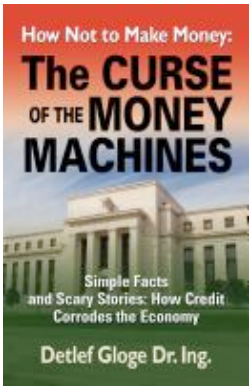
How Not to Make Money:

The CURSE OF THE MONEY MACHINES

Simple Facts and Scary Stories: How Credit Corrodes the Economy

Detlef Gloge Dr. Ing.



"We issue our money in proportion to the demands of trade and industry," Benjamin Franklin told the British. This book tells stories about wise and unwise money management, how people stumble through credit booms, and fail to foresee the inevitable bust. Read about bank credit's lure and torment and about possible controls. No math, no jargon! High school students will enjoy the book as class text, and hopefully grow up insisting on checks and balances.

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The Curse of the Money Machines

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Introduction

If you are looking for instant investment advice, this book is not for you. There is no fast way of beating the system. If you look for confirmation that the system is rigged, a casino, or a conspiracy, this book will disappoint you, too. That does not mean we don't need change; we do, but not by throwing everybody in jail. This book goes behind the sound bites, behind what the media say, and behind what we thought we knew was going on. You will be surprised how simple the truth is.

But once you understand it, you become aware of the broader connections—why people chase the "big bucks," claiming their trading improves prosperity. You become aware of future consequences of today's policies. Does "liquidity" really create wealth, now or in the future? The experts tell us they must boost our "animal spirits" in order for things to pick up again. "Animal spirits?" Is that what they think of our mental capacity?

Economics is not rocket science. High school students understand it, if it is explained in plain English, based on reason and simple examples without myths, math, or jargon. It is important, too, that it be taught to high school students, so they grow up economically and financially literate. Intended as an aid for teachers, this book presents the facts, clear and concise, but also stories and examples taken from a thousand years of human history.

The facts, unfortunately, also provide convincing evidence that this is a time for change again, as there always have been times like these through American history. Therefore, this book is also meant for those, who feel responsible for their own and our country's affairs and intend to take part in the making and shaping of informed decisions, if only in the voting booth.

Lastly, young people might want to read it, who think of studying economics with a critical mind and seek to judge its relevance to recent events.

To make the book easy reading, I abstain from filling these pages with references and footnotes. The bibliography lists papers freely

available on the Internet. They elaborate on all topics, and mention the most respected thinkers in the field. I cannot claim credit for the insights presented in this book, but I take responsibility for errors. I owe an enormous debt to the pioneers of economic thought, past and present, and those who make their thinking freely available in the blogosphere.

For better focus, this book is limited to economics as separate from social or political science. Although the book does not describe modern finance in detail, it treats money and credit as critical and central to economic matters.

In fact, treating credit as ancillary is one of the major shortcomings of prevailing economic teaching. Another weakness is economists' quest for a mathematically convenient, unified economic theory that has led them to model a world inhabited by identical homunculi endowed with infinite clairvoyance through space and time. Called "agents" in economic theory, they compete with each other rationally and fairly, and their actions always and instantaneously achieve the best possible outcome.

The third deficiency is the assumption of "equilibrium" or balance in economic conditions and markets, which almost never exists. It ignores transients, which can take decades to play out and which escalate the risk of crises and crashes. No wonder that this theory sometimes fails spectacularly in predicting the affairs of confused and indecisive mortals, who pursue their own interests in unexpected ways.

But one need not adhere to textbook approaches when all one is interested in is a bird's eye view of the collective economic activity. The book builds on three concepts: Irving Fisher's debt deflation theory, Hyman Minski's instability concept, Charles Kindleberger's description of manias, panics, and crashes, and Wynne Godley's fund flows approach. It also relies on analyses by Steve Keen, Michael Pettis, and researchers at the Bank for International Settlements: Stephen Cecchetti and Claudio Borio.

