religion, race, or ethnicity someone is. It is buying and selling. In my last essay, though, I propose how we can perfect this system.

Conversely, Socialism is a moral narrative that wants to impose an economic system, and which in turn HAS to impose a political regime as well. This point was made well by Hayek in "The Road to Serfdom".

If we take as our ideal some tribal people--think "Dances with wolves", or "The Last Samurai"--what we see is that everyone pays their own way, if they are physically able to do so. This is the only primary demand of Capitalism.

Capitalism can be an outflow of creative energy which need not be tied to greed. Facebook, initially, was not intended as a source of wealth. Countless inventions that went on to build fortunes arose from private projects that simply happened to be useful to many people at the right time.

Socialists offer no cultural alternatives to what we have today. Their method is one of taking away individual attributes, not adding them. Their goal is to take over the economy to force equalities not just of income, but identity. If the only good is equality, then inequality--culturally or economically--can be the only evil. This is a necessary conclusion. Given this, all cultural attributes whatsoever must be eliminated. Women must equal men. The talented must equal those lacking in talent. Religious belief must be destroyed.

Thus my intention here is to offer a core agreement with critics of our current system, and yet rather than rejecting it in favor of a murky utopian idealism that has failed every time it has been tried, to offer up concrete suggestions for reform. In this sense, I want to maintain a connection with Burke, who in effect suggested that the two paths of "revolution" are gradualism (one could argue the American Revolution was in fact a civil war in which we, paradoxically, best upheld English ideals) and what might be termed "catastrophism", as seen in the vast piles of bodies and economic wastelands that began with the French Revolution, and only got worse with time.

To the topic, there are five expositions here, and one Appendix. The underlying data and reasoning is contained in the following pieces, which are intended to be sequential. Please read them through, and at the end you will find a reasonably concrete proposal for ending the effects of that financial condition commonly called "wage slavery." <u>This proposal represents a revolution of sorts, to a form of society never attempted, but one which in my view can be achieved with no bloodshed, no mass injustice, and within the framework of our existing body of laws and practices.</u>

I

What is money?

This might seem a strange place to start—certainly a strange question--but paradoxically it is necessary to grasp the most pressing danger we face: the subversion of our currency. This is abstract, yes, but that very abstraction is how this danger has developed silently over the years without objection from voters. Most of us don't get how our system actually works, which I will correct here. If your biggest concern is our national debt—which is a great many of us—the solution starts here. This treatment will be quick, but if you spend a bit of time thinking it over, you should get it.

If you were purely self sufficient—if you provided your own shelter, clothing and food--you would have no need of money. Trade would never be necessary. However, you can get more stuff through the specialization of labor, where one person or group of persons focuses on making one thing, you focus on another, and you exchange them.

In barter, you might bring a beaver skin to market and exchange it for a new paddle for your canoe. If beaver skins were rare, and paddles common, you might get 3 or more paddles. If paddles were rare, you might need three beaver skins. This is the law of Supply and Demand, which states that as demand increases prices go up, with a fixed supply. Conversely, if supply increases, and demand stays the same, then prices go down. This is pretty basic.

Let us suppose, though, that I walk into a market wanting to buy some new moccasins. I find someone with moccasins, but he doesn't want my beaver skins. He does want paddles, though, so I swap for the paddles, then swap those for the moccasins. This is a cumbersome process—called indirect exchange--and obviously it might break down entirely if the guy with the moccasins is 40 miles from the guy with the paddles. There is no means by which to efficiently exchange goods.

There is a further problem of indivisibility, which means that one beaver skin may be worth vastly more than 1 pair of moccasins, but there is no way to parcel it up, since the beaver skin is usually used as a whole (this may not literally be true, but let's assume it for this purpose.)

This is where money comes in. Money is really ANY thing that people will agree has exchange value. It could be skins, or goose eggs, or cigarettes or beads. As long as everyone agrees on it, you're good to go. In our example above, the beaver skin is sold for money, and that money is then used to buy moccasins.

Historically, gold has by far been the most common unit of currency. It is attractive, it doesn't rust, it is somewhat rare (so it can't be easily added to the economy), and it can be melted reasonably easily, such that you can make units of any size or weight that you want, as well as jewelry. Let us compare, say, a classical Chinese coin and a Roman coin. What is the exchange rate? Absent governmental coercion (a big caveat), it is whatever the ratio of gold is. Say the Roman coin has twice as much gold: it is worth twice as much. You can just melt it, such that the picture of the Roman Emperor disappears, and then mint two new coins with the Chinese Emperor on it. It is the gold that matters, not the imprint.

Who actually made the money has varied throughout history. Sometimes it was traders, sometimes banks, and of course quite often governments. One almost universal pattern of behavior in the last case is that governments almost always spend more than they can bring in in taxes—typically for war or to fund a lavish lifestyle for the power elite--and sooner or later realize they can in effect "print" their own money, since they make the laws, own the police, and run the jails if anyone disagrees. Such policies are economically dangerous, and if pursued far enough ruinous, but by definition not illegal for those who make the laws.

With respect to gold money what they do is add another cheaper metal, such that the coins are only perhaps 90% pure gold. Say they had 100 pounds of gold bullion, they can make 111 pounds worth of coins, which of course is 11 pounds more than there ought to be. This allows them to spend money that they in effect created from nothing. This also means more total coins are in circulation, which creates inflation. The Romans did this, late in their imperial history.

Here is how inflation works. Let us assume that a merchant sells bread in a neighborhood where a lot of government officials live. These officials gave themselves "raises" by minting more money, and they are eager to spend that money. Normally he sells 20 loaves a day, but notices a gradual pattern that he is selling 30 loaves. He decides he isn't charging enough, so he raises the price, such that he is back to selling 20 loaves, and apparently making more money. However, because he has been selling more bread his flour costs also go up—since his wholesaler is using the same logic, and raising his prices--as do his other costs, so that even though he is making more money, he is paying more money, so it evens out. <u>The only people who win with inflation are those who create and spend the money that causes it. This point is critical.</u>

In ancient times, and even relatively modern times, money was usually "specie", which is to say a precious metal you could melt down. At some point, people got the bright idea that they could warehouse their gold, and simply trade receipts for the gold. That way they didn't have to truck the stuff around. You deposit, say, 10 pounds of gold into a vault, and you get ten pounds worth of gold receipts. Anyone who has one of these receipts can go to the bank the note was drawn on at any time, and get the actual gold. In theory, there are only as many paper notes in circulation as there is actual gold in the vaults, so they are effectively equal. They are claim tickets, just like you get when you check your coat.

One day, someone whose name we will never know was sitting in his front office, thinking. Nobody had redeemed any gold in a year. They just traded the notes, because they were simpler and lighter. He had printed the notes/receipts himself, with the press in the back office. He had friends in the shipping business: why not print up some notes for them, and loan them at interest? So he did. It worked. Nobody came to get their gold, and he made a tidy profit off of the gold he had stored. So he did it again. And again. He made money off money that was not his to loan. For all intents and purposes, he was counterfeiting receipts for real money, such that each piece of gold had 3 or more claim tickets issued against it . He was making money off of nothing.

Somewhere down the road, one of the more astute consumers of these notes realized he was seeing them everywhere, and started to wonder if there was really that much gold down in the vault. So he decided to redeem the notes. He goes into the vault, and see maybe 10% as much gold as should actually have been there. Quietly, he tells his friends, who go redeem their tickets too. Eventually, word gets out, and there is a rush on the depository. Our "entrepreneur" runs out of gold, and has to close his door, and slip out of town before he is brought up on charges of being a thief, and jailed or worse.

As we will see, this is how our system, more or less, works today. This is called a Fractional Reserve System. By law, most banks in the United States only have to keep 10% of the deposits they hold actually in hand. They lend out as much of the rest as they think they can get away with. It is not a wonder when we have financial crashes. It's a wonder we have as few as we do.

<u>Discussion Questions:</u>

1. How would you define counterfeit money? What makes money "real"?

2. Did our early banker actually commit a crime?

3. Was what he did ethical?

4. How does inflation transfer wealth? This will be discussed shortly, but can you see where this is going?

II

The "Federal" "Reserve" "System"

What you should understand better at the end of this section is how money is created in this and other countries, how fractional reserve banking works in practice, and how inflation is theft—or if you prefer "invisible taxation".

In our country and as far as I know *all* industrialized nations, the first key concept is that of the Central Bank. A central bank is an institution—normally a government run one in all countries but our own—which has the power to create and extinguish money. In our country the central bank is called the Federal Reserve.

In most European nations the central banks were created to enable deficit spending and money printing, normally first for wars and then later for social programs.

The Federal Reserve System, in contrast, was conceived in great secrecy by Wall Street bankers to protect their hold on the money system. In general terms, of course, this is an opinion, but the fact of the matter is we know who the people were who came up with the system, and the devious tactics they used to sell it, first to Congress, then to the public. All of them were bankers, and several of them were direct competitors with one another, acting in collusion for shared profit. The group that wrote the legislation represented between them roughly one fourth of the wealth in the world, and it is not unreasonable to suppose they wanted to keep it that way.

Think of the Fed as Apple, Microsoft, Oracle, Sun and IBM getting together to form a body with the legal power—unchecked by Congress--to determine who could make computers and write software, and under what terms. There was collusion at the very top and at the very beginning.

It was intended to be the sole source of currency in the United States, and to serve to bail out big banks who lent out too much relative to their reserves, and got bitten. It accomplished those goals.

As things stand today, the Federal Reserve operates without any Congressional oversight, and literally has the power to do ***anything*** it wants with our monetary system. They could write a $10 trillion check if they wanted to, to virtually anyone they wanted to, backed by nothing (they "create" money in the very act of writing the check), with vast and immediate inflationary consequences. They could cut our money supply in half by selling off their securities and drastically raising bank reserve requirements. Unelected, they nonetheless have control of our money, and by extension our economy and lives.

Internationally, their counterparts at the IMF and World Bank can likewise write checks in any amount to anyone they want, subject to no effective authority outside the boardrooms they control. Obviously, they value these privileges, so they rarely abuse them in obvious ways, but the fact remains that these statements are quite accurate.

If this sounds scary, it is. This is why the Federal Reserve intentionally shrouds what it does in mystery[1]. They claim that they are needed to fight inflation, but the simple and unavoidable fact is that inflation is impossible without the creation of money, and since they are by law the sole entity empowered to create money (directly or indirectly), they are deceiving us. *They are creating inflation with one hand, and demanding our respect for fighting it with the other.* It is a cruel lie.

The simple reality is that the so-called "business cycle" is impossible without inflation. Since the Fed creates inflation, the "business cycle" would be impossible without them. All a business cycle is, is growth funded by easy credit, followed by a crash when it becomes obvious too much credit has been extended. This may sound extreme or simplistic, but it is quite sound economically. This is the protocol for boom/bust cycle. And if you take this pattern, combine it with deflationary monetary policy, and add Keynesian economics, you get the Great Depression. That claim will be supported in a later chapter.

For now, let's return to fractional reserve banking, which is to say the practice of banks of loaning out most of their money, such that if all their depositors asked for it at once, they would go bankrupt. It's the problem of our goldsmith creating 4 receipts for every piece of gold.

At one time, all paper money was backed by—redeemable for—gold. The United States practiced fractional reserve gold banking until the 1930's—which meant we kept some percentage, say 1/10th , the gold we needed to redeem outstanding notes—then abolished the gold standard completely in the 1970's. That's why gold was in Fort Knox.

