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The Fate of Europe

The Battle for the Very Survival of the European Union

When the Economics Simply Become Unsustainable

By Martin Armstrong

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Preface

The Fate of Europe and the very battle for the survival of the European Union (EU) is being created primarily by the design structure which is coming back to haunt European Commission as a whole. While they like to picture Europe as one happy family with 500 million residents among 28 different member states, nothing is further from the truth. The idea behind the Eurozone was to create the United States of Europe. I have stated many times that the original commission tasked with creating the Euro attended our **World Economic Conference** in London back in 1997. We discussed the structural design and they understood that consolidating the debt was critical but said they did not believe the people would vote for that. They said they just wanted to get the currency through first and worry about the debt later.

The image of one happy family came to an end when the discussion comes to money and consolidating debt. The ramification of that issue spills over into everything else. For example, the bail-in policy emerged because the perception of money coming from Germany to bailout Italian or Greek banks. This also creates the budget crisis. Because each member state prints Euros, the demands where Brussels applies central controls over the member states stems from the very same structural flaw of the refusal to consolidate debts. In reality, Germany has imposed its economic philosophy by creating a single currency but sought to isolate any risks to each member state.

Unelected Troika

Christine Lagarde Head of IMF — **Jean-Claude Juncker** EU President — **Mario Draghi** Head of ECB

Then we have the structural design that intended to eliminate democracy because the objective was to Federalize Europe, yet they denied that would ever happen from the outset. The outright rejection of Democracy in Europe was cleverly accomplished because they realized there was no one happy family and it was believed that the people would never vote for the federalization of Europe. Thus, deny the people any right to vote democratically for they were too stupid to know what was best for them.

This was also supported by the theory that the way to eliminate European war in the future was to eliminate independent political states and to federalize Europe. This idea that if there was just one government would eliminate war was a strong philosophy behind this undemocratic structure in creating a federalized Europe that the people would never have a right to vote for the leadership.

Then there has been the refugee/economic migrants which has torn Europe apart. This entire crisis was unilaterally created by Angela Merkel simply to support her personal image as she was being viewed harshly by the world given her treatment of Greece. What this exposed was that despite the philosophy of one happy family, the reality illustrated that a single country can alter the entire political–economic trend for all of Europe absent any democratic process.

<u>The questions addressed in this report are:</u>

(1) What is the Political-Economic Fate of Europe?
(2) Will the One World Government Philosophy of Europe survive?
(3) Is the Dream of the Eurozone simply delusional?
(4) Can the Euro survive?
(5) What are the Global Implication of the Euro failure?
(6) Will the EU adopt a cashless society?
(7) What is the fate of the European Central Bank (ECB)?
(8) Can the European Bond Market survive?
(9) Are there economic public & Private solutions to save Europe?
(10) Why is the Structural Design Doomed?

The Creation of the Euro

The entire concept behind the creation of the Euro was truly to create the United States of Europe, but in a significantly different manner where each state surrendered its culture and autonomy under the primary direction being the elimination of European war. To sell that goal, it was well understood that to express their intent in that manner, the people would reject it.

Helmut Kohl
(1930 – 2017)
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What most people do not realize is that creating the Euro was never submitted to the German people to decide. Helmut Kohl (1930–2017), Germany's former chancellor, admitted that he acted like a "dictator" to create the Euro. Kohl said:

> *"I knew that I could never win a referendum in Germany," he said. "We would have lost a referendum on the introduction of the Euro. That's quite clear. I would have lost and by seven to three."*

VOTE TO JOIN THE EUROZONE

Country	Year	Pro	Against	Turnout(%)	Result
Denmark	1972	63.3	36.7	90.1	Joined
France	1972	68.3	31.7	60.2	Approved
Norway	1972	46.5	53.5	79.0	No action
Ireland	1972	83.1	16.9	70.9	Joined
United Kingdom	1975	67.2	32.8	64.6	Remained
Greenland	1982	47.0	53.0	-	Left
Åland	1994	73.6	26.4	49.1	Joined
Austria	1994	66.6	33.4	82.3	Joined
Finland	1994	56.9	43.1	70.8	Joined
Norway	1994	47.8	52.2	89.0	No action
Sweden	1994	52.3	47.7	83.3	Joined
Switzerland	1997	25.9	74.1	35.4	No action
Switzerland	2001	23.2	76.8	55.8	No action
Czech Republic	2003	77.3	22.7	55.2	Joined
Estonia	2003	66.8	33.2	64.1	Joined
Hungary	2003	83.8	16.2	45.6	Joined
Latvia	2003	67.5	32.5	71.5	Joined
Lithuania	2003	91.1	8.9	63.4	Joined
Malta	2003	53.6	46.4	90.9	Joined
Poland	2003	77.6	22.4	58.9	Joined
Slovakia	2003	93.7	6.3	52.1	Joined
Slovenia	2003	89.6	10.4	60.2	Joined
Croatia	2012	66.7	33.3	43.5	Joined
San Marino	2013	50.3	49.7	49.7	No action
United Kingdom	2016	48.1	51.9	72.2	Leaving
Macedonia	2018	94.2	5.8	36.9	Joining

Indeed, the German people were never allowed to vote if they wanted to join this idea of a single currency no less to federalize all of Europe abandoning sovereignty. Denmark had the greatest turnout, but France had the greatest number of people voting to create the Euro.

The entire sales pitch was (1) eliminate FOREX exchange fees, and (2) a simple single currency would create a single interest rate pointing to the USA as the evidence.

While the FX fees were a valid issue, misrepresenting that everyone would enjoy a single interest rate was just not true. They pointed to the USA as proof of that claim, but this applied only to a consolidated federal debt in the USA whereby each state paid an interest rate based on its own credit rating.

Of course, the benefit that Kohl was looking at for Germany was that a single currency would in fact mean that German cars and machines would have a standardized market eliminate foreign exchange risk which would enable a greater economic union within Europe. The problem which emerged was the incorporation of the idea that to eliminate European war, they needed to also eliminate the independent governments within Europe.

From a pure economic perspective, the primary incentive for Germany to back the Euro was to ensure its export mercantilist-based economy would be expanded enabling it to offer goods priced in a single currency which would eliminate foreign exchange risk thereby boosting sales throughout Europe.

September 22nd, 1985 - Plaza Accord

From left: Gerhard Stoltenberg of West Germany, Pierre Bérégovoy of France, James A. Baker III of the United States, Nigel Lawson of Britain and Noboru Takeshita of Japan.

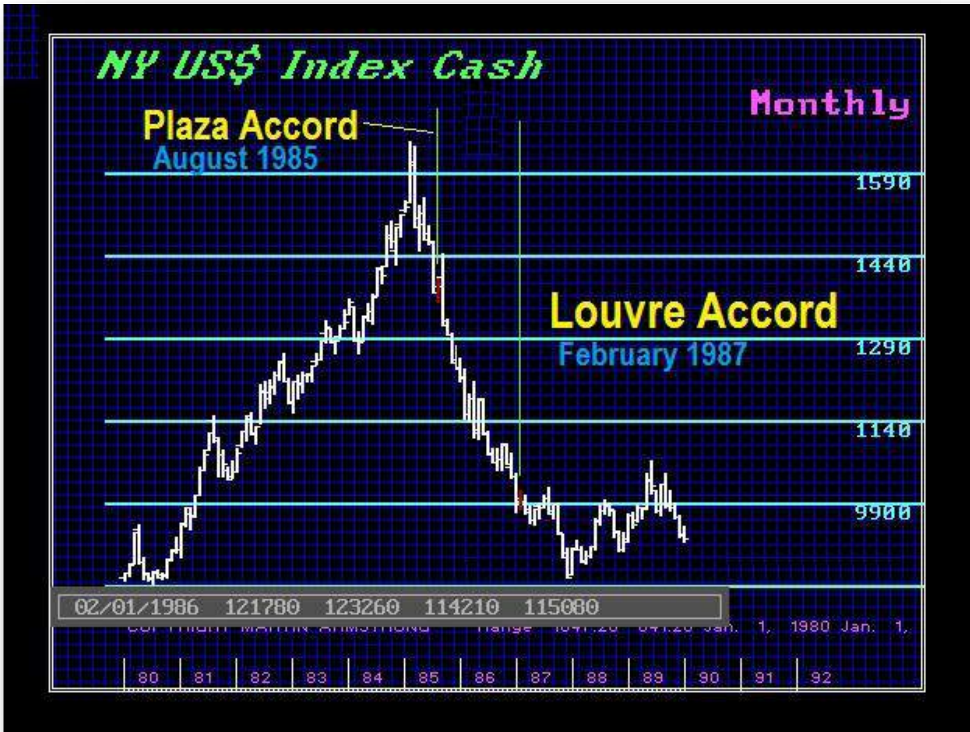
After the establishment of Bretton Woods, the European economy was still struggling. In Britain, the year 1949 saw the devaluation of the pound from $4.03 to $2.80. The next devaluation came in 1967 from $2.80 down to $2.40. Then the pound collapsed to par in 1985 as the dollar was propelled to all-time record highs.

With the dollar at record highs, the US sought to manipulate the dollar down for intervention alone failed to stem the rally. The US organized a meeting of the five major financial economies in September 1985 which created the Group of 5, **G5** as it was known, and the meeting became known to history as the **Plaza Accord**.

It was at the **Plaza Accord** that it was proposed that Europe should ban together to form a single currency to compete against the dollar. The details of this proposal were loosely idealized to mimic the USA and create a single currency.

As always, official interventions and manipulations of the free economy have always failed and even the Plaza Accord was just another disaster. The members stood up and proudly announced that they want the dollar to be devalued by 40%.

