Sound Money or Bust?

Author Stephen Marchant January 2019

Many are familiar with the film "Mary Poppins" and the author Pamela Lyndon Travers who wrote it based on her experiences as a child with an alcoholic father who was an unsuccessful banker. The story makes a good point that bankers have a social responsibility and that their actions can lead to personal as well as financial ruin.

In the UK and other Western countries banks are required to have a license so that they can be properly regulated. However, the system is based on fractional reserve banking where banks are required to hold minimal real capital in relation to their loan book. If these capital requirements are too low then a series of loan defaults will make the bank effectively insolvent. The bank must urgently raise capital or risk a 'bank run'.

We basically have a system of trust because even if a bank is solvent it could have a liquidity problem if everyone rushed to withdraw their money. In this case a central bank (Bank of England for UK) could loan fiat money against a bank's loan assets. This fiat money has kept our financial system alive ever since we left the pre-war gold standard. Most western countries have since relied on the US dollar as a trusted currency for international trade because it was pegged to gold up until 1971. Since that time it too has become a fiat currency with no actual peg but a promise to pay by the US Govt. Since that time we have seen an explosion in global debt, whether it be governments, corporates or private individuals.

A number of other actions of deregulation of credit markets, banking activities and capital controls have exacerbated the growth in debt. This debt is effectively borrowing from the future and we are at a point where we can borrow no more. We will have to discover some fantastic new resource such as 'unobtanium' or virtually free energy source of nuclear fusion that will help us to pay down this debt or it will act as a 'ball and chain' on real economic growth.

How do we get out of this debt problem? Well we could imagine we "go fly a kite" as in the Mary Poppins story and wake up to a new world where we all live happy family lives in peaceful neighbourhoods. The reality is that we cannot just allow the debt to implode without real moral hazard and the likelihood of conflict both within and between nations.

If we are to avoid a chaotic debt implosion we need to deal with it in three stages:

1) We need to create a sound currency for international trade. This needs to be based on gold and/or a basket of other commodities. Once we have agreed a new currency we can use it as a reference for dealing with debt between nations.

2) I have described in my short book (http://money-liberty.com/books/MoneyLiberation.pdf) an iterative mathematical formula for debt conciliation between nations. This could follow from a Bretton Woods type international convention.

3) Individual nations create fiscal policy (e.g. taxation or spending cuts) to suit their own national objectives and would be constrained by the new global currency.

This will require the US to give up its dollar hegemony and is a big ask but it may be the only way to prevent conflict and a complete breakdown in international relations. We are already seeing a multi-polar world developing and with it tensions as power blocks seek to grab or control resources.

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