The abolition of the gold standard means that all the dollars in existence today are backed by nothing, except the "legal tender" laws which require all of us, under penalty of criminal prosecution and possible jail time, to accept the dollar for all debts, public and private. (As a side note, there have been times when "money" came in different forms, where some could only be used for taxes, and other sorts only for private debts.)

Practically, this means that there are no limits to money creation. That's all gold really does, is limit how much money you can print. Even on a fractional gold standard you have to add gold to add money. As we saw, inflation is nothing but money that is created and circulated. If you suddenly have twice of something, then it is worth half what it was. If you have a printing

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[1] ". . .there is a federal agency that tops the others [including the CIA and DIA] in secrecy by a country mile. The Federal Reserve System is accountable to no one; it has no budget; it is subject to no audit; and no Congressional committee knows of, or can truly supervise, its operations. The Federal Reserve, virtually in total control of the nation's vital monetary system, is accountable to nobody. . .". Murray Rothbard. The Case against the Fed

press, then you can buy things with money that is worth more than it will be after it is exchanged a few times. Many dictators (such as Chavez and Mugabe) figure this out, and buy themselves whatever they want, to the great detriment of their people. It's a great game, since most people don't know how inflation happens.

The analogy that made this all clear to me was to imaginatively place a teacup on one side of a table. That teacup stands in for all the material goods in existence, such as railroads, houses, cars, and consumer items. On the other we place a dollar bill. This stands in for all the money in existence in that system, which is to say the legal tender for that country, which here is the dollar.

Common sense will tell you that as productivity increases, the cost of goods will fall. In this analogy, the cost of teacups should be dropping steadily. For every dollar you have, you should be able to buy two, then three, then four teacups, in an on-going expansion of the purchasing power of that dollar.

To take a very concrete example, when farmers switched from wooden plows to iron plows, they were able to farm much bigger areas with the same work. This meant they were more easily able to provide for themselves, and therefore had more available for sale. This meant more goods at the market, more competition, and lower prices for the consumers.

Technology has produced *enormous* gains in productivity in the last 100 years. We all know this. Yet, we work more hours than our grandparents did. Our houses may be bigger, and we may have two cars in the garage, but both parents in most families work to provide them. We seem to have done better providing the basics 50 years ago. Most people owned their houses, their cars, and did not struggle the way we do. What happened?

The short answer is we got hooked on easy credit. One of the explicit goals of the Federal Reserve (and of Keynesian economics, which will be dealt with shortly) was to reduce private capital accumulation. They wanted people to have to come to them to buy large ticket items.

Let us, then, look at the dollar side of the table. We have the teacup and the dollar. We then place a second dollar next to the first. This dollar doesn't belong to you. It belongs to a bank or the Federal Government. That bank (or Washington) created that money out of nothing, but now it holds a share of the physical property of the nation. This is inflation. ***Inflation is a system for the transfer of wealth from those who produce things (which of course includes ideas) to those who produce money or government.***

On this last point, we need to be clear that inflation is taxation. The Federal Government could literally suspend taxation tomorrow, and just print money to cover its bills. As a child I used to wonder why they didn't do this. Why would an entity powerful enough to force people to take its money not just, in effect or actually, take what it wants? How can a government ever go broke, when it makes the money?

The answer is that this solution has been tried many times, and it won't work indefinitely without the complete collapse of the financial system. Take modern Zimbabwe, under Mugabe, or Weimar Germany just after WW1, or the American colonies during the Revolutionary War. You can run the presses 24/7, but the more money you put into circulation, the less it is worth. We have all seen the pictures of Germans with wheelbarrows full of money with which they hoped to buy a loaf of bread.[2] The same thing happened with the Continental, our currency that was used to pay for the Revolutionary War.

This sort of policy leads to widespread impoverishment, social unrest, and economic instability. As we will see with Keynes, it can be used as a tool to undermine private property rights, but for now please accept that there is no fundamental difference between open taxation, and inflation, except that one is obvious, and one is covert. Both involve the transfer of wealth from individuals and corporations to those printing and distributing the money.

Discussion Questions

1. Who do you think has most of the wealth in this country? What do they produce? Your answer need not be "bankers". Really think about it, and do some research. Who owns the skyscrapers downtown?

[2] In their case, it was almost certainly the result of intentionally inflationary policy the German pursued to pay their war debts with devalued currency.

III

Money Creation: some details

As things stand today, there are three primary means of creating money--which is to say inflation--in the United States,. The primary means of creating money is for the Federal Reserve to buy up securities, which is called "Open Market Operations". The Federal Reserve can literally write checks for ***any amount ,*** that are backed by nothing. There is no account anyone can refer to that had money in it prior to that check being written. They can write it to whomever they want. They can buy up Euros. They can buy mortgage-backed securities, stocks, and derivatives. They of course buy up a significant number of the Treasury Bonds that are used to finance the national debt[3].

They write the check, and it clears, and the money is now "created". Those dollars are in circulation. Quite often they buy up securities that nobody else wants. Wherever their people are in trouble, you will find them pumping money in. The converse of this, of course, is that when they sell the securities they contract the money supply, which is deflationary. This is by far the most important tool of "monetary policy", which is to say controlling the amount of money in existence.

The second means is through the Discount Window. This is a means of helping banks manage short term cash flow problems, and for funding seasonal businesses, like agriculture. In general, these are overnight loans made so banks can balance their books on days after depositors take out more than the bank actually has in reserve.

It might not seem like the rate for one or two day loans would be that significant. Practically, it matters for two reasons. First, even though banks can theoretically only keep 10% reserves, as a practical matter most of them keep more, for the simple reason that they are more prone to bankruptcy if they overleverage themselves. Every time they use the Discount Window, it costs them money. This cuts into their profits. The lower the Rate, though, the more often it might make sense to operate with more leverage—more risk—and hopefully correspondingly larger profits. In effect, this rate dictates how close to the rock bottom of 10% banks are willing to consistently get.

The third means of money creation is the institution of fractional reserve banking itself. The Federal Reserve's role in this is its legal authority to tell banks how much money they have to keep in reserve. Currently that amount is 10%[4]. Remember the man who made loans on other peoples gold? That is what banks do. The details will vary, depending on the exact legal

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[3] Not the majority, though: most of them are owned by private investors and foreign governments.
[4] For banks with more than $55 million in deposits. It is 0% for banks under $10.7 million in deposits, and 3% for those in the middle : http://www.federalreserve.gov/monetarypolicy/reservereq.htm

climate, but the gist of it is that banks are allowed to loan some percentage of the money entrusted to them, and thereby in effect keep their cake and eat it too.

Let's run through all three methods, using the housing industry. Assume, for simplicities sake, that Main Street Bank has $1 million in capital. $100,000 was put in by the men and women who started it, and $900,000 came from depositors who placed their money in checking and savings accounts. They can loan out $900,000, which leaves them with a $100,000, 10% reserve[5] They loan all of it, for simplicities sake, to one person, John Smith, for a $1 million home. John puts down the first $100,000, which goes to the owner. This makes it harder for him to walk away from the house, and therefore makes foreclosure less likely.

The way this gets logged on the ledger is as follows: on the Asset side you still have the original $1 million, to which is now added $900,000 in "receivables"--which is to say money owed. Total assets equal $1.9 million.

On the debit side—which is to say money owed—you have $900,000 in deposits (since you owe that money, but not the money the investors put in, since you are the investors), and the $900,000 for the loan, for a total of $1.8 million. The reason the $900,000 is a debit is because you wrote the check. You paid the builder and the real estate agent and whoever else got a cut on that house. That went out as checks that got cashed. John Q. Smith Builders, Inc. spent $700,000 on framers, plumbers, painters, concrete, materials, etc., and they all need to get paid, and they do. They keep the rest. You literally spent every cent the depositors entrusted you with, less the down payment. (All of this money flows into banking accounts around the area, where this operation is repeated. I am only focusing here on one "pyramiding" of money, but in reality there are many pyramids.)

This means that where you actually did have $1 million in the bank at one time, now you truly only have $100,000 in the "vault" ($100,000 reserve). On the books you have plenty to cover yourself, but in practice you just spent $900,000, and still owe $900,000. Nonetheless, the balances reads $1.9 million in assets[6], less $1.8 million in liabilities. You're up the initial capitalization.

To be clear, in making this loan the bank engaged in what amounts to legal counterfeiting. $900,000 was created. This is the third form of money creation/inflation. This could perhaps be called phantom money, since the same money is being used in two places.

Think of it this way: imagine 100 gold coins laying in a vault somewhere. 10 were put there by the bank itself, and the rest were deposited for safe-keeping by members of the public. The

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[5] note that with actual deposits that small they need reserve nothing legally; I am pretending they are large here.

[6] I don't know the accounting details with respect to how the interest is handled, so I am simply dealing with the principle itself, and not the added money which will accrue in the long term. A $1 million loan will generate $718,695.08 in interest payments over 30 years at 4%.

bank takes 90 of the physical gold coins, and gives them to a mortgagee, who then gives them to the person selling the home. The money is gone. It has been spent.

And to the point, money was circulated that should not have been circulated. It should have been in the vault. That's where it was put. The people saving it obviously did not intend to spend it immediately, by definition. Thus what has in effect happened is a parallel money supply has been created. If inflation is dollars competing with dollars, then the loan caused a competition that otherwise could not have happened. In fact, the more people save, the less things cost.

Let's say our bankers then flip the loan to Fannie Mae or a New York investment banking firm. We'll deal with their side of it shortly, but for now assume Main Street gets a check for $1.4 million (at 6% interest the principle would pay more than double over thirty years; this number may or may not reflect actual rates of return). They have made $500,000 for a month's rent of someone else's money.

Note that these are not hard numbers; it is the principle of the thing I'm trying to show. It might be $100,000, and it might be $1 million. Fannie Mae never really needed to turn a profit, so it's hard to say what they were paying for what. Based on the inflation they enabled in California, Vegas and other places, it was likely quite a bit, though.

Our bankers have done good. They started with $1 million, and now have a cool 50% return in a short period of time. They can now loan Mike Jones $1.35 million (90% of $1.5 million) for his dream home, and repeat the process again.

What are the potential pitfalls to this bank? They are twofold: first, the borrower could default, so they lose that money, less what they can actually sell the house on the open market for; secondly, they owed $800,000 more to their depositors while the loan was outstanding than they actually had.

The first risk is managed by careful lending practices or by selling the loan. Most readers will have been through a credit evaluation. Banks that keep loans (and which are ethical) do a good job on this.

Banks that intend to sell loans only do a good enough job to satisfy the would-be buyer. If that buyer was Fannie Mae or Freddie Mac (or many investment banks), there were almost no strings attached, which meant they could loan to almost anyone at no real risk to themselves. Understandably, this was the policy most banks pursued. Such thinking is short term and unethical, but as we have seen also highly profitable.

In the first case, a default, let's go through the math. John Smith loses his job, and gets a divorce, and stops making payments on his home: what happens? The way this works is the loan is deducted as an asset—presumably when the foreclosure is filed, but it may be legally before or after that--but retained as a debt, since that money was spent.

Thus the $1.9 million in paper assets drops to $1 million ($1.9 million less $900,000). $1.8 million ($900,000 in checks written and cashed, plus what they owe depositors) in debts are, however, retained. The bank owes out $900,000 more than it has. It now actually owes the money it created, and there is no one to give it to them. By law, this condition cannot long endure. At some point regulators will force them to close their doors. They do acquire the rights to the house through the process of foreclosure, but such homes are typically sold at steep discounts, and often only after the bank doors have been closed as part of a general liquidation.