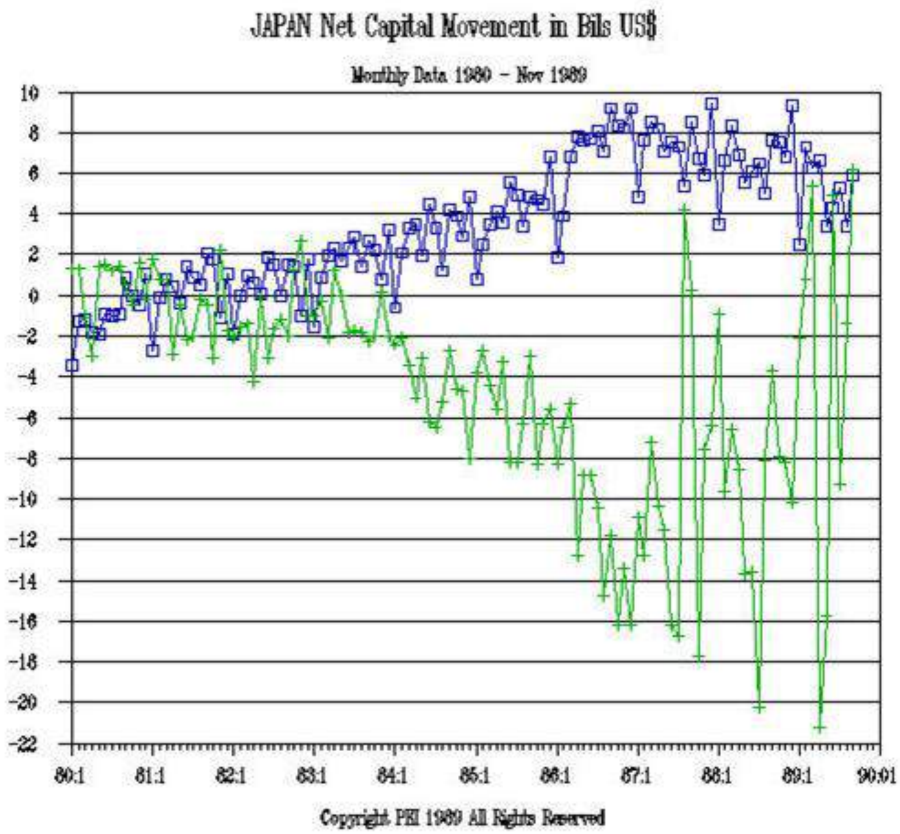
Plaza Accord - September 22, 1985



The **Louvre Accord** was an agreement, signed on February 22, 1987 in Paris, that aimed to stabilize the international currency markets and halt the continued decline of the US Dollar caused by the **Plaza Accord**. The agreement was signed by France, West Germany, Japan, Canada, the United States and the United Kingdom. Italy declined to sign the agreement.

The **G7** meeting of central bankers and finance ministers in Paris announced that the dollar was now "consistent with economic fundamentals." The announced that they would only intervene when required to ensure foreign exchange stability. The objective was then to manage the floating currency system. Democrats gained control of Congress in 1986 and immediately called for protectionist measures. The dollar depreciation agreed to in 1985 at the Plaza Accord, failed to really improve the trade perspective. In 1986, the trade deficit actually rose to approximately $166 billion with exports at about $370 billion and imports at about $520 billion. The object of manipulating currency to try to create jobs and alter trade flows proved to be completely false.

My concerns warning that volatility would increase made back in 1985 were materializing. What they did not understand was the lowering the dollar in value also led to a shift in capital flows and the selling of US assets. Foreigners were suffering loses by financing U.S. trade through purchasing United States Treasury bonds in an attempt to ease the trade deficit criticism. We were advising Japanese to buy gold on the New York COMEX, export it, and then resell which would also make it appear that the US exports were increasing. However, the lower dollar was then resulting in the importation of inflation into their own nations.



We can see that first of all the dollar had already begun a decline prior to the **Plaza Accord** in August 1985. By the time we arrived at the **Louvre Accord**, you can also see that the dollar continued to decline. The attempt to manipulate the foreign exchange markets proved to beyond the capacity of the **G5** which had been expanded to **G7** and today is now **G20**. We can see the capital flow data between the USA and Japan began to move in early 1984 establishing the trend that nobody seemed to pay attention to at that moment.

The price action of the dollar clearly proves that the central banks lacked the power to truly influence the markets. The trend had begun prior to the **Plaza Accord** and it continued to decline following the **Louvre Accord**.


Nigel Lawson (born March 11th, 1932)
Member of Margaret Thatcher's Cabinet from 1981 to 1989

Margaret Thatcher rejected the idea of creating a Euro because she saw this as a means to federalize Europe resulting in the surrender of British sovereignty. It was from this **Plaza Accord** that she saved Britain from the euro, which was an idea put forth at the Plaza Accord when the birth of the G5 was established. Thatcher's cabinet members such as Nigel Lawson, who had been at the **Plaza Accord**, was in favor of a single currency and terminating the British pound since he was really in favor of returning to a Bretton Woods system of fixed exchange rates. Lawson was joined by Geoffrey Howe (1926–2015) which was another cabinet member.

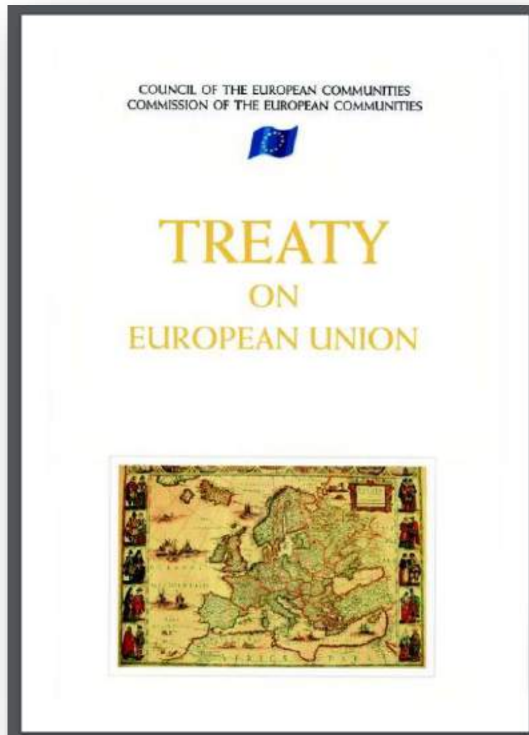

Richard Edward Geoffrev Howe
(1926 – 2015)

In June 1989, Geoffrey Howe and Nigel Lawson secretly threatened to resign over Thatcher's opposition to British membership in the **Exchange Rate Mechanism** (ERM) of the European monetary system. Both Howe and Lawson were sold on the ERM and the idea of the Euro.

Thatcher's cabinet staged a coup and forced her to resign. Immediately, her cabinet plotted to take Britain into this new currency proposal. Under the new Prime Minister John Major, Britain moved to place the pound in the temporary fixed exchange rate pre-Euro known as the ERM. followed by the end goal – the establishment of the Euro.

Margaret Thatcher's Burges Speech was spot on about the European Project. It was clear behind the curtain back on September 21, 1988, that this was all about the federalization of Europe and the surrender of national identity. The Guardian ran the story: ***Thatcher sets face against united Europe.***

It was back during 1979 when the **European Monetary System** (EMS) was founded. Twelve countries took part in the system with Spain joining only in 1989, UK during 1990, and Portugal finally during 1992. The EMS, they believed, was a quasi–fix exchange rate system within trading ranges that was hoped would create exchange rate stability. The EMS post–1987 was believed to lead to convergence of economic performance in preparation for the Euro. Therefore, within the EMS there was the **Exchange Rate Mechanism** (ERM) which contained ten currencies (Greece was not a member of the ERM, while the Luxembourg franc was set at par to the Belgian franc). Therefore, between May 1979 and January 1987, there were twelve realignments of ERM–parities. This was the attempt to create a quasi–fixed trading range for currencies within a band.



The mere fact that there were realignments reflected the fact that any attempt to fix currencies or even create a single currency would never eliminate economic and inflation differentials across all of the ERM–countries. Post–1987 there were substantial differences between southern Europe in Italy and Spain as well as in the UK when compared to Germany which practiced austerity for fear of hyperinflation. The realignment of 1987 resulted in important revisions of the EMS arrangements. This took place in what was known as the **Basle–Nyborg Agreement** which assumed Germany would continue to have low inflation and interest rates due to their policies and that the Bundesbank would defend exchange rates in the open markets. Of course, the Bundesbank would not be able to defend the rates alone and interventions would be counter to domestic policy objective.

It was during the **Maastricht Treaty** of 1991 that laid out four convergence criteria under which a country must qualify to participate in **European Monetary Union** (EMU). Stage one required that capital controls must be eliminated by 1990. This outline was to achieve convergence among EMS–countries that they anticipated would be essential to create confidence in the proposed monetary system. What was clearly surfacing was that no realignment or capital control strategy appeared to be working. This was again an early sign that the diversification among the EU members within their economies would present a serious issue going forward.

The EMS appeared to be working prior to 1980 when the dollar made its historic low before the storm between the low in October 1980 and February 1985. Europe was prospering really on the OPEC inflationary wave, or at least that is how it seemed.

During the process of ratifying the **Maastricht Treaty**, there arose significant public concern about the EMU. The **Danish referendum** took place during June 1992 with a 63.3% in favor against 36.7% against the Treaty. Germany under Kohl denied the German people any right to even vote while the **French referendum** were very uncertain when only a turnout of 60% compared to the Dutch turnout of 90%. Still, the results in France were in favor being 68.3% with against 31.7%.

German Unification Day took place on October 3rd, 1990, when the German Democratic Republic ceased to exist. It was at that time when five new Federal States in the East joined the Federal Republic of Germany. The Bundesbank raised its key interest rate because of inflationary tendencies resulting from a large fiscal deficit, caused by the unification. This is when the domestic policy considerations ran contrary to international policy since the other EMS countries needed lower interest rates in the midst of a recession.

1992/1993 ERM Crisis Prelude to the Euro Collapse

The **European Exchange Rate Mechanism** (ERM) of 1992 was a prelude to the coming crash of the Euro. While the 1992 ERM Crisis was still focused directly on currencies, what would unfold after the Euro was created became the shift in trading instruments from currencies of individual nations to their bond markets. The failure to consolidate the debts of member states in Europe allowed the speculative forces to still target the bond and share markets of the individual members as if their currency still traded.