Depending on the economic scenario to be described, we use three approaches: First, the flow concept of money allows the application of simple accounting rules. It describes only a small part

of a complicated economy, but it provides a backbone of reasonable predictability. The flows are linked, secondly, to the churn of economic activity. This churn is subject to human behavior and necessarily less accurate. Historic data and other empirical evidence must help in its evaluation.

The third, least predictable, but most fascinating scenario, is the "run." Runs range from simple bank runs to the run on a nation's money, which manifests itself in hyperinflation. During a run, contrary to normal economic activity, people's individual interests diverge from the common interest. People's anxieties determine when it occurs and make its timing unpredictable. Runs can accelerate to the point of panic.

Finally, it is necessary to caution the reader about some traps in economic thinking. The human mind is not a computer. Our thinking processes are influenced by our subconscious in ways we are unable to control. Our upbringing, ideologies, and views of the world affect the end result of our thinking even when we are convinced of our logic and rigorous thought. This is especially so when cause and effect are hard to discern and when we deal with a multitude of interactions and links, which are statistical in nature. As a result, economic science has spawned many schools of thought with opposing views.

I have nevertheless dared to tiptoe through this minefield. To keep the book short, I had to pick and choose. This gave me the prerogative to put forth my own biases, however subconsciously. If you resent or even detest my biases, please consider the well-known reaction called "confirmation bias" that amounts to a subconscious predilection for like-minded thought. It is up to you, dear reader, to stop here or keep reading.

2 - Banks: When Banks Lend, They Create Money

William Shakespeare: “All that glisters is not gold.”

The Story of the Venetian Banker

The year was 1086. St. Mark’s Square in Venice was bustling with merchants directing their shipments to the new Venetian trading posts in the Eastern Mediterranean. Tubal, the banker, leaned against a lamppost near his lectern. He noticed some of his clients in the distance and clerks rushing back and force carrying pieces of paper. One of them handed him a note. Tubal glanced at it. “Leave it on the *banco*,” he told the clerk pointing to his lectern.

Balthazar, his assistant, was ogling a pretty *signorina* passing by. Tubal said, “Balt, go and enter the note.” He pointed toward the lectern. Balt took the paper, which said “Salerino owes Antonio five hundred soldi.” He opened the book resting on top of the lectern. The right side, titled “deposits,” listed all the client accounts. Balt found Salerino’s and Antonio’s accounts. Salerino’s entry showed zero. “Eh, Signore Tubal, Salerino is broke and wants five hundred!”

Tubal frowned. A loan of five hundred soldi would earn him fifty soldi of interest a year, but it was a lot of money. On the other hand, Salerino had always paid when his loans came due. “*Va bene*,” Tubal said. “Enter five hundred on the left.” Balt entered a loan of five hundred soldi for Salerino on the left side titled “loans.” He added five hundred soldi to Antonio’s deposits on the right. He knew the left and the right had to balance, and they did.

But these entries always puzzled Balt. “From where did you just get the five hundred to lend to Salerino?” he asked Tubal.

“Never mind,” Tubal shrugged. For Balthazar, a gold soldo was a lot of money. He had never seen one at home let alone found one someplace.

"*Santa Maria*," Balt thought. "Where does Tubal find so much gold?"

But Tubal regretted his remark. Balt would never learn to run the bank in his absence if he did not tell him how it worked. "See, Balt," he said. "I make the five hundred up."

"Up out of what?" asked Balt.

"Out of thin air." said Tubal. "It's not gold, just a book entry.

Just then, Signore Antonio came by and asked Tubal for five soldi out of his account. Tubal handed him five gold soldi and Antonio left.

"Eh, Signore Tubal," Balt said while subtracting five soldi from Antonio's account. "You just said it's a book entry, now it's gold."

"Well, you are right," Tubal grinned. "It's gold as well as a book entry. It works because they are all my clients. The money just moves from account to account in my book. Sometimes, they need a few soldi. So I have some on hand. But they use them to pay in the stores around the *piazza*, and those stores are my clients, too. The stores redeposit these soldi with me at the end of the day."