The second way they can get in trouble is if they have sudden, large scale bank withdrawals. Remember, they "borrowed" other peoples money to do this deal. Obviously, the more private capital that goes into the bank—the more investors they have--the safer they are.[7]

As it happens, Smallville, USA is a tight knit community, so when it comes out that the bank president was having an affair with the minister's wife many people take their money out. Remember that although they had $1.9 million in paper assets, the number of figurative dollar bills they had in the vault was only $100,000. Yet, they owe people $900,000.. If depositors try to take out $100,001, they will have to call the FDIC and will go into receivership, which means the FDIC is in control of the bank. Depending on the exact financial situation, they will either be shut down, or absorbed by a larger bank (with or without a name change) which has the money to bail them out in exchange for their base of customers and loans.

There is an intermediate position, too, where short term withdrawals create a cash crunch. Let's say that the local ball team goes to the National Championship, and everybody decides to pull their money out, and travel with them. This is a short term liquidity problem, for which the Fed is the solution. They have to pay out $300,000 in deposits, which makes them $200,000 short.

Main Street Bank has two options: the Discount Window, or the use of Federal Funds. In the first case, they can simply borrow money from the Fed, at interest, to cover their shortfall. The loans are normally overnight, so they can balance their books when all the transactions post at midnight. In my example, they borrow the $200,000 overnight at whatever the primary rate is . This keeps them from having to close their doors.

Note that they can't do it indefinitely without getting shuffled from the primary to the secondary (higher) rate, and at some point they will get in trouble for being undercapitalized. But they can weather short term troubles through this mechanism.

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[7] In this case $100,000 may be a bit on the skinny side, but likely not too far off. Actual capitalization requirements are a matter for public policy, and subject to frequent change, and I'm just trying to show the operation of these things with as much simplicity as is possible for a complex topic.

The second option is the use of other banks money. We have been speaking of reserves. In the example I'm using, the actual reserves of the bank are $200,000. By law, some percentage of that has to be in the vault in the form of cash, and whatever is left is deposited with the Federal Reserve, which in this sense and this sense only can be viewed as an actual financial reserve. All member banks in the system have to do this.

In this example, let us say that whereas Main Street has short term cash flow problems, some bank somewhere else in the system has more money than it is required to keep. That bank can then loan the money to Main Street on a short term basis, normally overnight. This transaction is handled by the Fed. The interest rate charged is called the "Federal Fund rate".[8] This rate is influenced by the Feds monetary tools (reserve requirements, open market operations, and Discount window pricing), but not directly determined. What the Fed does is "target" (their word) a rate they feel is consistent with liquidity, long term growth, and the containment of inflation. As a general rule, one could view the entirety of Federal Reserve policy as oriented around a specified amount of liquidity in the system, which they measure using the Federal Funds rate, since that rate is set by the "market" of banks.

Currently, this is the preferred means of "book balancing", since the Prime rate is set above it as a matter of Federal Reserve monetary policy. Since the money used for these loans actually existed somewhere prior to being loaned, this is less inflationary. It is also more profitable for the really big, really well capitalized banks who make up the Federal Reserve.

This is how our system works. Quite obviously, banks that are less adventurous with other peoples money will over time have fewer problems. What this would involve is voluntarily keeping higher amounts of reserves than required by law, making better loans, and having more capital (money that didn't come from depositors) in the first place. At the same time, the more risk you take, the more you can make, if you don't go broke in the process.

Discussion Question

1. Monetary policy is influencing the amount of money in circulation, which is to say the value of our money. Do you remember what the three primary tools are?

[8] http://www.federalreserve.gov/generalinfo/faq/faqmpo.htm#3

IV

How our financial system is stabilized

What happens when things go south in a big way, as they do sometimes? Most of us remember the bank panic in "It's a Wonderful Life". All a "panic" is, is a collective realization that the bank has already spent your money. Most all of us have grown up in a world far distant from such a thing. The FDIC, we are taught from an early age, is the solution to bank panics. You don't have to take your money out, since it is insured. This is sort of true, and sort of a lie.

The truth is that the Federal Deposit Insurance Corporation charges fees for the insurance it provides. Who do you think pays this? We do. When the world seemed like it was collapsing in 2008, the deposit amount the FDIC insured was raised from $100,000 to $250,000. Who do you think paid for that rate increase? We did. Do not most of you remember receiving halfway decent interest on savings accounts, say 4-5%? Now it is close to zero. The banks pay the insurance, and then have less left to pay us for the use of our money. We are loaning it to them, by and large, for nothing right now. Most of us simply don't understand this. We pay for our own insurance. This is vastly more beneficial to large depositors--who gain much more from such insurance--making FDIC insurance effectively a regressive tax we pay to protect our money from a fundamentally unstable system.

Further, and more importantly, the FDIC only keeps on hand some 1-2% of the deposits it supposedly insures. Were an actual, widespread panic to hit for any reason, they would be wiped out almost instantly. The Federal Reserve or Federal government would have to provide the difference. The FDIC works as long as people believe it works, which has been close enough to prevent any panics in a long, long time.

Practically, there are three classes of bank failures: small, medium, and large. In general , small banks are allowed to fail. They are simply liquidated. Their assets are seized and sold, and their depositors are paid out of FDIC funds and the proceeds of the asset sales. Since the amount of money in play is not large, this works reasonably well.

Medium banks are normally purchased by larger banks, at steep discounts. Remember the problem is typically cash flow, such that with money injected and new management, they can keep going. Thus when they get into financial trouble, buying them up makes sense for the banks with the money to do so. This outcome is common. The money to keep them going normally just comes from other banks, possibly with some pot-sweetening guarantees or cash from some branch or other of the Federal or State government. They fail, come into FDIC control—nothing changes outwardly, as the bank continues in operation as before--and are then in effect flipped to the buyer that makes the best offer.

Finally, there is the supposed "Too Big To Fail". You have heard this argument: If the "X" Bank is allowed to fail, there will be a ripple effect, that could bring our economy down. Think about that for a moment: if such a failure can bring our economy down, then our economy is not built properly.

For now, let's see what happens.

Large banks can still file bankruptcy, in which case the assets are sold, and depositors paid. This is what happened with Lehman Brothers, whose various businesses were sold to a variety of interests around the world.

If the bank appears viable, money can be voted by Congress, or issued by the Federal Reserve, to provide cash. This is a bit like the Discount Window/Federal Funds transaction we looked at earlier, but with *much* more money involved, and with a much longer time horizon. Moreover, it's understood to be a loan, but with the important distinction that it is unknown if the money will be repaid.

As an example, in 2008, a $700 billion fund (called TARP, for Troubled Assets Relief Program) was created by Congress so that the Treasury Department could inject money into different troubled companies, like AIG and GM. This is what has normally been called "the bailouts". The intent was to put cash into the system, so that financial companies would keep making loans, and in the case of GM so they wouldn't be forced into liquidating their company, and firing all their employees.

The basic premise of the Too Big to Fail is that all companies exist in an economic web. AIG employs X number of people. All their jobs disappear if they close their doors. Those people then lose their houses and stop going out to eat, devastating small banks and the restaurant industry. Those industries then lay people off, because they aren't making any money. This process continues until we are in a full blown Depression. Further, AIG owed a lot of people a lot of money, and if they didn't pay it, all those loans would go south, such that many other banks would get into the position of the bank we looked at in the previous section that had their mortgage loan go into default. One bankruptcy would lead to a cascade of bankruptcies, which would sooner or later require a bailout anyway, or lead to a complete loss of liquidity/cash in the system, and another Depression.

This logic is not entirely wrong, given the nature of our financial system. That is a big caveat, though: with a sound system, all these bailouts would be unnecessary. That will be a topic I take up later.

Practically, though, this money was used by most recipients—especially the financial concerns--as money that just landed in their laps, and which they intended to use to further increase their market positions.

As one bank president put it: "With that capital in hand, not only do we feel comfortable that we can ride out the recession, but we also feel that we'll be in a position to take advantage of opportunities that present themselves once this recession is sorted out."[9]

Effectively free money is, of course, a good thing for banks, as it would be for any of us. If $1 million landed in your lap, do you think you could find a way to turn it into $2 million? This is how the rich get richer.

With respect to the Federal Reserve, it's worth looking in a bit more detail into one of the more sordid aspects of that whole mess of 2008, the saga of Bear Stearns. I will paint with a broad brush, which is accurate in general terms, but may be a bit off in some specific details, such as the exact money flow through Bear Stearns, which had many subsidiaries who did many different things.

Bear Stearns got into trouble, mainly by overinvesting in risky mortgages, which paid high rates of interest, but which also defaulted at high rates. People would buy homes on easy credit terms, at high rates of interest, and simply find themselves unable to make the payments, sometimes from Day One. As mentioned previously, strict underwriting standards (which is to say, the care taken in assessing someone's likelihood of being prompt and regular with their payments) are a critical feature of sound banking. Bear Stearns did not practice these principles. To be clear, they did not originate the mortgages, but entities under their control did. What they did is package the loans as securities and sell them.

Their troubles came when it became obvious that the value of those securities was indeterminable, since good loans were piled in with bad ones. This meant that piles of stocks were sitting somewhere, and nobody was buying them. They had paid for the mortgages—the money went out—but with nobody taking them off their hands, no money was coming in.

As a result, they got into a "liquidity crisis". In plain terms, they did not have enough money in the proverbial vault to pay out their creditors and their depositors. We saw two ways that can happen in the previous piece. In their case, the problem was an old fashioned "run on the bank", by institutional investors. Banks like Bear Stearns don't take John Q. Public's deposits. They take money from professional investors, who put up the money to buy stocks and other investment products that Bear Stearns and their ilk produce. These investors got antsy, realizing that the vaults were virtually empty. Bear Stearns had "X" in the bank, and institutional depositors asking for "5X" or whatever in cash. Bankruptcy was imminent.

Here is where it gets interesting: the Federal Reserve Bank of New York decided to loan $30 Billion to JP Morgan Chase, a competitor, so that JP Morgan could buy Bear Stearns. That money was collateralized by Bear Stearns assets, not JP Morgan's assets. What this meant is that if the loan went into default, the Fed could seize Bear Stearns assets but not JP Morgan Chases's, even though JP Morgan Chase is who actually got the loan and assets, and who actually stood to profit most by gaining the business of a competitor.

[9] http://www.nytimes.com/2009/01/18/business/18bank.html?_r=1

This "loan", of course, was an Open Market Operation, in which money was created from nothing. The Fed can do that. Who did they have to consult to decide to do this? Nobody. Congress did not need to be consulted. The President did not need to be consulted. They didn't even really need to consult Bear Stearns, except to the extent that they needed their approval to finalize the deal. Who did they certainly consult? JP Morgan Chase. The deal was initially going to be done at $2/share (Bear Stearns being a publicly traded company), but howling from investors—who do have pull on Wall Street, if they have enough money—caused it to be raised to $10.

JP Morgan Chase got Bear Stearns. This reduced their competition, and gave them access to all the profitable business Bear Stearns had. Importantly, too: the deal was structured such that if they defaulted on the loan completely, nothing bad happened.

Several points need to be highlighted here. First, J.P. Morgan himself—one of a handful of de facto billionaires at the beginning of the 20th Century—was an ardent supporter of the Federal Reserve. One of his right hand men was there at the private meeting that developed the plan for the Fed. Do you see why? Is not money for nothing a beautiful thing?