Sir John Major
(born 1943)
British Prime Minister (1990 – May 2, 1997)

The new government headed by John Major took the Pound into the ERM the same month that German unification began. The monetary policies of Germany were starkly different from Britain. I was called when the attack on the Pound unfolded and was asked what our model said about the Pound because they knew I was a friend of Thatcher. I relayed its analysis that the Pound had to be devalued. I was told that was impossible because John Major had said even the week before the Pound would be maintained in the ERM. I then said that the Pound must be suspended if not officially devalued. The pressure was intense. I explained that a fixed rate is a **GUARANTEED** trade. I can bet billions and if wrong, nothing happens, and I get my money back. That finally made the point.

The 1992/1993 collapse of the ERM was a system introduced by the **European Economic Community** on March 13th, 1979, to which Thatcher was against. It was part of the **European Monetary System** (EMS), intended to reduce exchange rate variability and achieve monetary stability in Europe in the aftermath of the collapse of Bretton Woods in 1971. Only after the Plaza Accord in 1985, did the EMS prepare for Economic and Monetary Union of Europe which gave birth to the introduction of a single currency, the Euro, which took place on January 1st, 1999.

The Bundesbank began to finally reduce interest rates only when the 1992 Crisis emerged. They did not cut its interest rates enough and speculation continued building tremendous pressure on the Italian lira and British pound. The clash between domestic policy in Germany concerned about reunification resulting in inflation with the economic recession external to Germany illustrates the problem that will always exist. Even within the United States, there were 12 branches of the Federal Reserve which all maintained a separate interest rates policy because there were regional differences. No matter what the theory would be, a single currency will not promote a unified European economy, and more than the dollar creates that illusion within the USA.

The real value of East German marks was worthless. The East German mark was officially valued by the East German government at parity with the (West German) Deutsche Mark. However, because it was not readily convertible and the GDR's export profile was restricted, it was practically worthless outside East Germany. The Germany government effectively bribed the East to join. East German marks were exchanged for West German marks at a rate of 1:1 for the first 4000 marks and 2:1 for larger amounts. Before reunification, each citizen of East Germany coming to West Germany was given Begrüßungsgeld (welcome money), a per capita allowance of DM 100 in cash.

Clearly, the tension within the ERM began to build up from mid-July 1992, concentrating initially on the Italian lira, then on sterling and then on a variety of other currencies. The 1992-93 **Exchange Rate Mechanism** crisis created a huge strain between countries in the E.U. - both economic and political. The generally accepted belief that there were four possible factors behind the crisis included competitiveness problems, German unification, and inevitable policy shifts with the fourth pointing to self-fulfilling speculative attacks on the currencies. However, the speculative attacks on the currencies were not the cause of the crisis, they merely facilitated the events by acting on the weakness of the attempt to create a fixed exchange rate system once again.

The foreign exchange markets remained disturbed for the rest of the year, with a renewed outbreak of speculative pressures leading to the abandonment of Sweden's peg to the ECU, devaluation of both the Portuguese escudo and the Spanish peseta in November and the abandonment of Norway's ECU-peg in December.

However, what was also overlooked was the fact that July 1992 was also when the Russian Ruble began trading for the first time.

Meanwhile, the Bank of China required foreign visitors to China to conduct transactions with **Foreign Exchange Certificates** that were issued by the Bank of China between 1979 and 1994. Effectively, this was a two-tier monetary system – domestic v international. Following the ERM Crisis, this two-tier system in China was abolished, and all transactions then took place in Renminbi. The entire global foreign exchange system was changing. The biggest mistake people make looking at the British pound crisis of 1992, has been to look at it through a myopic perspective of isolation.

The pressure on the Finnish Markka was so strong at that time it was forced to abandon its peg with the ECU. Italy raised its interest rates to try to support its currency, but still the lira weakened repeatedly. The Bundesbank did not cut its interest rates enough fearing inflation and speculation would continue, which put pressure on other European states.

It was on September 13th, 1992 when the Italian decision to devalue Italian Lira by 7% took place (other currencies revalue of 3.5%: Lira devalues 3.5%). The pressures on lira led traders to look around and saw that the British pound was also overvalued all relative to Germany.

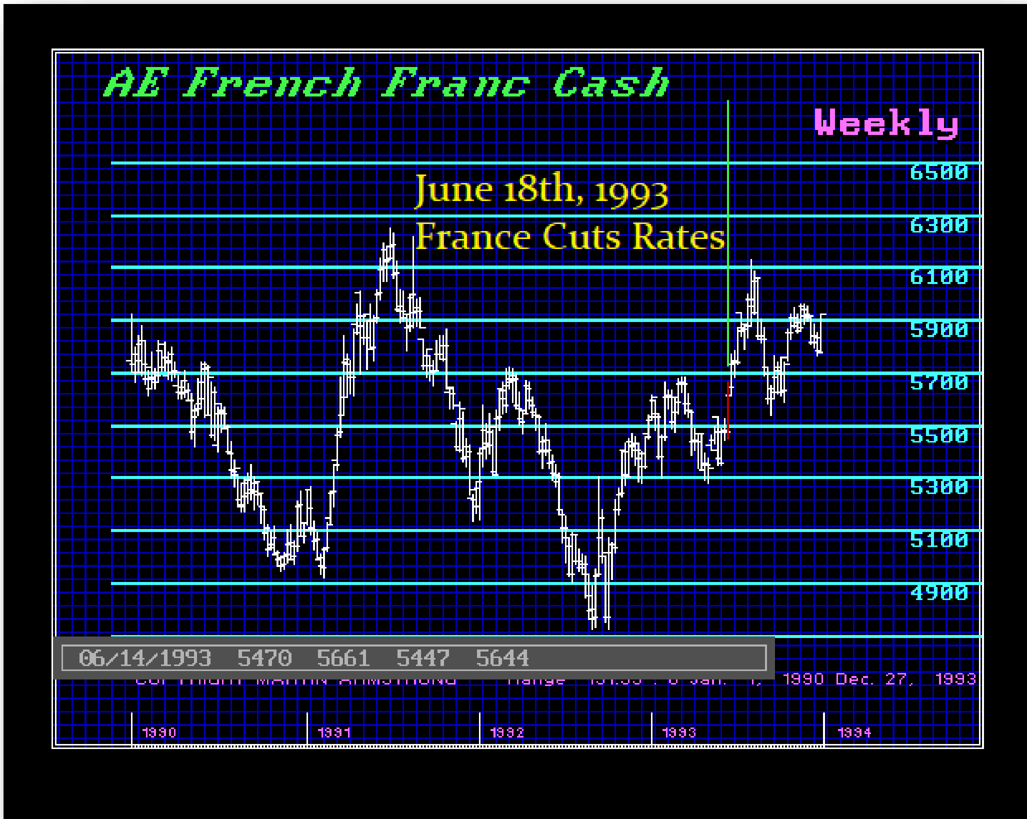
Hence, the pound sterling became the next target during the ERM crisis of 1992. **Black Wednesday**, September 16th, 1992, two-days after the Italian devaluation, the UK Conservative government which had thrown Margaret Thatcher out of power to take the Pound into the coming Euro was forced to withdraw from the ERM as well. John Major was forced to withdraw the pound sterling from the **European Exchange Rate Mechanism** (ERM) after it was unable to keep the pound above its agreed lower limit in the ERM.

The day after the British crisis of **Black Wednesday** ended being forced to exit the ERM, the selling pressure against the ERM and thus the European single currency movement turned back upon Italy. The very next day on the 17th of September 1992, Italy also withdrew from ERM. The scheme to create the Euro was proving to be a warning of what was to come in the decades that followed.

The Deutsche mark was sent to significant highs even against the dollar in September 1992. The foreign exchange markets remained disturbed for the rest of that year, with a renewed outbreak of speculative pressures leading to the abandonment of Sweden's peg to the ECU, devaluation of both the Portuguese escudo and the Spanish peseta came in November 1992 and the abandonment of Norway's ECU–peg in December 1992.

By January 1993, Ireland witnessed economic pressure due to the sterling devaluation by the UK, and this then compelled Ireland to devalue by 10%. Germany finally reduced its interest rates in February, March and April of 1993, trying to ease the economic pressure within the currencies that had not yet been realigned. The entire crisis of 1992–1994 was a prelude to the ultimate crisis that would hit the euro for similar reasons and Germany's fear of inflation that would impose austerity on the rest of Europe. It was Germany's high interest rates in 1992/1993 that broke the back of the ERM.

France then presented was have a problem also maintaining the franc at its existing parity. France wanted lower interest rates to relieve the recession, but it was influenced by the German concern for reunification inflation. France began to challenge the German economic authorities publicly of austerity. France, was forced to maintain its interest rates high abandoning its domestic policy objectives because of the Germans.



Finally, the economic pressures were building in France and on June 18th, 1993, the French money market intervention rate was dropped below the German rates. The markets were concerned and became skeptical about the success of the entire scheme. The stress within the ERM was becoming obvious to professional traders and the speculative positions began to increase. This time, traders now turned against the French franc during June 1993. The France began to drop sharply against the US dollar.

The Banque de France was forced to raise its interest rate to prevent the franc from falling through its ERM lower band. However, the Bundesbank did not lower its discount rate, and massive sales of the French franc, Belgian franc, Danish krone, Spanish peseta and Portuguese escudo all took place in response. It was Germany's misunderstanding of its Hyperinflation of the 1920s that once more dictated their response. Today, we have seen the price of German austerity upon the entire economic condition of Europe. While the ERM broke, today there is a full federalized government in Brussels attempting to maintain austerity and the same philosophies that broke the ERM during the 1992/1993 Crisis.

At this point in time, the ERM was in total crisis within Europe. One would think they learned from Bretton Woods, but politicians are blinded by their self-interest, which always comes before that of the people or country. Massive intervention was necessary to keep these currencies just above their ERM floor. On the 2nd of August 1993, the EC monetary officials and finance ministers finally agreed that the ERM bands should be widened from 2.25% to 15% (except for the Dutch-German one). With the wider bands, the system would be less vulnerable to speculation.