Balt was slightly dazed. What a racket, he thought. But he was not easily flummoxed. "Tell me, Tubal," he said. "You just made up five hundred soldi. Are there now five hundred more gold soldi in the world?" "No, no, I told you it's just a book entry. The five hundred soldi exist as long as I lend them to Salerino. When he gives them back to me, they disappear."

Balt thought about it and asked, "But as long as they exist, the world is five hundred soldi richer, gold or no gold, right?"

"Yes, yes," Tubal admitted. "You just saw Antonio take out five of them and spend them because he feels richer."

Balt said, "Right, and they were gold soldi, too. I bet he thinks he has five hundred gold soldi in your bank."

Tubal shrugged, saying, "That's his problem."

"But, wait a moment, Balt asked. "What happens when Salerino pays the loan back? Will Antonio be five hundred soldi poorer?"

"No, no," Tubal got a little irritated. "Salerino will earn the five hundred soldi to pay them back. He will not take them back from Antonio."

Balt hesitated. Something still bothered him. “You say five hundred soldi will disappear and nobody will feel poorer?” He thought of his family who had never seen a gold soldo.

Tubal responded, “Well, yes, maybe, somebody will be poorer, but not Antonio.”

Balt wondered who that somebody would be. He made one last attempt, asking, “Where will Salerino earn the five hundred soldi?”

Tubal looked at Balt scratching his head under his Yarmulke, and replied, “*Dio mio!* From my other clients of course, who else! When his ship returns from her voyage with a cargo of spices and artifacts, he will sell them to my other clients and so earn five hundred soldi.”

Balt still looked slightly suspicious. “Look, Balt,” Tubal said regaining his patience. “There is nothing unnatural or unethical about this. You are twelve siblings at home, right? Say, your little brother wants your toy that cost you a nummo, but he can’t pay. Your mother hangs a little chalk board in the kitchen and tells you kids to mark down what you owe each other and makes sure things stay reasonably even with all of you trading with each other. That’s a bank.”

Just then, Antonio was back asking Tubal for a *nota di banco* to Tubal’s bank branches at other Venetian trading posts. Balt had to fill it out. It said: “Pay Antonio one hundred soldi on arrival. Antonio took it and left.

“That’s one hundred soldi as good as gold,” Tubal said. “But it’s just paper. Money comes in many varieties. Go and mark the entry.”

That evening, Tubal went home in deep thought. He knew if Salerino did not repay, he, Tubal, would be on the hook for five hundred soldi of his own money, real gold soldi. He could come up with the money all right, but what if clients worried about Salerino defaulting on five hundred soldi? Would they think Tubal could not handle it and pull their deposits? He knew banking was all about trust, and trust is a fickle commodity.

Banks in Today's World

When you pay your restaurant bill, you likely give the waitress a credit card. She uses it to initiate a transfer in the card company's computer. One might call what is being transferred "electronic money." Just like cash circulates in the economy, electronic money circulates from account to account in computers as transactions occur. You can convert the electronic money to cash at an ATM. To you, it all just looks like the same money, but there is a difference.

You have probably noticed the resemblance of the credit card company with Tubal's medieval bank in Venice. Just like Tubal's clients create money by borrowing, you create money when you run up a debt on your credit card. Since electronic money is convertible to cash, it has the same effect on the economy as any other money. Somebody earns the money you just created. Collectively, your debt adds money to the economy, just like the Bohemian Count added money in the story of the Joachimsthaler.

But unlike the Bohemian Count, who minted money from his silver, you create money by running up a debt on your credit card. When you repay the debt, the "credit money" disappears again, while the Count's talers remained in circulation. So the distinguishing features of credit money are:

1. It is created by debt, not by minting or printing.
2. It disappears when the debt is extinguished.
3. It depends on people's desire to borrow and on banks' ability to lend.