Secondly, the executives at JP Morgan Chase—and every other large bank on Wall Street, including Bear Stearns—are buddies with the Federal Reserve. They *are* the Federal Reserve. The decision to loan the money to JP Morgan Chase was made by the Board of Directors of the Federal Reserve of New York, presumably in conference with the Federal Open Market Committee in Washington, which had to actually commit the money. This Board is elected by member banks, whose names are not a matter of public record; that is proprietary information that the Federal Reserve protects, even though they are supposedly operating on behalf of the public.

Interestingly, their CEO, Jamie Dimon, now sits on that Board, *as a representative of the interests of bankers.*[10] His term apparently started in 2009, not long after they got the money. He will be overseeing the use to which that money is put when he puts on his Federal Reserve hat, and using that money to make more money when he puts on his CEO hat. This would be blatant conflict of interest, if the Fed were overseen by anyone except the Old Boy's Club that runs it. As it is, no one can say anything. Indeed, most of what they do happens in complete darkness. Their meetings are secret—no reporters, no Congressman--and they are directly accountable to no elected or appointed member of our government.

They claim this is to protect them from being unduly influenced by "politics", but one doesn't need much imagination to see much more obvious motivations.

The bottom line here is that our system is oriented around taking care of the needs of large banks who come out smelling like roses no matter what they do, and not in the least bit around "we the people", except to the extent that we are needed as consumers of credit.

[10] http://www.newyorkfed.org/aboutthefed/org_nydirectors.html

Discussion Questions

1. Would you consider the FDIC to be an actual insurance program? Why or why not?
2. Does our financial system appear safe and solid? Why or why not?
3. Who do you think this system most benefits?

<u>**V**</u>

<u>How to fix our financial system: general considerations</u>

Free market capitalism has two key components: free markets, and capitalism. This should be obvious enough, but it is not: a*s things stand today, neither applies fully to our banking system.*

To consider this topic more fully, let's consider the question of what a capitalistic, free market banking system would look like.

To begin with, inflation—which is to say the creation of money from nothing--is inconsistent with capitalism. We need a certain amount of money, but the precise quantity doesn't matter. If a pencil costs $2 and you make $2 an hour, has anything changed if it costs $4 and you make $4 an hour?

Capitalism works best when prices only change with changes in efficiency. This leads necessarily to deflation, which is to say an increase in the purchasing power of money. Deflation, in turn, provides an incentive to save, which is to say to personally capitalize your purchases as an individual and as a businessman. This is quite obviously the opposite of a reliance on borrowing facilitated by money creation, which as an economic system I have labeled "Monetary Mercantilism". This fact—that our purchasing power should be much, much greater than it is--is actually quite sad, because once you grasp it fully, you realize the sheer quantity of waste we have seen over the last 100 or more years. <u>**Core point: True Capitalism is self funding. It is a system for the conversion of innovation into wealth.**</u>

To be clear, if at one moment there is no money, then in the next there is, that money does not thereby become "capital". It is what economists call "fiat money". As I have already stated, those who control that process are positioned over time to own everything in our country, since they can get something for nothing, over and over and over. This is the process of inflation, and a just system would abolish it.

I should demolish a common misconception here, too. We hear, over and over and over, how our economy has to grow every year. If we don't grow for some reason, economists fret. What is actually happening is they are fretting over the lack of credit expansion. If people don't borrow, then we might lapse from our current system of Monetary Mercantilism back into genuine Capitalism. The bankers don't want that, and neither do their spokespeople.

The simple reality, though, is that many human societies have existed in relative stasis for thousands of years. At a certain point, enough is enough. If we had actually been able to keep the fruit of our labor—if our money was worth what it should have been worth, if we had not turned the keys to our lives over to Wall Street and Washington—our economy would likely be contracting, and no one would care. We would have plenty of money to live comfortable lives.

We work so hard and so feverishly only because most of the product of our labor goes somewhere other than our pockets.

As far as free markets, the Federal Reserve prevents interest rates from reaching their natural levels. They do this by creating money as needed to keep us all awash in a sea of credit. When they create money, they affect the supply/demand equation by increasing the supply.

If the amount of money in circulation were fixed, then the price of that money—the interest rate charged—would go up as demand went up, and down as demand declined. This would automatically prevent the ups and downs of the business cycle, since it would incent rational investing behavior, and not gambling with other people's money.

A truly capitalistic bank would make money in three ways. First, they would warehouse people's money. If you don't want to keep your cash in a safe or your mattress at home, you would pay them a nominal fee to keep it safe for you. Private companies could come into existence to provide insurance for them in the event they were robbed.

Secondly, they could borrow money from individuals for a specified amount of time and rate of interest, and then loan it out at a higher rate of interest. This arrangement today is called a Certificate of Deposit. I am not in any way calling for an end to business or personal loans. I am calling for an end to loans of money that is already spoken for. Loans could still go into default, in which case the bank absorbs the loss, and will still owe the depositor. Again, private companies could be created to whom dues are paid in exchange for insurance against this. Good banks that make good loans would pay nominal rates, and risk-takers would pay higher rates. This will be a free market in banking.

The third option would be charging for clearing checks and debit card transactions. Currently, that is done through the Federal Reserve System. An argument used for this is that it prevents one bank from not accepting the checks of another. With 100% reserve banking, this would not be a problem, since all banks will have to have the money to clear checks drawn on their accounts. You pay a flat rate per transaction, or a monthly fee, or however your bank structures it in a free market.

What free market, capitalistic banking will not include is fractional reserve banking. We have covered it directly. Now let's use an analogy. Think of fractional reserve banking in the following way: a friend asks you to watch his house while he is away. You look at the empty house, and realize you can rent it out for your own profit. He comes back from time to time unexpectedly, so you can only rent it out a certain amount of the time. The luckier you feel, the more time it stays rented. When you do finally get caught, though, he fires you. This is the equivalent of a banking panic. Panics are an inevitable result of lending money you don't have.

All the Federal Reserve System, the FDIC, and the various Congressional bailouts serve to do is gloss over the fundamentally dishonest, illusory nature of our system, which is unsound in its *very basis.* It is a deck of cards, propped up by inflation/fiat money creation, which is to say the Federal Reserve.

If there is no variation in the quantity of money, there is no need for monetary policy, because monetary policy can only be the solution to business downturns because it is the *cause* of business downturns. It is no exaggeration to say that all the Fed does is inflate and deflate our currency, fund Federal budget deficits, and protect banks from the consequences of stupid risk taking. Particularly since inflation is wealth transfer, it is inconsistent with a just economic system.

Discussion Questions

1. Do you see the difference between economically exploitative activity, through money creation, and Capitalism, per se? Do you agree that someone that invents something new should be rewarded for it, and that if they are not rewarded, less will be invented?

2. If you had plenty of money and leisure, how much would it bother you if some people had more? Could you accept a 5 hour work week?

VI

<u>How to fix our financial system: a concrete proposal</u>

I have developed a plan for eradicating the risk of large scale financial trouble. This means no more recessions, depressions, and "melt-downs". It does not mean continuous high speed growth, but rather slow and steady growth, coupled with increases in the purchasing power of the average, middle class American. It will further enable the creation of the jobs that will help those living in poverty to raise themselves into comfort.

I am fully aware these are radical proposals, and likely only to be seriously considered *in extremis*. Yet, <u>we have reached a point where the bankruptcy of the United States is something reasonable people can view as possible, and even inevitable, if we continue on our current path. We are also seeing credible talk of another Great Depression.</u>

Plainly, this plan may not be EXACTLY what we need, but in my view something on this order is going to be required. Moreover, the claim I am making is not just practical, but moral: our system as it exists today is unfair, and needs to be changed for that reason alone. At some point, the likely alternative will be an equally large "revolution" that accomplishes nothing positive and much that is terrible.

Net: when things really hit the fan, we need to have thought the thing through. Any radical new idea has to be proposed for the first time, so people can get used to the sound of it. Here are my ideas:

1) Use the Federal Reserve Open Market Operations to buy up every Treasury Note and security in existence. To make sure this gets done (since Congress currently has no direct authority over the Fed) we would first pass legislation bringing it directly under Congressional control. We offer the holders of such securities the choice of either taking the money, or getting that debt cancelled directly through default.

This will eradicate our debt. To be clear, we use the Fed to write some $10 trillion in checks (we owe roughly $13 trillion, but they already hold roughly 20% of our debt), such that the Federal Reserve holds the entirety of our debt. We further write checks to cover all the debts of all the States and municipalities in the country. This will be highly inflationary, which I will deal with in a later step.

2) Use the Federal Reserve Open Market Operations to fully capitalize all banks and lending institutions, and in exchange for that require them to forgive all loans. To this add a per person deposit of some substantial amount, say $25,000, or the amount that would be due them in whole with Social Security if they had reached retirement age.

First off, all personal debt disappears. All credit cards, all mortgages, all business loans. We start from zero, with sound banking.

Second, we add enough money to fund the liquidity requirements for business development. To avoid immediate inflation, this money will be unavailable until the person in question reaches retirement age. This will replace Social Security, and it will also ensure that the banks have money in their accounts to lend. Those whose money is lent do, however, earn interest on it (Social Security contributors currently earn negative interest, since the costs of administering Social Security come from their deposits).

Third, banks which operate in areas considered poor will be given money for local investment. This money will not be used for home ownership, or charity. It will be used for business loans, preferable of the microloan variety, in which small loans are easily obtained. Cultural training programs should be instituted, such that self discipline, basic financial management, business development, and accounting principles are taught to those wanting these loans. Once they complete this training, they get preferred interest rates. The most important problems in most poor areas are cultural, not financial, and throwing money at them manifestly has not worked.

The objection could be raised that we are giving banks money. This is true, but they create money already through the process of Fractional Reserve Banking, and when they screw up, taxpayers wind up paying for it anyway, one way or another.

This, too, will be extremely inflationary. I have been unable to find a number for the amount of private indebtedness, but let's place it somewhere around $7 trillion for simplicity. The exact number doesn't matter until the implementation phase. It could be $20 or $40 or $60 trillion. It only matters when we try to reconcile the money in Step 4. By law, the Fed has the power to create money, and all American citizens have to accept it. No one is losing anything, except that the Lords of Wall Street lose their absolute power over our national finances. Since they get checks too, though, they do alright as well.

3) Require all banks to be henceforth 100% capitalized. They would only be allowed to make loans with actual investor capital, which would mean certificates of deposit held by individuals and investing institutions. Since most people would have extra money following the forgiveness of their loans, this would be the starter base from which liquidity would be built. In other words, this is how those banks would then be able to continue funding industrial and business growth.

Such banks would ever-after only be able to make money through investing real money, through charging "warehousing" fees for the safe storage of money, and through transaction processing. No more pyramiding of money. All credit card issues would have to be backed by corresponding Certificates of Deposit, and have maturities. No more revolving lines of credit. The sheer volume of cash injected into the system would help reduce the economic impact of this, particularly since those already in debt would get a new start. This would be somewhat unfair to those few who were not in debt, but the task here is a global fix that will last. Such people would not be hurt; they simply wouldn't benefit. The resulting improvements in the economy, though, would more than make up for it.

4) Implement a stable currency based on gold. This needs to be done in steps.