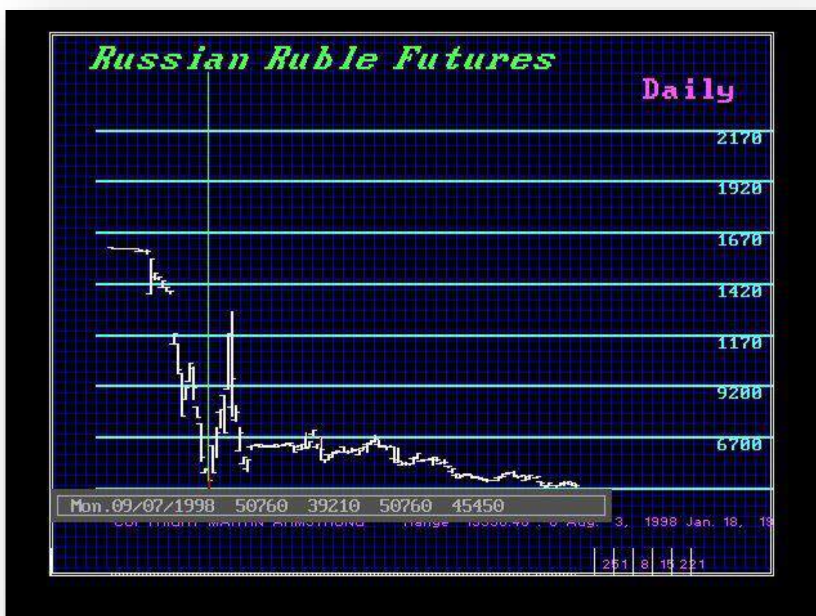
At the core of all of this was German's complete misunderstanding of the Hyperinflation and their attempt to impose austerity upon all of Europe, which is deflationary and anti-economic growth.

The ERM Crisis of 1992/1993, made George Soros famous, yes, but it awakened international hedge fund traders to the currency markets. Traders then turned to the peripheral markets – Russia next and then South East Asia, which saw its share market peak in January 1994 and bottom in September 1998 (56 months).

It was on October 11th, 1994, when the ruble tumbled in the Moscow interbank market by over 20% against the U.S. dollar. "**Black Tuesday**" became the first currency crisis in post-communist Russia also caused by politicians. From July 1992, when the ruble first could be legally exchanged for United States dollars, to October 1995, the rate of exchange between the ruble and the dollar declined from 144 rubles per US$1 to around 5,000 per US$1. It was the float of the Ruble in July 1992 that started the shift in global capital flows and currency markets.

Politicians, for pride, artificially set the Ruble's value too high against the dollar reflecting past glories, which was the exact same mistake of the British entering the ERM. Rapid changes in the nominal rate of the Russian economy reflected the overall macroeconomic instability. After the ERM crisis, traders then turned to emerging markets targeting Russia. This was the Black Tuesday with a 27% collapse in the ruble's value against the dollar. Eventually, in July 1995, the Russian Central Bank announced its intention to maintain the ruble within a band of 4,300 to 4,900 per US$1 through October 1995. They later extended the period to June 1996. They attempted a "crawling band" exchange rate which they introduced to allow the ruble to depreciate gradually through the end of 1996. This led to a further collapse from 5,000 to 6,100.

After the Russian introduction of the "**crawling band**", traders turned their attention to the emerging market in Southeast Asia with more concerted force. This eventually manifested in the **1997 Asian Currency Crisis**. Then traders turned back to Russia. I have stated many times how I was invited to the IMF dinner put on by Edmond Safra in Washington. I was being pitched then to join **"the Club"** and buy into Russia for they had the IMF in their pocket. The IMF would continue to guarantee Russian debt so you could buy debt and earn 5 times the amount of interest otherwise. The IMF would eliminate the risk. I said, ***"No way, my computer warned Russia would collapse."***



Of course, this eventually led to the collapse in 1998, which in turn set in motion the financial crisis known as Long Term Capital Management which was the first instance where the Federal Reserve bailed out a hedge fund. The entire crisis between 1992 and up into the 1998 Long-Term Capital Management Crisis, this entire period was all set-in motion by politicians trying to fix currencies that they cannot fix with domestic policies in opposition to international policy objectives.

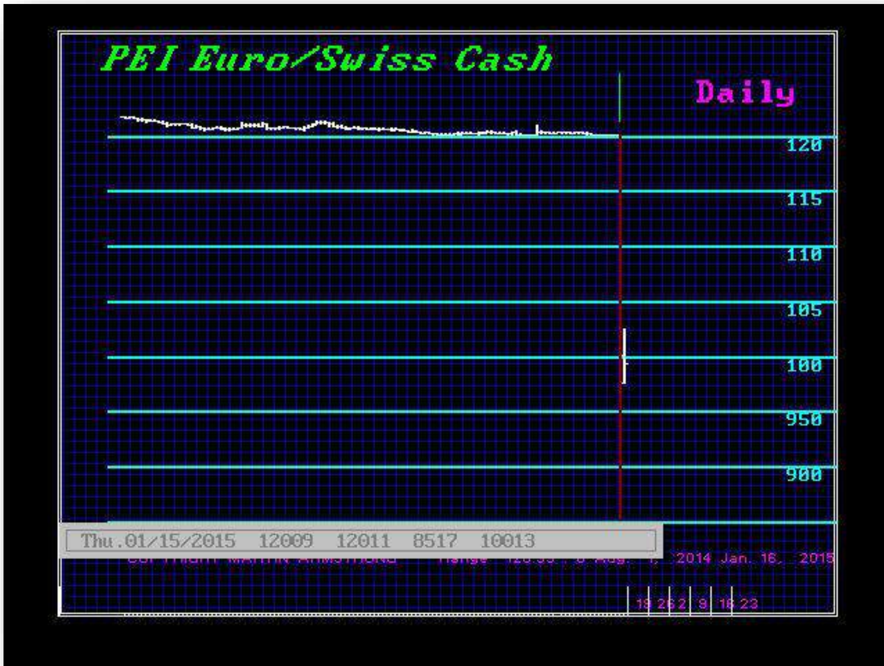
Swiss Pegged to Euro

The Swiss Peg

Just as the ERM failed in its attempt to fix the value of European currencies even with a trading band, government seem to constantly attempt to freeze the value of currencies and fail to grasp that they are the hedge against governments reflecting capital flows both in and out.

On September 6th, 2011 the Swiss National Bank (SNB) was aiming for a substantial and sustained weakening of the Swiss franc after Swiss companies threatened to leave because the rising franc reduced their exports. The SNB would no longer tolerate a EUR/CHF exchange rate below the minimum rate of CHF 1.20. The SNB set out to enforce this minimum rate with the utmost determination and it began to buy Euros in unlimited quantities.

Indeed, the peg lasted about **Pi** 3.14 years before the pressure really built and 3.3 years it cracked. Who is to blame? The Swiss? Or does the blame belong to Brussels and stupid traders/investors who hopelessly just believed whatever government says and the press merely report without critical analysis.



The Euro collapsed against the Swiss falling to 8517. This was a historical decline and at first glance one would think this was a bad tick gone way out of bounds. So how do we analyze such a new historical move? You cannot approach this with a view of the whole.

Here we have the Euro/Swiss recreated back to 1984 when the just before G5 began in New York at the Plaza Accord. You always need a map even in markets. How can you figure out where you are going if (1) you do not know where you have been and (2) you do not know where you are right now? This pattern shows that we have now broken the double bottom I warned had to give-way. That has now been accomplished. So yes, the Euro/Swiss collapsed to historic lows and the Swiss ought to run out and buy whatever they can while the Swiss in strong.

The Swiss attempted in vain to stem the capital flows into the franc from the rising concerns about the Euro. Indeed, Switzerland should have created a ***Financial Franc*** that could have easily been used to segregate capital inflows without altering the value of the domestic Swiss franc on international markets. What is abundantly clear is that the crisis building at the European Central Bank (ECB) is presenting a global contagion that is threatening the entire world economy on the failure of Draghi's policy of negative interest rates and Quantitative Easing. With the ECB completely trapped holding 40% of Eurozone government debt, the implications of even rate hikes will be devastating.

The Swiss abandoned the peg as was the case of Britain and others during the early ERM crisis. What the Swiss failed to comprehend is that being the target of capital inflows, it becomes impossible to prevent when capital if fleeing elsewhere without closing the currency markets to open trading.

The European Union & Its Anti-Democratic Structure

The European Parliament

Most people are clueless as to how and why the European Union was transformed into an anti-Democratic Dictatorship. It has become all about the Euro at the expense of Democracy. From the very beginning there was the intent to Federalize Europe creating the United States of Europe. The central theory revolved around this notion that if there was only one government, then that would end future European wars. Of course, both Napoleon and Adolf Hitler also believed by conquering all of Europe they too would promote world peace. The problem with this theory is always the same. All we need do is look at Charlemagne and Constantine the Great who both believe one emperor would change everything.

Upon the deaths of both Charlemagne and Constantine the Great, their empires were divided among their children. The idea of one grand empire has never survived historically. No matter how people dreamed on one supreme power, it has only existed for a brief single moment in time always reverting to its separatist origin dictated by culture, language, and custom.