An individual credit card debt does not make much of a difference, but collectively, if bank loans grow for decades, the amount of money created and the debts in existence can become too large for an economy to handle. The following chapters explore this subject in detail.

One can judge the amount of loans and credit money created from a bank's balance sheet. It shows, just like Tubal's book, all loans on one side and all deposits on the other. The two sides always balance, and the identical quantities on each side are a measure of the money the bank has created.

Banking is a lucrative business, and banks provide an important service by lending to people and projects serving the community. They must be careful in their lending practices and have enough bank capital to meet deposit withdrawals and loan defaults. When a borrower fails to repay a loan, the banker must replenish the shortfall out of his own capital. Often, bankers have partners who pledge their own capital in the case of shortfalls.

Bankers earn money by trying to maximize both the number of loans they grant and the interest they charge. They try to minimize their bank capital as that earns them no interest. As a rule of thumb, they need bank capital in the range of one-tenth of deposits.

National Banking System

A nation's financial system operates in the same way as a single bank in a closed community. All the nation's banks are linked together by "reserve" accounts at a central bank, which essentially performs the bookkeeping when money moves between individual banks.

To understand the inner workings of the national banking system, consider the example of a new loan. When a loan officer of a bank extends a loan to a customer, she creates electronic money in the customer's account and the customer may then use the money to pay a client of another bank. At the end of the day, the central bank sees to it that that payment is reflected in the two banks' reserve accounts. If a bank's reserve account runs temporarily low, it just borrows over night from another bank or from the central bank.

All bank loans end up as deposits in the national banking system, and banks continue to make new loans creating money in the process. It is the central bank that regulates banks' liquidity, reserves, and

prudent lending. A sovereign nation's banking system as a whole cannot become illiquid since the central bank can create more reserves when needed.

In the U.S., the central bank, usually called "The Federal Reserve," encourages or restrains bank lending when it deems that desirable for the economy. It does that by paying interest on reserves and determining the interest rate banks must pay on reserve loans. For the banks, this interest is a cost, which affects their profits. They adjust by changing the interest on new loans, which alters their clients' desire to borrow. In other words, it is the policy rate affecting the desire to borrow, which determines bank lending.

The notion that the central bank can restrict banks' lending by limiting their reserves is still taught in economics courses. It is called "fractional reserve banking." But this notion has been dispelled by the central bank itself. Carpenter, an economist at the Federal Reserve Bank of New York, writes, "The narrow textbook money multiplier does not seem to be a useful means . . . (of controlling) bank lending." At least in the U.S., the policy rate or "Federal Funds Rate" is the tool used to effectively manage money supply and indebtedness under normal conditions.

Fragilities of Modern Banking

During the last century, banking has become more complicated, as people tried to find investment methods more lucrative than bank deposits. Banks, brokers, pension funds, and life insurers have responded to that desire. They have created more sophisticated investment accounts and adopted some banking functions in the process.

The principal banking premise has remained: Attract accounts, make loans, watch accounts grow, make more loans, and keep bank capital as small as possible. The old ratio of one to ten between bank capital and deposits has given way to sophisticated risk measures. Regulators allow bank stock, sovereign debt, and other financial instruments to be counted as bank capital. Banks augment their

deposit base by debt they issue. Government insurance of deposits has obscured bankers' fiduciary responsibility.

As a result, credit variety and volume have soared, and banks keep inventing new ways to entice borrowers. Households borrow on credit cards, take out student and car loans, and have mortgages. Financial and non-financial firms issue long-term obligations, short-term commercial paper, and offer and accept secured and unsecured credit lines. The borrower "secures" a loan by pledging collateral, for example the house the borrower plans to buy and live in, or any other asset the bank will accept.

A national banking system, composed of the central bank, regional reserve banks, and all accredited banking institutions, has a consolidated balance sheet. The size of this balance sheet indicates the amount of money the system has lent to private and public borrowers. It is a measure of bank money in circulation.