First, Congress passes legislation to empower each of the fifty States to print their own currency, and establish gold depositories. The law will be a Federal law, but the implementation needs to be by the sundry States. These depositories are built, or converted from existing vaults.

Second, we create new currencies, which "translate" the inflation back to pricing we are used to. This is by far the hardest step, and some imprecision is inevitable. There is an easy way to look at this, and a hard one. The easy way, which I prefer, is to simply figure out how much money was in existence, determine the total of the checks written, and use that as a multiplier. If $13 trillion was in existence, and we wrote checks for $26 trillion, then the money supply has increased by 200%. It will now take $3 to buy what previous took $1.

Given this, we ask for $3 in the old money, and offer out $1 of the new. This will roughly normalize prices, and minimize economic disruption. All holders of U.S. Securities who were paid off do the same exchange.

This can be done through any bank. Obviously account balances are simply altered on a specified day, and money is distributed to banks to pay out. Excess currency can be printed to make sure there is enough, with the proviso that any leftovers will be returned promptly, then destroyed.

A few words of explanation are needed before I offer up the alternative.

There are two types of inflation: monetary inflation and price inflation. Monetary inflation is any increase in the amount of money that could be spent. The reality is that much of the money out there is not in circulation. Even if that money is sitting in a vault somewhere gathering dust, it has still been created, and could still be used to cause price inflation.

Price inflation is the actual increase in the costs of things like housing, food, and transportation. Following any injection of cash into the system, it takes some time for the prices to stop rising.

To expand on this point, which is a bit abstract, let us suppose that only 80% of the dollars in existence are actually in circulation. This means that the buying power of the dollars that *are* in circulation is artificially high. Our dollars are buying more than they would if the money left its hiding place. For the purpose of this translation, though, I'm assuming that money *was* in circulation.

To the point here, if we did this over the period of say one week or one month, the effects of the monetary inflation may not have worked through the system by the time we switch currencies. Were we to wait, it would be very destabilizing. Frankly, it will be chaotic, no matter how we do it, but we're trying to save our democracy and way of life. Responsible adults understand that sometimes short term pain and confusion are the price of long term peace of mind and comfort.

Given this, the ratio may be somewhat deflationary in the near term, particularly if much of this money is held overseas, as it is today. Since the money to buy up our debt went out into the economy, prices will continue rising even after the transition, but in the near term $1 of the new money may not buy what $3 of the old money did.

The hard way, then, is to try to reconcile actual before and after purchasing power in our ratio—for example, maybe we make it 2.5: 1, or 2:1. This appears to me to be a Gordian Knot best cut quickly with a sharp knife. If private citizens, the banks, and businesses are suddenly all out of debt, they can deal with some short term price disruptions. If the ratio is wrong, prices and wages will go down quickly, and previous purchasing power will be restored in reasonably short order. It is, it should be noted, critical that the government not interfere with this process of price reconciliation.

This will be followed by permanent increases in our buying power, and corresponding standard of living, since the steady leak of our money into the pockets of the Monetary Mercantilists will have ceased**.**

In this system. Texas will have their own notes, as will Massachusetts. All the States will. All of them will equal one another. My thought process here is to begin returning the balance of power to the States, who were properly the focal political institutions in the intent of most of our Founders (for good reason, as I will argue in a later piece.) Practically, this may be more symbolic than real in its effect, but symbolism still counts for a lot. Not to be glib about such an important issue, but I think this would be fun, too. It would offer a lot of room for creative competition in the designs of the various currencies.

The "control" of the currencies is a moot point, since there will be no more monetary manipulation, but in theory this will still be in the end under the control of the Federal Government.

Third, transfer the gold currently held in reserve in Fort Knox and the Federal Reserve Bank of New York to the States, in proportion to the money they issued. Foreign owners of dollars can "redeem" them in any State they want. Since the goal is to tie the currencies to the gold, logically the gold goes to those who issued the currency, such that the currency/gold ratio of all States is equal.

Historically, nations on the gold standard either saw the value of their currency fluctuate with the value of gold (the currency was defined as how much gold it would buy on the open market), or artificially pegged their money to some amount of gold, such that a dollar by definition equals X amount of gold, say 1/10th of an ounce. I don't find either of these acceptable.

Returning to the analogy of the teacup and the dollar bill, please recall that inflation is equivalent to a decrease in the value of a dollar. Deflation equals an increase in the value of the dollar, achieved by reducing the number of dollars in circulation. In both cases, the value of real goods fluctuates for reasons extraneous to the actual value of the product. To put it bluntly, it can and has been manipulated by those able to do so.

There is absolutely no benefit to anyone in this, except the banks, who as we have seen benefit almost exclusively from this process, even though most of us have not historically seen this. Obviously, the Federal government benefits, too, as it uses fiat money to fund war, social spending, and whatever else is the issue de jour.

As I see it, the task is to fix the value of the dollar, once, and never change it again. You will see people claiming that if the amount of money is fixed, and people "hoard" it—put it in a mattress or vault somewhere—that there won't be enough. This is silly. What will happen is the value of the dollars in circulation will go up. When they reach a certain value, the money will come out of the mattresses, quite naturally. This is a good thing, and the only reason we don't realize this is we have never experienced it. It hasn't happened since the 19th Century, in the way it ought to.

Fifth, given the foregoing considerations, we fix the value of the money relative to the gold once, and never change it again. We have some 8,000 tons of gold in reserve. Let us say there are $13 trillion of the new dollars that are issued. This works out to some $50,000 per ounce. This is, of course, ridiculously higher than the price of gold currently, which I need to explain.

This concept is a hybrid between a true gold standard and fiat money. It is a gold standard, since gold backs the currency. It is "fiat" money, since the value of the money is fixed outside the marketplace, which would not come even close to valuing gold that high. In effect, I am inflating the value of the gold so the math works.

A logical question arises: if the "value" of the gold, or the money, is defined artificially, why use gold at all? I wrestled with this, and here is my answer: because the goal is to prevent any more money from being issued. That is it. This is best done if it is necessary to add gold to add money. Otherwise, it is too easy just to pass a bill to print your way out of trouble. Moreover, the knowledge that gold stands behind the money will strengthen our currency yet further. We were for many years on a fractional gold standard, which meant that a multiple of dollars were issued against the gold in reserve. Say the gold was valued at $50/ounce. At a multiple of ten, this meant $500 could be issued against it. If it eases the cognitive dissonance, think of it that way. The point is that the need to have gold to issue money decreases the issuance of money, and that *we already have this gold.*

On one point I want to be clear: in wars, and other sorts of troubles, we have historically relied on the Federal Reserve (or its predecessors) to print money. This seems clean, but it is a tax, plain and simple, that take the fruit of our labor and reassigns it to the Federal Government and their contractors, and to those who collect the interest. One obvious example is World War 1. We printed our way through that, with the result that the purchasing power of the dollar was cut in half. If you had $2,000 in savings in 1915, it was worth, effectively, $1,000 in 1920. Where did that value go? To the war. It was a tax.

In future such situations, if they occur, we simply need to tax our way through it. This makes it plain to everyone what the cost of the war is. <u>This will mean that the American people will need to be solidly behind the effort, or it won't happen.</u> This is more democratic than playing games with money only a few people understand. Obviously, the ability to play such games is one of the features that has made the Fed so attractive to the Federal Government all these years. It is not overstating the case to say that without central banks, here and abroad, neither of the World Wars could have happened. They could not have been funded.

5) Abolish the Federal Reserve System, root and branch, and abolish with it all our national debt. We should encourage everyone else to do likewise. The countries of Europe could use this method to solve their problems.

I will reiterate that I fully grasp how radical these ideas are. At the same time, *national bankruptcy, another Depression, and submergence in a dark age of Socialism are also quite radical*. There was a horrendous amount of suffering in the Great Depression. There is horrific suffering around the world, today, as a result of despotic economic policies. My intent here is to restore decency, fairness, and social justice to our economic system. Actually, "restore" is perhaps not the right word: our system has never been fully just, even in the periods when we didn't have a central bank, since it has always relied on fractional reserve banking.

This is a truly, genuinely brave new world I am proposing. Please consider it carefully.

<u>**Discussion Question**</u>

1. What do you think? Focus on one or all details and think them through in your own way.

Appendix

The Disaster of Keynesian Economics: a treatise

I

No single person deserves more blame for our modern financial condition—our lack of personal and national savings, and the extent of our indebtedness--than John Maynard Keynes; and no group more cause for our contempt than foolish economists like Paul Krugman and Robert Reich who continue to hawk his discredited ideas vigorously. Disproving Keynes theses is simple: it was done by Henry Hazlitt back in 1945, in his book "Economics in One Lesson. The primary task, therefore, that I have set myself here is showing not just that Keynes was wrong, but that his errors were intentional, and had as their aim the erosion of our political and economic liberty.

Let me begin with the same simple observation Hazlitt used: no policy can be considered sound which does not take into account all groups which are affected, and what the effect of that policy will be in the long term. Confronted with the long term consequence of debt his ideas fostered, Keynes countered with what many considered wit: "in the long run, we are all dead". Self evidently, our children and their children are not (he himself, by the way, had no children.) They inherit what we bequeath them, and it is precisely to try and build a better future for coming generations that this series has come into being.

In its vulgar (which is to say common sense and entirely accurate) rendering, Keynesism amounts to the contention that you can borrow your way into prosperity. When businesses aren't hiring, you give them money, and they hire. Those employees then spend money, which increases aggregate demand, which stimulates production, which causes economic growth.

Yet what the right hand giveth, the left hand taketh away. Whose money were you given? Your own, in the form of future taxation. Governments, per se, have no money. All they have is what is taken in actual taxes, and what they can print; and as we have seen, printing money amounts to a tax, since the real purchasing value of your money goes down. Thus, all you have done is make a loan to yourself, at interest, and generally with created money. This is the equivalent of drinking salt water to ease thirst. It always works in the short run, and always fails in the long run. Hence our national debt—our systemic thirst--at least in part.

The necessity of inflation in Keynesism is missed by many. In theory, loans made in bad times are repaid in good times, but Keynes was plenty shrewd enough to realize that the impulse of politicians to pander to the electorate would prove insurmountable, and on-going inflation to pay the debt unavoidable. This is, in fact, what has happened.

To be clear, X amount of money is spent to build, say, a dam. The government doesn't have that money in pocket, and can't exact it in current taxes, so—in the United States—it issues X amount of Treasury Bonds, which are then purchased by the Federal Reserve through fiat money. Since those dollars were in effect "printed", they are inflationary. Inflation, in turn, decreases the value of every other dollar in existence. Existing private wealth is reduced.

Thus, supposed "stimulus" spending is always going to cost more than is given. The obvious corollary of Hazlitt's observation is that you can always help a few people at the cost of the many, and can solve problems in the short term at the expense of the long term. When you build a dam, the people working on it benefit; everyone else loses, through the added taxes this imposes, which are not offset by the supposed economic utility of the dam. Further, even the workers on the dam lose in the long run, since when the work is complete, they will not have jobs, and whatever money they will have saved will have diminished in value.

Who wins? The government, which now has the power to again use inflation to create employment, but only for those who are in favor. (It takes me beyond my intent with this piece, but the principle role of the IMF—which Keynes helped found—appears to be taking this basic approach around the world, in support of what amount to fascist governments.)