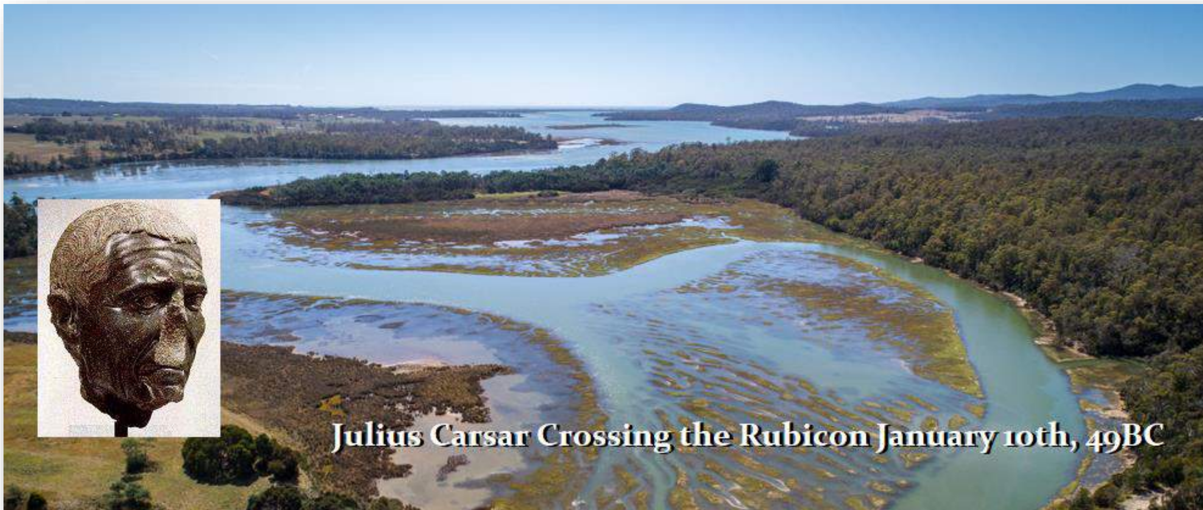
In designing the EU, they realized that the people would **NEVER** approve of the federalization of Europe. Therefore, aside from the tactic to get them to simply agree to a single currency under the promise there would **NEVER** be the federalization of Europe into a single government, they set out on creating a structure to eliminate any right of the people to vote on matters of government. The assumption was they were too stupid to know what was best.

Eliminating Democracy

The core structure of the EU was deliberately designed to eliminate any democratic form of government subject to popular vote. It is true that the European Parliament is subject to popular vote, but it has **no power** to create laws or even vote on them. The EU was intentionally designed to prevent any vote by the people because it sees itself as an Omnipotent dictatorship to prevent a third European war that the people cannot understand.

The EU was deliberately structured to deny the people any possible right to vote against the will of government, and simultaneously, create a false image of a Parliament they could vote for yet would have no power. This clever structural design has fooled the majority of the people who have handed their lives and their future over to those who look down upon them as the despicable **"Great Unwashed"**.

In truth, the EU is actually an anti-democratic creation because the belief was that the people just did not know what was best for them. Consequently, the EU is a modern-day version of a political dictatorship where no person wielding power will ever stand for election by the people. They are appointed only by politicians and never stand for election.



History repeats simply because human nature never changes. We are approaching that moment in Roman history that compelled Caesar to cross the Rubicon for those in the Senate simply became dictators pretending to represent the people. The EU is now identical in oppression to the fall of the Roman Republic. On January 10th, 49 B.C., on the banks of the Rubicon River in southern Gaul (near the modern-day city of Ravenna), Julius Caesar and the soldiers of the 13th Legion waited and weighed their options. The Rubicon was the official border between Italy and Cisalpine Gaul, and thus crossing this humble river would have serious consequences. According to the law of the Roman Republic, any provincial governor leading troops across the border back into Italy would be declared a public enemy. It was, quite simply, an act of war. It is the later historian Suetonius who actually gives us the quote ***alea iacta est*** – "the dice are thrown."

In this respect, the EU has taken the same approach crossing the Rubicon (point of no return) by deliberately eliminating the right of the people to vote. The oligarchy-controlled Rome. When Caesar crossed the Rubicon, the people cheered, and the corrupt senators fled Rome. There are those in government who actually perceive themselves as the soul and embodiment of the nation with the people merely forming the **Great Unwashed** to be placated with socialistic promises of manna from heaven as did the Romans give the sporting events and free bread.

The EU strategy was to pitch only the creation of a single currency that would produce the promised land. They misled the people to vote on that single issue and thereafter they would never have any right to vote again. What they deliberately never told the people was that one currency would require the federalization of Europe which was the goal from the outset. They assumed that if there was only one government, that would end all wars. They forgot about the history of civil war which has ravaged most countries. There was the English Civil War, Spanish, and let us not forget the French Revolution.

Cultural Differences

In Germany, the country is still divided on religion. In celebration of the 500th anniversary of the Reformation, all of Germany was to have a holiday on October 31st, 2017. Seventeen percent of Germans were against the idea that Reformation Day should be an annual nationwide holiday. Why? Currently Bavaria, a mainly Catholic state, gets 13 holidays per year, including days such as Assumption of Mary Day on August 15th and All Saints Day on November 1st while the rest of Germany gets just 9 holidays – absent the religious holidays. The northerners were the protestants who revolted against the Catholics.

There are cultural differences throughout Europe and long memories. Even when they created the Channel tunnel to connect Britain with Brussels and France by Train, the British steer the train to Waterloo Station which was the victory over Napoleon. The French insisted the station be renamed so the Brits merely redirected it to a different station.

Wrote said that under the EU organization, the French insisted there would be a prohibition against issuing any coin that commemorated Waterloo. Can you elaborate on that? I never heard of that clause before.

As part of the EU agreement, the French demanded that no member nation would be allowed to issue any coin celebrating the French defeat at Waterloo. Belgium defied the rule by issuing a commemorative 2.5-euro coin that was **NOT** for general circulation. It was a special issue collector's coin. Great Britain also issued a commemorative 2-pound collector's coin in 2015 also celebrating the victory at Waterloo. Both were for collector purposes and thus skirted around the prohibition included in the agreement for the Euro by the French.

The problem emerging from Europe is the very structure of the new federal government was cleverly crafted to ensure they did not stand for election. The people could only elect members of Parliament, but that is just for show since the Parliament neither introduces legislation nor do they vote on anything. That have absolutely no power to do anything and that includes even electing the leaders of the European Commission.

The EU is rapidly growing and expanding only according to its self-interests of federalizing Europe denying the people any right to vote on the topic. There is absolutely no election process so there is no possible way for the people to even object or change direction of government through any democratic process whatsoever. The very structure has left the only means to change the direction of government is indeed civil revolution. The EU is operating under anti-democratic principles and was designed assuming the Great Unwashed were too stupid to know what was best for them. The EU is not even a republic; it is disconnected from the people for there is no accountability to the people whatsoever. This is the next step in the evolutionary process government power much like the rise of communism claiming this is for the benefit of the people. There is no actual Social Contract either implied or specified. It is all about government maintaining control.

Unelected Troika

The Troika, unelected head of IMF, unelected head of ECB, and the unelected EU President, is the living breathing example of pure tyranny for it is a 3-part commission that is charged with monitoring the Euro debt crisis. There would have been no crisis had there been a real intent to create a monetary union rather than a covert economic union. The Troika are also responsible for managing the policy solve the Euro debt crisis. The policies from negative interest rates to bail-ins of banks as took place in Cyprus, are all the policies of the Troika and if the people disagree, they cannot be removed for they never stand for election. This is pure economic tyrannical dictatorial power.

The Troika is currently made up of the Christine Lagarde of the International Monetary Fund (IMF) who was put in that position by her friend US President Obama, not even a European. Then we have Jean-Claude Juncker the President of the European Commission (European Council), and Mario Draghi at the head of the European Central Bank (ECB) who is ex-Goldman Sachs. Not one of these people stood for election, yet they dictate the fate of the European people. Even if the people rise up and disagree with negative interest rates and bail-ins, there is no non-violent means to remove them from this dictatorial role. Britain is being asked to surrender all its rights to the Troika?

From this position, tyranny always erupts because government sees itself as the nation constituting its soul not the people. Therefore, those who desire to rule over the people assume we surrender our individual rights like serfs tilling the soil for the lord of the manner in return for the safety of his castle.

Why a European Army

One of the great political lessons come from Constantinople back in 532AD. The people began to protest against high taxes and the police as well as the local army would not defend the emperor Justinian. Emboldened by the 5 days of rioting that even the military troops would not suppress, some of the Senators drew the courage to call for the overthrow Justinian. The Emperor was about to flee the city for his life. Then his wife insisted he stay and use a legion stationed outside of the city which was not Greek. Justinian called them for support, and they had no problem slaying Greeks since they were of European origin.

Nika Revolt January 13th, 532AD Constantinople

General Belisarius stormed into the Hippodrome with his foreign legions and slaughtered the remaining rebels. Reports put the death toll were about 30,000. Justinian also had all the senators who had supported the riot exiled confiscating their property as well. From the ashes, Justinian then rebuilt Constantinople and the church destroyed by fire was rebuilt – the Hagia Sophia, which still stands to this day as a museum. Justinian was then free to pursue his ultimate goal, the reunification of the Roman Empire.

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It has become a primary rule that you can never send the military in to supress a riot if the people rioting are their family and neighbours. Therefore, the primary strategy is always to employ foreign troops. Now we find that the EU is clearly preparing for the same outcome. They are preparing to create their own army whose allegiance will be to the EU and not to individual member states.

The German Chancellor Merkel has joined the President of France Macron in calling for a European army. With the rise of the Yellow Vests in France and some police starting to sympathize with the protesters, this illustrates the crisis and furthers the need for foreign troops to suppress the people. As in the Nika Revolt of 532AD, they need standing armies to suppress a revolution who are disconnected to the people where they are sent to oppress.

There is little doubt that those behind the curtain see the pending threat created by the faulty design of the system from the outset. The implications of the financial crisis for the relationship between monetary integration and democratic government in the European Union (EU) is surfacing. This crisis has exposed the clash between economic and monetary union (EMU) that has been sought to maintain between monetary integration and one government policy which is becoming unsustainable. The Eurozone is being propelled to eventually make a choice of one of three governance models: executive federalism, democratic federalization or EMU dissolution. From the political self-interest, if the Euro fails, the politicians in Brussels lose their jobs and pensions. That has become the number one priority which is pitted against the desires and best interests of the European people.

The Great Euro Gamble

Based upon this very idea of creating a one European government to eliminate war, the structural design of the European Union was based upon this belief and the assumption that the people would never vote for it. Therefore, they pitched only a single currency promising **NEVER** to federalize Europe.

The European Union's motto is ***"In varietate concordia",*** which is officially translated as **"United in diversity" w**hich stands in stark difference to the United States motto ***"E pluribus unum"*** (Out of many, one). The difference in mottos reflects the original promise not to federalize Europe. However, the Refugee Crisis proves that there is no respect for diversity and any member state that refuses to surrender their culture and diversity is to be punished.