It is also the amount people have borrowed and promised to repay in due course. Banks are responsible for the soundness or all these loans and hold some capital in case of defaults. But when times are difficult, that capital is not enough to restore depositors, and banks depend on the government for help. As the next chapter shows, bank lending creates risks that multiply with the quantity and duration of the loan.

Key Points to Remember:

- Bank money and cash are interchangeable and indistinguishable.
- Unlike cash, bank money appears and disappears with bank loans.
- Bank money and bank loans need willing borrowers.
- Money supply grows with a nation's bank lending.
- A banking system's balance sheet is a measure of its money creation.

8 - Inflation: Asset Inflation Destabilizes the Economy

John Maynard Keynes: "By a continuing process of inflation, government can confiscate secretly and unobserved an important part of citizens' wealth."

The Story of the Pioneering Central Banker

In the autumn of 1728, an elegant French gentleman, wearing an ornate hat on his powdered wig, was pointing his silver-studded walking stick at a dilapidated door across from the church of San Zaccaria in Venice. "That's his apartment, over there?" he asked an old woman nearby.

"Si, l'alloggio del'Inglese," she nodded. Monsieur Montesquieu strode on across the *campo* and knocked at the old door with his walking stick.

He heard a gruff voice and shuffling feet. The door opened a slit and a worn-out face framed by unkempt hair looked at the Frenchman suspiciously. *"Pardon,"* said M. Montesquieu with a polite bow, raising the silver nob of his walking stick to his hat. *"Monsieur le President de la Banque Royale?"* The man behind the door did not move.

"What about him?" he asked with a Scottish accent?"

"Baron de Montesquieu," the other introduced himself with more bows. "May I enter?" The door opened a little wider, revealing a dirty shirt without collar.

"I'm not receiving guests today," said John Law after a long pause.

"Pardon, M. Low," Montesquieu said, having difficulty pronouncing Law's name. "I've come all the way from Paris for this interview. I'm writing an article *au sujet de la Banque Royale*." Law

changed his mind, let him in, and wiped a book off a chair, which he proceeded to clean with his sleeve.

"Merci beaucoup," Montesquieu bowed again and sat down. He read the title of the book on the floor: *Le Divisament du Monde*. He ignored the abject poverty and filth in the room, asking, "Marco Polo's voyages, is that where your ideas about paper money come from?"

John Law lowered himself with difficulty into an old, dirty lounge chair. "No," he said. "I had the ideas in Scotland. I figured more money would employ more Scotsmen and banks could create the money. I told my father to issue bank notes, *note di banco*, that people could trade and use as money. But the Scottish are a suspicious lot."

"The French are more credulous," Montesquieu smiled.

"Yes," said Law. "Besides, their economy was in shambles, the king was broke, and the state debt was enormous in 1716."

"So you thought the French needed more money?" Montesquieu asked.

"They seemed to be desperate to try anything." Law responded. "I wanted to find out whether people would trust my bank notes if the king endorsed my bank." Law's past enthusiasm showed in his worn-out face. "We called the bank *'La Banque Royale.'* I redeemed the state debt, and issued bank notes. People loved them."

"Is it correct that prices started rising, farmers horded grain, and famine spread in Paris?" Montesquieu asked, smiling again.

"Yes, I told you, the economy was in shambles. But I had another idea. I saw in Antwerp how the Dutch offered everyone profits in the Dutch East India Company by selling company stock. So I figured I could issue stock and soak up bank notes to stop prices from rising."

"How exceptionally ingenious!" Montesquieu smiled again. "That's how you created the Mississippi Company."

"Yes," Law became livelier by the minute. "People just loved the stock, and it doubled and quadrupled. Imagine all that land from Louisiana to Minnesota, all those riches, all the silver and gold to be discovered!"

"Yes," smiled Montesquieu. "Incredible! How many employees did the company have in the New World?"