What Keynesian apologists never talk about is that the goal was not economic equilibrium in a condition of freedom, but an economic equilibrium that was in effect under the complete control of the government:

> *The State will have to exercise a guiding influence on the propensity to consume, partly through its scheme of taxation, partly by fixing the rate of interest, and partly, perhaps, in other ways [such as?]. Furthermore, it seems unlikely that the influence of banking policy on the rate of interest will be sufficient by itself to determine an optimum rate of investment. I conceive, therefore, that a somewhat comprehensive socialization of investment will prove the only means of securing an approximation to full employment. . .It is not the ownership of the instruments of production which it is important for the State to assume. If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic rate of reward to those who own them, it will have accomplished all that is necessary. Moreover, the necessary measures of socialization can be introduced gradually and without a break in the general traditions of society. (General Theory, 378)*

What is he saying here? That if the State controls how companies get money, how much profit they make, and how much their employees earn, then it doesn't have to actually OWN them. Further, that his system enables a gradual transition in that direction, without setting off any alarm bells. This is socialism, plain and simple, of the Fabian variety.

To be clear, for a true Liberal, the role of government is to protect us from one another. For Keynes, it is to foster full employment at the expense of economic and—inevitably—political freedom. The two go hand in hand.

How is it that the Federal Government owns some 63,000 homes as a result of foreclosure? Simple, it held their mortgages. How is it, then, that the Federal governments holds some 80% of American mortgages? How did our government get in the banking business? As far as that goes, how is it that the Federal government will soon own all student loan debt (this was inserted into Obamacare, purportedly as a means of defraying cost increases)?

If you think about it, the role of Fannie Mae and Freddie Mac has been determining—to a great extent--home prices and mortgage interest rates. Since local banks sell almost all their loans to the Federal government (remember, both FM's are now back "in-house") the price is effectively dictated by what our government will pay. Absent FM and FM, the California/Vegas/Florida/etc. home inflation could not have happened. There would not have been enough cash to issue the loans.

I will deal with the role of these two in our 2008 banking crisis in another piece, but for now let me point out the congruence between what Fannie Mae and Freddie Mac did, and Keynes call in "The End of Laissez Faire" for "semi autonomous bodies within the State". The role of both was clearly to gain control of our housing market, which they have plainly done.

These are some preliminary observations. Let me now deal in a bit more depth with who Keynes was, what his ideas were, what they were supposed to do, and what they have in fact done.

II

The first thing I think most people should know, and which most don't know, is that Keynes was a seminal figure in the "Bloomsbury Group", which was an aggregation of what I would call social decadents, who spent a lot of time in various homosexual, extramarital and sexually experimental couplings, and all of whom—certainly Keynes—were to my knowledge atheists.

Keynes himself was an active homosexual for most of his life, and kept a record of his trysts. He at one point wrote to his lover Lytton Strachey that "bed and boy" could be had for cheap in Tunis. Given that it was at that time common practice for poor parents to prostitute their children, this would seem to indicate an actual familiarity on his part.

Strange love triangles were common. For instance, Keynes stole a younger man, Duncan Grant, from Strachey, who was apparently quite upset. For his part Strachey developed a very intimate relationship with cross dressing bisexual Dora Carrington, who, when he fell in love with a man named Ralph Partridge, married him. Partridge would come by on weekends with his own lover, a woman, who he would later marry. As Carrington put it, she had to manage "a great deal of a great many kinds of love"

She killed herself when Strachey died. Virginia Woolf, another core member of the Group, also committed suicide.

It was in that sort of atmosphere that Keynes spent his youth: uncommon enough now, completely unheard of 100 years ago. To hew to a stereotype, they all belonged in San Francisco, or somewhere along the California coast.

Keynes was also a life-long protégé of Fabian Socialist George Bernard Shaw, who was one of the first people Keynes wrote when he completed his "General Theory". They were quite close intellectually, sharing frequent letters to one another.

When he married—and his marriage indicates his homosexuality was volitional, and not genetic—he married a Russian women, with whom he was allowed to travel the Soviet Union freely, a privilege which he appears to have been unique in enjoying.

My intent is to deal with his ideas, but these few details about his life appeared sufficiently relevant to an analysis that I have included them. Provided it is between consenting adults, I could care less what happens behind closed doors. The point is that Keynes was a lifelong intimate of social and political radicals. Is radical bad? If the goal is the maintenance of social and political order, yes. The argument I will be making is that his goal was the subversion of our economic, moral, political and social lives, and that it was a natural outflow of his social milieu seems self evident to me.

III

Keynes thought does not appear to have evolved much, but his outward rhetoric did. In my view, what is plainly perceptible is a progression from a goal—the bankruptcy of the Capitalist class—to a means which sounded plausible enough to get repeated. For that reason, I would like to take a close look at some of his earlier work, quote some of it at length, and then compare it with the conclusions he drew in his most influential work "The General Theory of Employment, Interest, and Money", upon which Keynesian economists base their prescriptions. I will do this in sections, to facilitate the intellectual digestion of what at times are subtle ideas.

The book which made him famous was "The Economic Consequences of the Peace", published in 1920. He attended the Paris peace talks, which led to the Treaty of Versailles, ending World War One. He was immensely frustrated—apparently sincerely—at the unwillingness of the allies to recognize that the "peace" they had negotiated was going to lead to economic and hence political instability. Most importantly, the indemnities which France insisted on inflicting on Germany were simply grossly excessive relative to Germany's ability to pay, a fact which he underscores in some detail. Most of the Continental combatants had already paid much of their way with inflation, and he could well see that more would be needed. He could also see that inflation was damaging in many ways:

Lenin is said to have declared that the best way to destroy the Capitalist System was to debauch the currency. By a continuing process of inflation, government 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. – As the inflation proceeds and the real value of the currency fluctuates wildly from month to month, all permanent relations between debtors and creditors, which form the ultimate foundation of capitalism, become so utterly disordered as to be almost meaningless; and the process of wealth-getting degenerates into a gamble and a lottery.

"Lenin was certainly right. 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.

In the latter stage of the war all the belligerents practiced, from necessity or incompetence, what a Bolshevist might have done from design. (Great Minds 247)

What is he saying here? Four things: first, that printing money creates economic dislocation. The money of the rich becomes worthless. Investing becomes extremely risky, because the future can't be predicted. If the essence of trade is buying low and selling high, it has become impossible to gauge the present value of goods, or their likely future value. In response the only safe thing to do is buy some property or gold, and hold on.

Second, he is saying that some people win. Who wins? The people who create the money—here the governments—those who own things that rise in value, and those to whom "undiluted" money is given. As Keynes puts it: "If prices are continually rising, every trader who has purchased for stock or owns property and plant inevitably makes profits."

Consider in this regard William Shirer's commentary on the Weimar hyperinflation, from <u>The Rise and Fall of the Third Reich</u>:

. . .goaded by the big industrialists and landlords, who stood to gain from the masses of people who were financially ruined, the government deliberately let the mark tumble [i.e. kept the printing presses running day and night, and used that money to pay its bills] in order to free the state of its public debts, to escape from paying reparations, and to sabotage the French in the Ruhr. Moreover the destruction of the currency

enabled German heavy industry to wipe out its indebtedness by refunding its obligations in worthless marks. The General Staff. . .took notice that the fall of the mark wiped out the war debts and thus left Germany financially unencumbered for a new war.

The masses of people, however, did not notice how much the industrial tycoons, the Army and the State were benefitting from the ruin of the currency." (Rise 96)

Third, inflation is a means of undermining Capitalism as a system. It is an instrument of Bolshevism.

Fourth, very, very few people understand it.

Later, he summarizes it in an interesting way:

Thus the menace of inflationism described above is not merely a product of the war, of which peace begins the cure. It is a continuing phenomena of which the end is not yet in sight.

*All these influences combine not merely to prevent Europe from supplying immediately a sufficient stream of exports to pay for the goods she needs to import, but they impair her credit for securing the working capital required to re-start the circle of exchange and also, **<u>by swinging the forces of economic law yet further from equilibrium rather than towards it, they favor a continuance of the present conditions instead of a recovery from them</u>**.*

Inflation and equilibrium are incompatible. Let us call this Data Point One.

IV

Data Point Two is his expressed foundational understanding of the Capitalist system. I will quote him at length, interspersed with my commentary, again from <u>Economic Consequences of the Peace</u>:

Europe was so organized socially and economically as to secure maximum accumulation of capital. While there was some [much, if he is honest] continuous improvement in the daily conditions of life in the mass of the population, Society was so framed as to throw a great part of the increased income into the control of the class least likely to consume it. The new rich of the nineteenth century were not brought up to large expenditures, and preferred the power which investment gave them to the pleasures of immediate consumption. In fact, it was precisely the inequality of the distribution of wealth which made possible those vast accumulations of fixed wealth and of capital improvement. . . Herein lay, in fact, the main justification of the Capitalist System. .If the rich had spent their new wealth on their own enjoyments, the world would long ago have found such a regime intolerable. (Great Minds 67)

What is he saying? First, that he analyzes the world in terms of class. Second, that the Capitalist System (his capitalization of the words) is unjust, and would be overthrown if seen in its true light.

He goes on:

> *. . .this remarkable system depended for its growth on a double bluff or deception. On the one hand the laboring classes accepted from ignorance or powerlessness, or were compelled, persuaded, or cajoled by custom, convention, authority and the well-established order of Society into accepting, a situation in which they could call their own very little of the cake, that they and Nature and the capitalists were co-operating to produce. And on the other hand the capitalist classes were allowed to call the best part of the cake theirs and were theoretically free to consume it, on the tacit underlying condition that they consumed very little of it in practice. The duty of "saving" [his quotation marks, as if savings were somehow unreal] became nine-tenths of virtue and the growth of the cake the object of true religion. There grew round the non-consumption of the cake all those instincts of Puritanism which in other ages has withdrawn itself from the world and has neglected the arts of production as well as those of enjoyment. . .*
>
> *Saving was for old age or your children; but this was only in theory—the virtue of the cake was that it was never to be consumed, neither by you nor by your children after you. (Great Minds 67)*

This is really quite an extraordinary and counter-factual claim, that warrants some common sense analysis. As I have argued throughout this series, Capitalism is a system in which money is saved, expressed creatively, and which in turn yields more money. You gather together a seed, plant it, then harvest the result, which is larger than the seed.

Prior to World War One, standards of living were rising for ALL classes throughout Europe. This was made possible by increases in efficiency. For example, the railway system made all sorts of goods cheaper. It also created markets for goods, since foodstuffs, and the products of industry could be sold less expensively over a broader area, which in turn fostered employment and wealth. The seed was investment in transportation technology and the fruit was greater prosperity.

As I have often been at pains to point out, Marx's ideas of class warfare—which Keynes is expressing here more or less openly—were falsified by the emergence of the middle class. Where he posited that the rich would get richer on the backs of the poor--who would get poorer--what actually happened is that all boats rose in a swell of general prosperity.

As Keynes himself notes: ". . . escape was possible, for any man of capacity or character at all exceeding the average, into middle and upper classes, for whom life offered, at a low cost and with the least trouble, conveniences, comforts and amenities beyond the compass of the richest and most powerful monarchs of other ages." (Great Minds 61)

I am getting slightly ahead of myself, but Keynes also quotes Bastiat in his later address which was published as "The End of Laissez Faire": "I believe that the invincible social tendency is a constant approximation of men towards a common moral, intellectual, and physical level, with, at the same time, a progressive and indefinite elevation of that level. I believe that all that is necessary to the gradual and peaceful development of humanity is that its tendencies should not be disturbed, nor have the liberty of their movements destroyed."