Forcing a European Identity

The European model at its root is a mosaic of different peoples and cultures that has developed over the course of its long history. The United States is a melting pot where people from all over Europe fled and by the second generation were intermarrying because they adopted a common language – English. It is very common that when you ask an American what are you, they respond 50% German and 50% Irish or whatever rather than America. Such mixed cultures are much rarer in Europe because the barrier is always language.

There has been a secret agenda that behind the curtain many believe that they will eventually achieve by force a unified European identity. A single political system like that of the US, they insist, presupposes a common language and a single nationality. That may be an unachievable wish list. Nevertheless, to this end, the structural design of the EU was to deny the right of the people to have any democratic say in their future.

The United States of Europe

Obviously, this theory of creating the United States of Europe emerged after World War II proposing if there was a single government as in the United States, there would be no war. Of course, this theory appears to have emerged from someone who clearly did not comprehend history. They ignored the fact that even under one government, there are tensions from central philosophies being imposed upon the whole. The American Civil War stands as an example that even under a one government structures, there is still the risk of civil war.

This idea of creating a one world government in Europe fails the test of history to deliver its promises. The structural design of the Eurozone was intended from the outset to be the federalization of Europe, yet that was constantly denied. Ever since the **Treaty of Rome** there has been the theory that to federalize Europe would be to prevent a European War. Yet the paradox has been that both Hitler and Napoleon sought to establish a unified European state by force of arms under the same theory that this would be the **war to end all wars** with one single government.

That idea has prevailed and before Parliament on November 22nd, 1990, Margaret Thatcher stated publicly that the single currency was all about the federalization of Europe and not an economic common market.

"We had arguments which might persuade both the Germans – who would be worried about the weakening of anti-inflation policies – and the poorer countries – who must be told that they would not be bailed out of the consequences of a single currency, which would therefore devastate their inefficient economies."

Of course, from the outset, European leaders denied that there was an agenda to federalize Europe. They swore that they were just creating a single currency to compete with the dollar. This idea was sold to the European population all based upon trade. To put it into the language of the common person, the public was told that (1) a single currency would end exchange fees, and (2) since everyone used a single currency meant that all would be paying lower interest rates.

The President of France, François Hollande (born 1954), spoke before the European Union Parliament to address the anti-Euro rising tensions. He explained that the entire purpose was to federalize Europe in order to prevent war. This has been the real agenda they no longer hide. He stood openly and stated:

"Why are the Chancellor and I here? Why the both of us? Because our populations are the biggest in Europe? That's not even true. Because we're the most important economies? Probably. Because there were 2 wars. Suring the last century opposing France against Germany. And those two countries, after the tragedy, wanted Europe to be, taking the horror that happened in

the continent as a starting point. It's the reason why the representatives of Germany and France always wanted to take initiatives in new European constructions, like De Gaulle and Adenauer. We have remembered the Chancellor and I, the Treaty of the Elysée. Then it was Kohl and Mitterand, not only them, who made Europe take steps forwards. That's why we're here."

The federalization of Europe has conversely produced exactly the opposite of what the elite politicians believed. They assumed if there was only one government, there would be no European war. Just as the one government in the United States did not prevent the American Civil War, the differences in culture, religion, and language will always prevent this dream of a unified European culture.

It has been the assumption that after a deeper European integration under centralized control from Brussels, a single political system will offer a solid foundation with practical advantages that will inspire the surrender of individual culture and the merger of languages. The assumption that the right to move freely across borders would encourage the development of a single language. The idea of free movement of goods and services would also surface, yet this has been hardly the case. Then there was the convergence of law and thus legal certainty for cross-border economic activities would further economic expansion. These were all the dreams that behind the curtain they assumed would cement the foundation for the United States of Europe.

Banking Regulation

One would think that banking regulation should be the most typical area in which collective action makes sense. If banks are regulated at the federal level for all of Europe, that this should produce a stronger and more unified European banking system. With a centralized national regulatory authority, it was presumed that that would end regulatory competition which they claimed degenerates into a race to the bottom.

However, this fake image of Europe being one happy family comes to an instant end when the discussion comes to consolidating debt and banking. It became very clear that there was no mutual respect among European member states. Southern Europe was regarded as if it were the drunk brother-in-law who spent all their money on wine, women, and parties. They would always have their hand-out asking for help. This is what lead to the **Bail-In policy** rather than the **Bail-Out policy** with respect to banking. If Italian banks were in trouble and the policy was for the EU to provide a Bailout, that would mean that capital would flows across borders and amount to the same as debt relief implying debt consolidation. Thus, the very purpose of socialism was to protect the people against banking failures as in the Great Depression. That has been abandoned because the policy against debt consolidation. This returns to the structural design failure.

The Disparity of Taxation

There has been tax-chaos in Europe and the EU has tried to fight against competition among member states to attract corporations. There have surfaced disputes over taxation on the income level with respect to corporations. Ireland's government was compelled to fully recover more than €14bn in disputed taxes and interest from Apple, holding it in an escrow fund pending its appeal against a European Union tax ruling.

The European commission ruled back in August 2016 that Apple had received **unfair tax incentives** from the Irish government. Both Apple and Dublin filed appeals against the original ruling. Both stated that the iPhone maker's tax treatment was in line with Irish and EU law.

Ireland's finance ministry estimated last year the total amount could have reached €15bn including EU interest. In the end the amount was €13.1bn in back taxes plus €1.2bn interest.

Jean-Claude Juncker
President of EU Commission

Country	Corporate
Albania	15%
Andorra	10%
Austria	25%
Belarus	18%
Belgium	29%
Bosnia-Herzegovina	10%
Bulgaria	10%
Canada	50.90%
Croatia	18%
Cyprus	12.50%
Czech-Republic	19%
Denmark	22%
Estonia	20%
Finland	20%
France	30%
Germany	22.83%
Georgia	15%
Hungary	9%
Iceland	25%
Isle-of-Man	0%
Italy	27.90%
Latvia	20%
Liechtenstein	12.50%
Lithuania	15%
Luxembourg	29.22%
Macedonia	10%
Malta	35%
Monaco	0%
Montenegro	9%
Netherlands	25%
Norway	22%
Poland	19%
Portugal	21%
Romania	1%
Russia	20%
Serbia	15%
Slovakia	22%
Slovenia	19%
Spain	25%
Sweden	22%
Switzerland	16.55%
Ukraine	18%
United Kingdom	19%
United States	21%

The European Union also turned its sights on McDonald's and their deal with Luxembourg. Curiously enough, Jean-Claude Juncker is a Luxembourg politician serving as President of the European Commission since 2014. From 1995 to 2013 he served as the 23rd Prime Minister of Luxembourg; from 1989 to 2009 he was also Minister for Finances.

The EU accused Luxembourg of granting McDonald's and unfair tax deal to attract their business. The commission ultimately found that these deals did not constitute illegal state aid. Many have assumed that such a ruling was necessary for anything else would have implicated Juncker himself causing a political crisis.

The profits under scrutiny had not been taxed in Luxembourg or the United States, according to the commission. They amazingly said that Luxembourg did not violate the law despite the fact that the admitted that profits in question were never taxed by anyone. (***Table shows varied corporate tax rates***)

The Value Added Tax, or VAT, in the European Union is a general, broadly based consumption tax assessed on the value added to goods and services. Here too we have a huge disparity across Europe.

The VAT applies more or less to all goods and services that are bought and sold for use or consumption in the European Union. Thus, goods which are sold for export or services which are sold to customers abroad are normally not subject to VAT. Conversely imports are taxed to keep the system fair for EU producers so that they can compete on equal terms on the European market with suppliers situated outside the Union.

Turning to the consumption taxes, here too we find great disparities among member states. The EU itself is citing VAT collection figures showing that the total amount of VAT lost across the EU in 2016 was an estimated at €147.1 billion. This, they maintain, represents a loss of 12.3% of the total expected VAT revenue within Europe.

The VAT is not like a sales tax as in the USA. Americans never include the tax so you always know what the government is doing. It is also far less burdensome since it is applied only on final sales whereas VAT is charged every step of the way requiring endless paperwork.

The VAT is a consumption tax that is always ultimately paid by the final consumer. It is not a charge on businesses. As a result, combined with income and municipal taxes, the net disposable income is drastically reduced compared to Americans.

charged as a percentage of price, which means that the actual tax burden is visible at each stage in the production and distribution chain.

The argument is the tax is neutral upon business. The tax is collected fractionally, via a system of partial payments whereby taxable persons (i.e., VAT–registered businesses) deduct from the VAT they have collected the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism, they argue, ensures that the tax is always neutral regardless of how many transactions are involved. However, this ignores the cost of accounting.

The tax thus is excessive, and it is paid by the consumer who is the "taxable person." Since the tax is included in the price, the tax is really sheltered from the public's eye. After paying such high income–taxes, to then impose a 20% tax on what you spend is really abusive.

The danger of following such a tax scheme remaining hidden from the public eye only encourages abuse of power to redistribute resources but most simply go to funding the expense of government salaries and pensions.