"None," Law said. "But that's not the point. I wanted the French to know that France was unimaginably rich. The stock and my bank notes were backed by all this wealth. People just had to trust me—and they did."

Montesquieu knew the outcome, but he asked anyway, "Well, what happened then?"

"In 1720, the aristocrats manipulated the stock price, the company went bankrupt, the bank notes lost half their value, and food prices soared again."

Montesquieu probed some more, "Do you think your four-year experiment made the French happier?"

Law was defensive. "You must admit the experiment was well thought out and rational. Nobody can save the irrational French."

Montesquieu ignored the remark. "It was all based on trust and faith—*comme les actions de la Jeanne d'Arc, n'est-ce pas?"* said Montesquieu still smiling. "She called it faith, you call it trust, and I call it manipulation."

"I don't care what you call it," Law said. "Louis XV treated me like his Joan of Arc. When he had little further use for me, he discarded me."

Montesquieu smiled. "Are you here hiding from the English Bishops?"

Law ignored the sarcasm. "Have you noticed? Last year, France went back to paper notes just like mine. That's the way of the future, and the way of the world. Marco Polo says the Chinese used them and they will use them again."

When Montesquieu left, he had stopped smiling. Was manipulating whole societies into chaos the way of the future? He would have to think of checks and balances for state institutions to stop such madness. Little did he know that Law's prophecy would come true in the twentieth century.

As for the near future, in 1789, the French had finally enough of their aristocrats indulging in a deluge of credit. They exchanged their king for an emperor, who proceeded to devastate the rest of Europe,

including its financial and political system. Paper money had to wait for another day.

The Yanus Head of Inflation

In most people's minds, inflation is easy enough to describe: Prices go up because abundant money loses value. The common measure of inflation is the consumer price index or CPI. It includes the prices of most consumer goods and services, including food, energy, rent, and health care. The CPI represents the official inflation gauge because it is most relevant to people's daily needs. Most assets, including houses, are not part of the CPI. Of course, house and asset prices inflate just like anything else that money can buy.

In fact, as we have seen in the Bohemian stories, when money is plentiful, people save more and savings flow predominantly into assets. John Law, the pioneering central banker, used this fact to drain money out of the economy by offering people stocks, another attractive asset for savers. This scheme allowed him to keep consumer prices stable for a while. Inflation is like a Yanus head with two faces: Most people see only one face, consumer inflation, but there is a back face, asset inflation, which is just as important.

Complicating inflation further is the fact that prices respond to both demand and supply, another Yanus head, if you will. Demand, of course, is the result of need, desire, and the availability of money. But equally important for price moves are the means and ability to supply the assets, raw materials, goods, and services in demand. If whatever is in demand is scarce and hard to produce, its price will soar.

Examples are land, trees, beach or lake property, rare materials, some metals, and certain forms of energy. If money is plentiful, their prices are the first to soar. Take oil, the most convenient form of energy indispensable to most activities. In today's world, economies grow with credit growth until oil prices reach a certain level. Beyond that level, economies tend to stall until oil prices retreat again. These fluctuations are the reason that policy makers exclude oil and gasoline

from their inflation gauges, even though oil's long-range upward price trajectory has been unstoppable for years.

There is another reason to link Yanus, the god of time and transition, with inflation: The time lags between inflation's cause and effect, money creation, and price rises, extend over years. During the time lag, money supply exceeds what is needed for economic activity until the prices of assets, raw materials, and goods and services adjust upward slowly and sporadically.

Each price moves on its own trajectory; some prices may even move down, while others move up. As mentioned, excess money is largely boosting asset and commodity prices, while wages and consumer prices could be dropping at the same time.

In today's world, automation, abundance of labor, and aging populations depress labor income and consumption. If it were not for credit, firms would have to cut output, reduce prices, or both. To prevent unemployment and deflation, the central bank makes plenty of credit available. Most credit, even consumer credit, eventually raises asset and commodity prices, especially scarce ones.