Keynes sets that up, so that he can deliver the devastating Argument from Authority that "From the time of John Stuart Mill, economists of authority have been in strong reaction against all such ideas." That's it. That's his only rebuttal, to an argument he has already admitted had merit, in that those who wanted to could rise socially and economically as high as their talents and dispositions inclined them.

Thus we have to reconcile the tension between Keynes class warfare rhetoric, patently false claim that savings and spending are incompatible, and his own admission that self elevation was possible within the Capitalist System, even as he described it.

That reconciliation cannot happen within the economic sphere. It must happen within the moral sphere. To that I will turn in a separate exposition on "Socialism as a Moral Claim", but want for now to take one more nugget from Economic Consequences of the Peace.

V

> *The war has disclosed the possibility of consumption to all and the vanity of abstinence to many. Thus the bluff is discovered; the laboring classes may no longer be willing to forego so largely, and the capitalist classes, no longer confident of the future, may seek to enjoy more fully their liberties of consumption so long as they last, and thus precipitate the hour of their* ***confiscation*** *[emphasis mine](Great Minds 69)*

Building on an earlier theme:

> *Where we spent millions before the war, we have now learnt that we can spend hundreds of millions and apparently not suffer for it. Evidently we did not exploit to the utmost the possibilities of our economic life. We look, therefore, not only to a return to the comforts of 1914, but to an immense broadening and intensification of them. (Great Minds 54)*

This is the essence of the modern European Welfare State. What is he really saying here? That governments can print money to create the illusion of prosperity. How was the war financed? In large measure, through inflation.

When Winston Churchill, as Chancellor of the Exchequer (effectively, Secretary of the Treasury) put England back on the gold standard in 1924, the subsequent economic downturn showed very effectively that much of England's supposed prosperity depended on an inflated currency.

As Churchill put it: "I will tell you what it [the return to the Gold Standard] will shackle us to. It will shackle us to reality."

Data Point One, then is an understanding that inflation is a means of wealth transfer.

Data Point Two is a distaste for the system of Capitalism.

Data Point Three is an understanding that apparent wealth can nonetheless be generated through inflation.

Logically, then, inflation can be used to take wealth from Capitalists, and give it to others.

VI

"The End of Laissez Faire" was a lecture given twice, once at Oxford, and once to the University of Berlin. In it, Keynes seeks to explain "why State action to regulate the value of money, or the course of investment, or the population, provoke such passionate suspicions in many upright breasts."

He never really explains why such State action should not arouse suspicion. After all, this speech was delivered while both Fascism and Bolshevik Communism were in ascendency.

His method of argument is quite interesting. He offers up some admirable quotes from common sense political economists and theorists, only in effect to say "but we all know that isn't true."

For example, consider this one, from Archbishop Whately: "True liberty is 'that every man should be left free to dispose of his own property, his own time, and strength, and skill, in whatever way he himself may think fit, provided he does no wrong to his neighbors. . .".

Response? "In short, the dogma had got hold of the educational machine; it had become a copybook maxim". And why should it not have? He doesn't say. He calls doctrines of equality before the law and individualism "exploded sophistries", "preposterous", and those who hold them "degenerate".

The closest he gets to refuting common sense economics is in what we might term "the parable of the giraffes". The essence of the argument is that giraffes with longer necks shut out those with shorter necks. The rich get richer, and the poor get poorer.

Ironically, he repeatedly accuses orthodox political economists of ignoring facts, yet the only "data" he offers to support his own contentions is an analogy, that of the hypothetical short, starving giraffes. To this, must be opposed the manifest material progress of all of Western Europe and the Americas, under Capitalism. As is usual with leftists, he inverts the truth, while pretending to be the honest one.

Having pretended to refute orthodox economics, however, he later feels free to pursue his actual agenda: "Perhaps the chief task of Economists at this hour is to distinguish afresh the *Agenda* of Government from the *Non-Agenda*; and the companion task of Politics is to devise forms of Government within a Democracy which shall be capable of accomplishing the *Agenda* [italics his] (Great Minds 37)

By *Agenda*, what does he have in mind?

First, the establishment of the already referenced "semi autonomous bodies with the State". He offers as examples "universities, the Bank of England, the Port of London Authority, even perhaps the Railway Companies." Phrased another way, institutions with power, but no democratic governance. Fannie Mae and Freddie Mac would absolutely fit this mold; or at least they did until they went broke and ceased being Government Sponsored Entities. The Federal Reserve would definitely qualify (if he could get his people in), as would the IMF and World Bank.

He goes on to say: "One of the most interesting and unnoticed developments of recent decades has been the tendency of big enterprise to socialize itself." Gradually, in other words, the profit motive gives way to public-spiritedness, and what was a Capitalist institution is now socialized. This would of course be greatly facilitated by making the sure "right" people get placed in the key positions, which is something that could be done over time without excessive difficulty.

He has no objections to State Socialism, per se, either:

> *I criticize doctrinaire State Socialism, not because it seeks to engage men's altruistic impulses in the service of Society, or because it departs from laissez-faire, or because it takes away from man's natural liberty to make a million, or because it has courage for bold experiments [e.g. Bolshevism].* ***All these things I applaud*** *[emphasis mine]. I criticize it because . . .[it] is in some respects a clearer, in some respects a more muddled version of just the same philosophy as underlies nineteenth century individualism. [Bentham and the doctrine of free competition] equally laid all their stress on freedom, the one negatively to avoid limitations on existing freedom, the other positively to destroy natural or acquired monopolies. They are different reactions to the same intellectual atmosphere [of individualism, which I reject] (Great Ideas 39)*

Phrased another way, his primary objection to State Socialism is, apparently, that it goes too far in protecting individual liberties. Small wonder that Benito Mussollini, in reading this piece, commented:

> *All this is pure fascist premises and I cordially recommend Mr. Keynes to proceed to Italy and there to study Fascism with an open mind and with the same scrupulous care as he has studied Bolshevism. An essay from his pen on Fascism would doubtless prove a most valuable piece on constructive criticism.* [11]

Secondly, he wants to separate "those services which are *technically social* from those which are *technically individual*." [italics his] (Great Ideas 40).

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[11] James Strachey Barnes, *Universal Aspects of Fascism,* Williams and Norgate, London, 1929, pp. 115

> For instance: *". . .deliberate control of the currency and of credit by a central institution [and in] the collection and dissemination on a great scale of data relating to the business situation, including the full publicity, by law if necessary, of all business facts which it is useful to know. . .I [also] believe some coordinate act of intelligent judgment is required as to the scale on which it is desirable that the community as a whole should save, the scale on which these savings should go abroad in the form of foreign investments, and whether the present organization of the investment market distributes savings [income] along the most nationally productive channels. I do not think that these matters should be left entirely to the chances of private judgment and private profit, as they are at present. (Great Minds 41)*

In other words, he wants a very large State to be able to tell people what they can and can't do with their money.

Finally, he wants to be able to tell people if they can reproduce, and he implicitly invokes eugenics:

> *The time has already come when each country needs a considered national policy about what size of Population . . .is most expedient. And having settled this policy, we must take steps to carry it into operation. The time may arrive a little later when the community as a whole must pay attention to the* ***innate quality*** *[emphasis mine] as well as to the mere numbers of its future members. (Great Minds 42)*

Consider in that regard what his mentor George Bernard Shaw had to say about the future of people who in his view lacked quality:

> *We should find ourselves committed to killing a great many people whom we now leave living... A part of eugenic politics would finally land us in an extensive use of the lethal chamber. A great many people would have to be put out of existence simply because it wastes other people's time to look after them*[12.]

Have you begun to see a pattern, possibly, of something other than a sincere desire to "save Capitalism"?

VII

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[12] *The Daily Express* (London), March 4, 1910, quoted in Dan Stone, *Breeding Superman: Nietzsche, Race and Eugenics in Edwardian and Interwar Britain* (Liverpool University Press, 2002

Finally, let's turn to the General Theory. The task Keynes sets himself is solving the problem of unemployment, which he views as fundamental. "Why?", one may reasonably ask. If unemployment is not excessive, and if some sort of social relief is in place, why would that be the primary task? Why not continue the generalized economic amelioration which patently began with the Industrial Revolution, and has continued apace since then?

The simple answer is that it offers him the space he needs to make an argument in favor of putting the government in charge of the economy.

Here is what he has to say:

> *The authoritarian state systems of to-day seem to solve the problem of unemployment [note, they didn't and they don't; most Cubans spend all day on their doorstep staring at the ground] at the expense of efficiency and freedom. It is certain that the world will not much longer tolerate the unemployment [emphasis mine] which, apart from brief intervals of excitement, is associated—and, in my opinion, inevitably associated—with present day capitalistic individualism. But it* ***may*** *[or may not; emphasis mine] be possible, by a right analysis of the problem to cure the disease whilst preserving efficiency and freedom.*

Please consider carefully what he is saying, and when he said it. This book came out in 1936. When he wrote it he knew there was high unemployment in the United States and elsewhere. He knew that Communist agitators were trying—both openly and secretly--to foment revolution. Some of them were his friends, such as Harry Dexter White.

What he is saying is that it MIGHT not be necessary to have a revolution, but something has to give. Capitalism inevitably leads to structural unemployment. He is positioning himself as a moderate, but as we have already seen, he was nothing of the sort. He wanted government control of all important aspects of the economy, and said so explicitly in The General Theory.

Now I should devote a short moment to the content of his argument. What is the basic thesis he offers us? Simple: spending equals savings.

> *. . . up to the point where full employment prevails, the growth of capital [savings] depends not at all on a low propensity to consume [savings] but is, on the contrary, held back by it; and only in conditions of full employment is a low propensity to consume [savings] conducive to the growth of capital [savings]l. (General Theory 372)*

Phrased another way, the more you spend the more you save, and the more you save, the more you can spend. Is that nonsense? Of course.

But it is hidden in verbiage like this: ". . .the volume of employment in equilibrium depends on (1) the aggregate supply function, ϕ··(ii) the propensity to consume, X, and (iii) the volume of investment, D2. This is the essence of the General Theory of Employment." (General Theory 29).

As I view it, the book has three parts: the introduction, where he discusses Classical Economics, briefly; then you get strapped onto a roller coaster, where he invents words, uses intentionally opaque prose, and generally tries to confuse you; and finally, the end, where he reveals his actual objectives.

When you watch a magic act, the entirety of the effect depends on misdirection of attention. In my view, the entirety of the General Theory can be ignored, in favor of looking at the concrete outcomes he openly stated he hoped to achieve, which are perfectly congruent with the entirety of his previous output.

What he is in fact building is a theoretical template for a Command Economy in everything but name. He wants government to have the job of equalizing output and demand, in conditions in which only the government has capital for investing. He wants all three variables under State control, as he already more or less said in "End of Laissez Faire".

He talks specifically about the destruction of Capital:

> *I feel sure that the demand for capital is strictly limited in the sense that it would not be difficult to increase the stock of capital [i.e. use a central bank to induce inflation] up to a point where its marginal efficiency had fallen to a very low figure. . .*
>
> *Now, though this state of affairs would be quite compatible with some measure of individualism [a very, very small measure], yet it would mean the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital. . .*
>
> *. . .it will still be possible for communal saving through the agency of the State to maintained at a level which will allow the growth of capital up to the point where it ceases to be scarce.*
>
> *I see, therefore, the rentier aspect of capitalism [i.e. the ability of individuals and banks to charge interest on loans, and more generally of anyone to invest in things that they own] as a transitional phase which will disappear when it has done its work. And with the disappearance of its rentier aspect much else in it besides will suffer a sea-change [for example, the State now controls the economy in every aspect that interests it]. It will be, moreover, a great advantage of the order of events which I am advocating, that the euthanasia of the rentier [note that he is presumably speaking metaphorically, but given his association with Shaw that is not a given], of the functionless investor, will be nothing sudden, merely a gradual but prolonged continuance of what we have seen recently in Great Britain, and* ***it will need no revolution*** *[emphasis mine**]**. (Great Minds 376)*

He goes on to stipulate that the aim is "depriving capital of its scarcity value within one or two generations."