Country	Corporate	Income Ta	VAT
Albania	15%	23%	20%
Andorra	10%	10%	4.50%
Austria	25%	55%	20%
Belarus	18%	15%	20%
Belgium	29%	50%	21%
Bosnia-Herzegovina	10%	10%	17%
Bulgaria	10%	10%	20%
Canada	50.90%	47.95%	13%
Croatia	18%	40%	25%
Cyprus	12.50%	35%	19%
Czech-Republic	19%	53.50%	21%
Denmark	22%	51.95%	25%
Estonia	20%	20%	20%
Finland	20%	25%	24%
France	30%	49%	20%
Germany	22.83%	47.48%	23%
Georgia	15%	20%	18%
Hungary	9%	33.50%	27%
Iceland	25%	40%	23%
Isle-of-Man	0%	20%	20%
Italy	27.90%	45.83%	22%
Latvia	20%	31.40%	21%
Liechtenstein	12.50%	28%	8%
Lithuania	15%	55.20%	21%
Luxembourg	29.22%	43.60%	17%
Macedonia	10%	37%	18%
Malta	35%	35%	18%
Monaco	0%	-	-
Montenegro	9%	12.65%	17%
Netherlands	25%	52%	21%
Norway	22%	46.40%	25%
Poland	19%	32%	23%
Portugal	21%	82.75%	23%
Romania	1%	41.50%	19%
Russia	20%	13%	20%
Serbia	15%	52%	20%
Slovakia	22%	50%	20%
Slovenia	19%	50%	22%
Spain	25%	45%	21%
Sweden	22%	69.80%	25%
Switzerland	16.55%	22.50%	8%
Ukraine	18%	17%	20%
United Kingdom	19%	47%	20%
United States	21%	37%	5%

Fiscal v Monetary Policy

The identity crisis that has consumed the decision making in the Eurozone has been torn between increasing the money supply with Quantitative Easing at the central bank while the pollical decision process with respect to fiscal policy has been dominated by Austerity. These two policies are in fact mutually exclusive.

Of course, the decisions taken by the European Central Bank (ECB) only illustrate the lack of any democratic process. Decisions are taken by a simple majority of a body that is not even democratically elected. All central banks act in that manner, but to adopt negative interest rates which have never been attempted before is like creating a new drug without previously testing its validity.

The ECB's decisions lead to a massive redistribution of wealth denying equal treatment of all citizens. Negative rates have adversely impacted retired persons who counted on their savings to earn interest. The ECB's experiment has failed for 10-years disrupting the economies of the Eurozone's members in addition to causing global capital flows to shift. In contrast, the European Commission's Fiscal Policy cannot be altered by any election since the member of the Commission never stand for election.

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Therefore, we have a clash between the Monetary Policy of the ECB trying to stimulate the economy by increasing the money supply while the European Commission maintains it Austerity philosophy in its decisions with regard to the Fiscal and Monetary Policy objectives. There is no democratic process available to the people under this political structure which historically leads to civil unrest as the **ONLY** alternative. This came to the forefront when the Commission rejected the increased spending in Italy while allowing that policy in France.

The ECB has been providing virtually all of its refinancing credit to the Eurozone's five crisis-stricken countries: Italy, Spain, Portugal, Greece, and Ireland. All the money circulating in the Eurozone originated in these five countries and was then largely used to buy goods and assets in the northern member countries and redeem foreign debt taken from them.

The US Federal Reserve would never be allowed to conduct such a regionally imbalanced policy. The Fed cannot even provide credit to specific regions, let alone states on the verge of bankruptcy (for example, Illinois, California, New York, etc).

Creating a Euro Bond & European Stability Mechanism

Recently, the European Council President Herman Van Rompuy, backed by most of the troubled Eurozone countries, proposed the creation of Eurobonds and debt-mutualisation schemes. These ideas go well beyond the American system. The kind of fiscal integration and centralised power that they would require do not even remotely resemble those in place in the US. Many see this as a threat to the Eurozone Project based on joint liabilities, against the wishes of large parts of its population, that would not lead to a federal state in the true sense of the term, but more of a union whereby each promise to protect each other.

This idea would be akin to Virginia coming to the aid to bailout California or Illinois. This type of Eurobond would be significantly different than the structure of the United States where the states do not stand behind each other. This again is trying to pretend the Eurozone is one big happy family but refusing at the same time to distinguish between a federal government and individual member states.

The assertion that the Eurozone could be transformed into a United States of Europe is no longer convincing under this type of scheme. The path toward joint liability is far more likely to lead to finger-pointing during a crisis within Europe, because turning the eurozone into a transfer and debt union that can prevent the insolvency of any of its members would require more central power than currently exists in the US.

Then there is the **European Stability Mechanism** (ESM) which was established in late 2012 as a permanent bailout fund for the Eurozone. It was born as a compromise during a crisis and its powers were deliberately limited by the desire of creditor countries to segregate risks within the periphery. In other words, this became another midlevel agency because of the original refusal to consolidate the debts of member states as the joined the Eurozone.

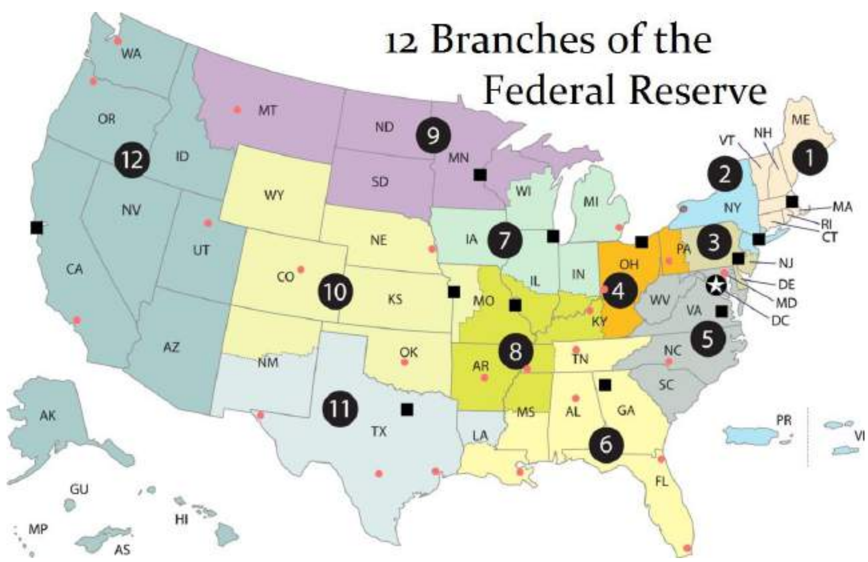
There are some who argue that the ESM should be transformed into a real stability provider for the Eurozone as a whole. It would become a transition mechanism to a unique federal debt for the euro area. The argument is that there should be a risk-weighted cash contribution system that should increase the financial soundness of the ESM in terms of balance sheet structure. In return for the insurance premiums received, the ESM should guarantee the public debts of all member countries, allowing the progressive transition to a single federal debt of the euro area.

In this manner, capital injections would provide the ESM with the opportunity to fund worthwhile investments in stressed countries while supporting the realignment while trying to smooth-out the business cycle for all of Europe that would be supported by the single currency.

These ideas are interesting, but extremely unrealistic. Even within the United States with a single currency, the local economies of states are NEVER in sync as a whole. The Midwest is dominantly tied to agriculture, while Texas was always tied to crude oil. Even in 1927, there was the land speculation in Florida which peaked, yet the stock market rose sharply thereafter into 1929.

The idea that the ESM would emerge as a sort of IMF of Europe providing a role as an emergency lender to support the financial economy, completely misses the point. Europe is very diverse and there cannot be one fiscal or monetary policy that fits one and all at the same time.

When they created the Euro, they never did their research. Had they done so; they would have noticed that not only did Alexander Hamilton consolidate all the debts of the states to create a national debt leaving all states on their own thereafter. Refusing to consolidate the debts meant that Brussels then had to have powers over state budgets whereas that does NOT exist in the United States. If Illinois goes bankrupt, it does not impact the dollar or the national debt.



Additionally, the European politicians also failed to understand the Federal Reserve was created because of the regional disparity among the states. This was why the Federal Reserve was created back in 1913 with 12 branches. When the Fed was created, it was the solution to the **Panic of 1907**, which was set in motion by the disruption of the **internal domestic capital flows** caused by the San Francisco earthquake of 1906. The insurance companies were in New York. Consequently, the cash flowed to the West and a shortage developed in the East.

Federal Reserve August 1927
Discount Rate

Atlanta	4.0%
Boston	4.0%
Chicago	4.0%
Cleveland	4.0%
Dallas	4.0%
Kansas City	3.5%
Minneapolis	4.0%
New York	4.0%
Philadelphia	4.0%
Richmond	4.0%
St. Louis	4.0%
San Francisco	4.0%

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The original structural design of the Fed was to establish 12 branches to manage the capital flows **domestically**. Interest rates would decline where there was an excess of cash and rise where there was a shortage. This, they believed, would cause capital to move between the branches to balance the national capital flows and economy. Each branch acted independently to manage the capital flows. When crops would come to market, then Kansas would have an excess of cash and rates would decline as we can see from the table showing the rates set by each branch in August 1927.

When Roosevelt comes to power in 1933, he wanted to control the economy for his socialist agenda. He usurped the power of interest rates from the various branches of the Fed and consolidated then into Washington DC making it **one-size-fits-all**. He, therefore, abandoned the structural design of the Fed and ever since the capital flow focus has been international, not domestic.

FDR's Fireside Chats

Even if we look at Canada, we see the very same regional disparity. Alberta joined Canada in 1905. The rising separatist movement began because they are dealing with regional capital flows and economic differences. Alberta is getting the short–end of the stick because the central bank and government pays more attention to real estate speculation than the economic conditions in Alberta based upon commodity production.

Moreover, when Roosevelt came to power, he established the Federal Deposit Insurance Corporation (FDIC) in 1933, assuring people it was safer to keep their money in a reopened bank than under the mattress because people were hoarding their cash as they are doing in Europe today.

Then on August 23, 1935, Congress approved legislation that had a major impact on the Federal Reserve Banks, the **Banking Act of 1935**. This Act structurally altered forever the entire concept behind the Federal Reserve, whereas its purpose originally was to provide stability with respect to internal capital flows in addition to a regulatory clearing house for the banks. This is where the Open Market Committee was established, and ***national monetary and credit policies*** were determined in Washington which would gradually become the new political economy and *Laissez–faire* was now officially dead.

As World War II approached, politics took control of the Fed. Once again, the Fed was ordered to support US government bonds at par. This decree was not lifted until 1951. The Fed remained fairly independent thereafter until the Vietnam War. Politicians viewed its authority to increase the money supply on an elastic basis meant that inflation was their problem, not Congress'. Politicians began to spend whatever they wanted to win election and criticized the Fed if inflation appeared when they had no control over the fiscal spending of Congress.