In other words, prevailing economic conditions have been deflationary for some time, and without credit growth, there would have been mild downward adjustments of consumer prices. Such periods are natural and historically common, sometimes caused by demographics, sometimes by innovation. Today, credit prevents the adjustment and inflates asset prices in addition. As soon as credit contracts, these prices collapse and add to the deflation caused by the shrinking money supply. This kind of deflation is rapid, destructive, and needs preventing, in contrast to occasional gentle downward adjustments of prices.

How Inflation Affects Debt

Anybody who remembers prices twenty years ago is aware of the compounding effect of inflation. If annual inflation is larger than the return on one's savings, these savings will not buy much by the time they are needed. What is important is the inflation-adjusted or "real"

return of one's investment. Savings invested for a long time usually earn a higher return, but are subject to risk since inflation can increase and real returns become negative. Obviously, the saver's loss is the borrower's advantage.

For this reason, times when inflation accelerated unexpectedly as in the 1960s and '70s benefitted borrowers, but hurt savers. During those decades, credit created less inequality, debt build up, and fewer loan defaults. Borrowers were able to repay the old loans in depreciated currency, while their incomes had generally kept pace with inflation.

In contrast, the deceleration of inflation in the 1980s and '90s surprised borrowers and led to the opposite outcome. What is more, lower inflation allowed the central bank to lower policy rates, which encouraged people to borrow with abandon. Credit money soared. Accumulating debts became unsustainable. Savers benefitted from the asset inflation that resulted from the enormous credit expansion. Income inequality surged.

The Dynamics of Hyperinflation

When a nation approaches the point where bank credit, private, and public debt are unsustainable, savers begin to wonder where their money will be safe. A sovereign state interested in stability will try to sustain contracts and promises as long as possible, if necessary by increasing public debt and demonstrating its ability to repay its debt unconditionally. Savers respond by lending to the safest borrower, the state, at any return it offers.

How long can public debt increase? As long as a nation can potentially tax income, provide security and organization, and uphold its laws, citizens will trust the currency. This trust is not easily shaken, as the need to save and to trade and the desire to be part of a functioning society is very powerful. Some societies will shoulder great sacrifice before they abandon this trust. That is why people trust the Yen and Japan, which is a sovereign nation with enormous public debt, but great societal cohesion.

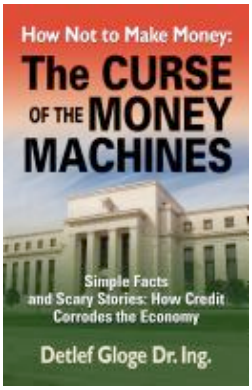
Past incidences of hyperinflation resulted either from outside encroachment on a nation's sovereignty or a breakdown of civil order within. Like in Law's case, the state often takes corrective action before the currency totally collapses. Only a threat to people's subsistence will force people to abandon the accustomed order and try to exchange money for existential commodities, eventually rendering the currency worthless.

As for the U.S., its currency, the dollar, is the world's preferred medium of exchange with trillions being held outside U.S. borders. In times of stress, the need for dollars increases even more as people trust the U.S. system of market freedom, flexibility, and stability. As a result, even foreigners lend to the U.S. government at any return it offers. In a world where all currencies have been debased by unfettered credit creation, safety is relative.

Law's experiment and failure and the meeting between Montesquieu and Law are historic facts. But their conversation was not recorded, so I had to reinvent it here. I wish we had better knowledge of what these two men thought, given how much Montesquieu influenced the U.S. founding fathers and the Constitution they wrote. Did Law's ruthless actions influence Montesquieu's and their thinking? The next chapter deals with the issue of how credit money distorts economic growth, the one parameter, which is usually considered the hallmark of a vibrant economy.

Key Points to Remember:

- Excess credit money causes asset inflation
- Oil prices limit the growth of today's economies.
- There are delays between money creation and inflation.
- Sovereign states have the means to avoid or abort hyperinflation.



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