If money is not scarce, what does that mean? It means all the means of production are in effect managed by a centralized authority, along with means of employment. Scarcity of capital means some people are rich. Non-scarcity of capital means there are no rich people, and that the State has control of all the money, and can create it at will.

As he comments—redundantly, given the foregoing: "The central controls necessary to ensure full employment will, of course, involve a large extension of the traditional functions of government."

He does make some noise here and there to the effect that every last detail need not be controlled, and there is room in his heart for some individualism but of course anyone who causes trouble in the world he is envisioning could be dealt with easily enough, one way or another.

VIII

Keynes was not coy, for those with eyes to see. What we must assume when we see modern economists touting his ideas is that they support his ends, which amount to the collapse of economic—and hence political—freedom. Without the right to private property, political liberty is impossible. Without the right to property, you are not free in your home; you have no right to the results of your labor; you cannot enforce contracts; you cannot safely initiate business of any kind; and your ideas belong to the State.

If true Capitalism is a system for converting ideas into wealth, and wealth into leisure—as I would argue happens inevitably in conditions of monetary stasis--then Keynesian economics is a system for converting ideas into political power and political power into (relative) money.

Concretely, though, how would this work? How do you take the basic idea of using inflationary deficit spending to stimulate "demand", and "euthanize" capital? How far along are the Keynesians in this country?

First off, it must be said that Keynes was working to implement Socialism, and socialism doesn't work. His claim was that his system would enable full employment. It didn't and it hasn't. I will deal with the Great Depression in the following piece, but the simple reality is that his polices, once adopted, did not reduce unemployment, for the same reason salt water doesn't reduce thirst: in solving one problem, it creates another.

Generally speaking, most Socialist revolutionaries take as their goal inducing national bankruptcy, then taking advantage of the confusion to seize power. That they would want to induce misery in order to solve problems of misery is of course a species of insanity that is best explained psychologically and morally, as I will do later in this series.

In America particularly they have found it hard to counter our national tendencies towards innovation, our capacity for hard work, and our skepticism with respect to socialism. Absent Keynes "General Theory", in fact, they would have little progress at all. Make no mistake, though: they have made substantial inroads, and effectively taken over our universities. We are $13 trillion in debt, and that number is growing. This is the sort of outcome Keynes wanted, although he would find much fault with the present positioning of those advocating socialism; other than, of course, our election of a socialist to our Presidency, and the pathway that has been laid, for now, towards socializing our healthcare system and health insurance companies.

We forget, though, that socialism has been much more advanced in other nations for many decades. Most countries have had politically relevant Communist Parties. Here, the lunatics have been forced into the use of subterfuge, with the result that they can't openly espouse their positions, and expect any significant amount of support from any but a radical and politically irrelevant fringe. This makes them easy prey, since all anyone has to do is tell the truth about who they are, and what they really want. Self evidently, my intent here is to roll Keynes back into the closet, and give people ample reason to reject his ideas in total.

You can't spend your way into prosperity. All people with a shred of common sense have always known that. Now you know why an intelligent man would nonetheless propose it, and why Harvard and MIT educated economists would support that proposal: they are closet socialists. I have quoted you enough of his texts that you should be able to see that no person of even average intelligence could fail to see what Keynes real goals were. He stated them: euthanization of the Capitalists through State control of investment, savings, and production.

With respect to the United States, one key element he wanted and could not get was control of our central bank, the Federal Reserve. He and Soviet agent, Asst. Secretary of the Treasury Harry Dexter White tried in the 1930's to get the Fed brought under direct Federal control, and failed.

I favor ending the Fed, for reasons I have articulated, but it is very much the case that we cannot assume confluence of interest between the Fed and the Keynesian socialists, as some conspiracy theorists are inclined to do. On the contrary, the Fed clearly favors the interests of the "rentier" class, much of whose money the Fed has created. They themselves may well want to rule the world—everybody wants to rule the world, don't they?--but they no doubt make no pretense privately about wanting to help anyone but themselves.

The "Stimulus" was clearly Keynesian, and socialists like Paul Krugman keep calling for more spending, but their calls are falling on increasingly deaf ears. It is simply impossible to maintain fictions forever. The maintenance of patent nonsense like Keynesian economics has always depended on controlling the media and message, and they have lost that control.

In my view, therefore, the purest expressions of actual Keynesian economics at work is the activity of the IMF/World Bank. Perhaps some of you don't know this, but Keynes and Harry Dexter White (who, again, was clearly a Soviet agent, but who unlike Alger Hiss died before he could be brought to trial) created both the IMF and World Bank. What these institutions do is fund public works projects throughout the developing world, via the agency of the local government. Local strongmen get the money, flip it to their backers, they build something, then the money runs out. What happens then, consistently, is that the government can no longer pay the loans back. The IMF then tells them in effect to use inflation to pay their debt, then loans them more money, starting the cycle anew. This process has enabled the World Bank to insert itself into very intimate details of national economies. It has fostered dictatorship, rewarded elites, and impoverished many. Zimbabwe would be one good example of many. Of course, at some point most countries tire of drinking salt water, but IMF remains a potent force on the international scene. Like the Fed, it needs to be ended.

As was clearly seen in the Weimar Republic, inflation—far from taking wealth from elites—actually strengthens them. Keynes ideas—like those of all socialists—have accomplished much evil, despite their pretense of being well intentioned.

Socialism—in its truest form of being government ownership (or control) of the means of production--is intrinsically Fascist, in a formal sense, as ratified by the founder of Fascism himself, Mussollini.

IX

In the end, we have to see Keynes as what he was: an academic, well divorced from reality, unused to actually solving real problems, and whose ideas—ambitious as they may have been—have succeeded in causing a lot of problems—mostly for the working poor—and helped no one.

The debt we have accrued following his ideas is still quite dangerous. Social Security (nationalized savings, correct?) is not solvent. Medicare (nationalized medical care, in part, correct?) is not solvent. Medicaid (redistribution of wealth via healthcare access, correct?) is not solvent in most States. We can't afford to keep doing what we are doing.

At the same time, we are still in better position than the Europeans, the Japanese, the Chinese, and the rest of the world.   That's not a lot, but it's something.

Keynes talked about economic equilibrium. This is a topic worth the discussion. As I view it, we can achieve economic equilibrium and full employment via continuously increasing the value of labor. As Bastiat said, this is the natural outcome of letting things take their course. Specifically, we have to stop monkeying with our money. My proposal for this is entitled "How to fix our financial system". We can undo all the evil Keynes sponsored, and then continue, into a much better world.

For my part, I am willing to use the word "Liberal"—in the sense in which Bastiat and Adam Smith were Liberals—even for government programs which provide a basic social safety net, where some of my conservative friends might object. Certainly, if we fix our financial system, I think poverty will disappear. Further, private charity is and always has been until recently the first and primary source of communal succor. But where gaps appear I don't object in principle to social spending of a limited sort. What I object to is the use of social spending to foster the erosion of our Constitutional form of government, which is what socialists are invariably after.

Ironically, the course Keynes prescribed for full employment has only achieved systemic unemployment, wider poverty, and the loss—really, redistribution—of wealth we should have been able to keep. In general, that redistribution has been from the "have not's" to the "haves". When gangsters rule, the best gangsters get the loot.

I see cause for fear, but also pathways forward. What we need more than anything is clarity of thought, and an ironclad resolution to correct the errors into which he led us, all those many years ago.

X

Some of you may want to read "Keynes at Harvard", link here:
http://www.keynesatharvard.org/index.html

In general, I agree with his conclusions, but I found his lack of an overarching narrative reference to Keynes actual ideas unhelpful. I have of course tried to rectify that problem here.

Still, many of the quotes he offers up give the thoughtful reader—I would almost say "with a pulse, and a shred of genuine patriotism and Liberal spirit"--ample cause for anxiety, especially as regards the patent political subversiveness which has characterized our universities for at least two generations now; and in some cases—for example Harvard—for the better part of a hundred years. He traces the people, the ideas, and documentary record.

For example the author of the book "A New Deal", Stuart Chase, had this to say:

> *Best of all, the new regime would have the clearest idea of what an economic system was for. The sixteen methods of becoming wealthy would be proscribed—by firing squad if necessary—ceasing to plague and disrupt the orderly process of production and distribution. Money would no longer be an end, but would be thrust back where it belongs as a labor-saving means. The whole vicious pecuniary complex would collapse as it has in Russia. Money making as a career would no more occur to a respectable young man than burglary, forgery or embezzlement. "Everyone," says Keynes, "will work for the community and, if he does his duty, the community will uphold him." Money making and money accumulating cannot enter into the life calculations of a rational man in Russia. A society of which this is even partially true is a tremendous innovation.*

Lest the significance of this be underappreciated, the entire concept of the New Deal originated with that book, and he is here in effect offering up Communist Russia as an ideal. The Republicans who--then and now--called FDR's program socialist were quite technically and ideologically accurate. Chase himself had a very successful career in the Roosevelt Administration, and eventually became the head of UNESCO after the formation (under the direction of Soviet agent Alger Hiss) of the UN.

It might be worth noting, too, that the idea of the League of Nations, of which the UN was the heir, was that of Bloombury Group member Leonard Woolf, husband of Virginia.

With regards to the section on moral depravity, I looked up his references, and was unable to verify many of them. The "bed and boy" quote clearly was in a letter; but as to the more sensational claims, such as frequent sex trips around the Mediterranean, I was unable to find any supporting material in the Strachey biography, which I did not read in full, but canvassed fairly extensively. I suspect that in the course of his investigation he got so angry that he substituted what he felt strongly to have been the case (and which of course may well have BEEN the case) for what he could actually prove from the extant record.

XI

I will conclude by asking the reader who agrees with my conclusions, and sees the persisting dangers of these ideas to share this link—and my series on our financial system more generally, especially my proposed solution—with as many people as he or she thinks might have an interest.

Keynes well understood the power of ideas:

. . .the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. . .I am sure the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so that the ideas which civil servants and politicians, and even agitators apply to current events are not likely to be the newest. But, soon or late, it is ideas, not vested interests, which are dangerous for good or evil.

Thus ended the most influential work of political philosophy published in the 20th Century, under whose thrall a generation of economists and politicians grew into maturity.

If you ponder his words, though, you should see ample cause for hope as well.

Books referenced

Hazlitt, Henry. Economics in One Lesson. New York: Three Rivers Press, 1946

Keynes, John Maynard. The End of Laissez Faire/The Economic Consequences of the Peace. Amherst: Prometheus Books, 2004. (Note: within the text I have called this "Great Minds" for simplicity. Self evidently, I see some irony there, but that was the title of the series, and the pagination conflated both texts, so I thought this approach simplest.)

Keynes, John Maynard. The General Theory of Employment, Interest, and Money. New York and London: Harvest/HBJ, 1964.