Clearly, the design of the Eurozone, no less the ECB, was taken post–Roosevelt which has ignored the regional disparity. Any ESM transition scheme to create a pretend liquid market for Eurobonds, would never be able to compete with US treasuries in attracting international investors as long as they maintain this structure where Brussels tries to dictate to member states and their budgets rather than consolidate the debts, draw a line in the sand, and let each member to stand on its own without one taking down the whole.

Can European Debt Crash

Mario Draghi has actually destroyed the European bond market and the economy on an unprecedented scale between 10 years of **Quantitative Easing** and negative interest rates. Draghi policy of perpetual low to **negative interest rates** has also wiped out savers in Europe, especially the elderly retired. Talk about a grand experiment, Draghi has acted like some medieval doctor chopping off body parts until he discovers a cure for something, he has no idea what is going on.

Draghi bought into this absurd theory based on the assumption that if you make money insanely cheap to borrow, people will run out and buy everything and thereby kick–off the economy. Nice theory, but people did not borrow when they did not trust the future. They will not borrow at even 0.1% if they do not see an opportunity to invest.

Draghi has also kept this failed theory of **Quantitative Easing** up for about 10 years without success. He owns about 40% of sovereign debt in Europe issued by member states. The Bank of Japan (BoJ) owns 45% of Japan's national debt. The ECB now cannot possibly sell its debt holdings. There is no longer a big for debt at these rates. If the ECB stops buying, rates will explode. The ECB is trapped and incapable of managing the economy whatsoever by this insane theory of **Quantitative Easing**.

Add to that the fact that Draghi never considered the impact upon those who saved all their lives to retire and suddenly discovered their life savings earned nothing. He leaves the ECB in October 2019. But the May elections are approaching and the stress his **Quantitative Easing** has inflicted upon Europe is causing a ripple effect within the political discontent. With the economy turning down hard once again into 2020, Draghi has no means to even try to pretend he can manage the economy. We are headed into a NEW ERA in which the belief in central banks and government being in control is about to collapse before our eyes.

One of the fascinating aspects of what we face is clearly the crisis within the sovereign bond markets. The ECB and the Bank of Japan fund their government debts without end, and they have both destroyed their bonds markets. The ECB cannot sell the bonds it has already bought, and neither can the BoJ. They have stated that as bonds mature, they will reinvest that money aside from any new purchases because there is no market. Since they have destroyed their own bond markets, we are **UNLIKELY** to see a crash if there are no bids and offers. They will simply pretend that sovereign debt is perfectly fine. Private interest rates will rise, but they will blame that on greed as they always do.

What we should expect to see is private sector debt decline as rates rise. The premium of private over government will widen simply because the government debt is not a free market number. I can say that there are a lot of people in various governments who are contacting us these days. This shows there exists people who are deeply concerned that this is not going to end very nicely.

There has been rising speculation that Italy may also exit the Euro. Indeed, the question of which is more serious, BREXIT or an Italian exit, it will be the latter and not the former. Why? Italy was a founding member of the Euro and it uses the Euro. Therefore, Britain never joined the Euro thanks to Maggie Thatcher. Italy leaving the Euro will be far more devastating to the Eurozone itself and will complicate matters since the ECB is saturated with Italian debt. There are a lot more ties that have to be cut besides trade, as is the case in Britain.

Eurozone countries, according to theory, must continuously reduce government debt as long as it is above 60% of GDP. Only a handful of countries actually meet this criterion. The Eurozone average is almost 87% of GDP. Reality of keeping debt down under 60% is really delusional and impossible under the current socialistic system. Projections into the future show the debt levels will be well above 60% with no end in sight.

By the middle of 2018, the ECB had already bought €341 billion worth of Italian sovereign debt with an average remaining maturity of almost eight years. This figure was rising about €3.5 billion per month. The ECB purchases ceased to be Quantitative Easing and simply became a life-support for member states to just keep borrowing.

Italy's gross government debt had reached €2.26 trillion by the end of 2017. That was a percentage of GDP which reached 132%, the second highest in the Eurozone after Greece.

The original scheme was that the ECB would simply hold the bonds until they mature. But the Quantitative Easing went on for so long, the ECB was forced to then reinvest the cash back into new debt issued by the same country. The entire Quantitative Easing suddenly became a permanent ownership of member states debts. The ECB may had believed it would be able to shrink its balance sheet in the future if the economy recovered, but they never could even reach the first step of stopping to reinvest maturing debt.

Why Could the ECB Not Cancel all the Debt it has bought?

Simply put that would be illegal. The ECB is barred by law from providing financing to governments, even though that is precisely what it has been doing. It is also independent and can't be instructed by governments on what to do with bonds it purchased.

Germany has challenged the ECB over this situation where Quantitative Easing is indeed financing governments when it was expressly forbidden under the creation of the Eurozone. Since the ECB can buy no more than one-third of a country's bonds, this is accepted as a **monetary policy tool** aimed at reducing the term premia, or the premium investors demand to hold longer dated debt over shorter papers.

Governments are still required to service their debt and the ECB has made sizable profits on the purchases so far. But this profit is then paid out to national central banks who frequently pay it into their government budgets. So, some of the cash does make it back to state budgets and governments also benefit from lower borrowing costs.

Therefore, the ECB is completely trapped. There is no possible way for it to sell the in the market without causing interest rates to rise dramatically. What would happen is effectively the amount of old debt and new debt coming to the market all at once would create a bond crash in Europe. The ONLY way to now avoid a European bond crash is for the ECB to hold what it has at the very least and to keep buying the debt. This would mean that the ECB would clearly exceed the one-third limitation of holding a country's bonds.

The Failure of Quantitative Easing

The **European Central Bank** (ECB) is dangerously trapped holding 40% of Eurozone government debt. The asset purchase program, a monetary experiment known as **Quantitative Easing** (QE), was launched in March 2015 to prevent sub-zero inflation from further hitting an economy. The ECB had initially spent €2.6 trillion euros over nearly the first four years, buying up mostly government but also corporate debt, asset-backed securities and covered bonds — at a pace of €1.3 million Euros a minute. That equates to roughly €7,600 Euros for every person in the currency bloc.

After 10-years of **Quantitative Easing** (QE), Europe has been unable to rise from the deflation imposed simultaneously by the Austerity policy that has resulted in greater tax enforcement and rising taxation. While the purpose of QE was to stimulate the economy, Austerity imposed by regulation and taxation was carried out to prevent inflation.

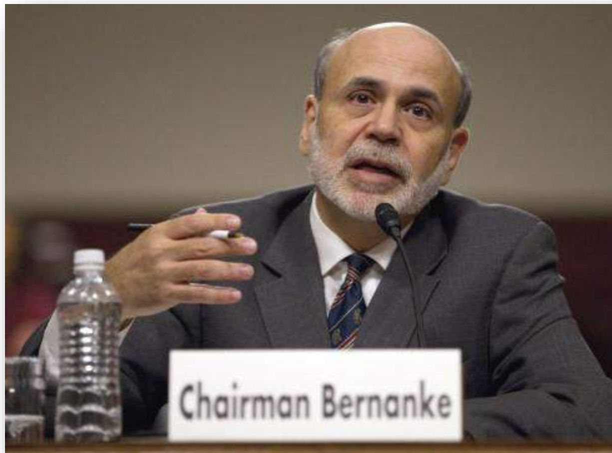
The theory of QE has been based upon this silly idea that if you simply rooted in the Quantity Theory of Money that an increase the money supply will increase inflation. The assumptions are rooted in the misinterpretation of the German

Hyperinflation of the 1920s. The theory ignored the creation of the Weimar Republic which came to power as a 1918 Communist revolution in Germany following the 1917 Revolution in Russia. People converted their wealth to assets or foreign currency and investing collapsed. The Weimar Republic was unable to issue bonds internationally and sought to imposed forced purchases of its bonds upon the wealthy segment of German population.

The entire program of QE has failed because of this seriously flawed theory. The "stimulus" never reached the pockets of the average individual while they imposed negative interest rates to punish citizens in Europe for failure to spend their money. Moreover, the ECB merely purchased government debt of its member states keeping member state on life support paying ridiculous low rates of interest. Its negative interest rates imposed on banks maintaining deposits at the ECB led to massive capital flight where they used an American branch to deposit funds at the Federal Reserve into their excess funds facility.

However, the banks are hoarding the cash because a stiff wind will blow them over. If the money injected does not reach the consumer, it is incapable of stimulating anything. Moreover, they totally fail to understand that the empirical level of interest rates means absolutely nothing. It is the net difference between the interest rates and the future expectation of profit that matters. If you think you will double your money, you will pay 25% rates of interest. If you do not see 1% in possible profits, you will not pay even a 0.5% interest rate.

This attempt to stimulate the economy by increasing the money supply assumes that it does not matter who has the money. If we are looking only at the institutional level, then this will never possibly contribute to **DEMAND** among consumers that produces any level of inflation only **ASSET** inflation by causing share markets to rise in proportion to the decline in currency value.



In 2002, when the word **"deflation"** began appearing in the business news, Bernanke, then a governor on the Board of the Federal Reserve, gave a speech about **deflation** entitled **"Deflation: Making Sure "It" Doesn't Happen Here."** In that speech, Bernanke assessed the causes and effects of **deflation** in the modern economy. He stated:

> *"The sources of deflation are not a mystery. Deflation is in almost all cases a side effect of a collapse of aggregate demand – a drop in spending so severe that producers must cut prices on an ongoing basis in order to find buyers. Likewise, the economic effects of a deflationary episode, for the most part, are similar to those of any other sharp decline in aggregate spending—namely, recession, rising unemployment, and financial stress."*

Draghi completely moved with the Keynesian model to increase the money supply with Quantitative Easing, but this simply failed. He did not give up and then pushed interest rates negative to punish savers and consumers for not spending money that never reached their pockets to start with.

Negative rates promoted hoarding cash outside of banks since one did not earn interest and the risk of banks thereby increased and people withdrew funds. To combat that, Draghi and others have considered eliminating cash using the slogan "Cash is for Criminals". But negative rates have been simply a tax on money. The attempt to **"manage"** the economy from a macro level without considering the capital flows within the system has led to the brink of a new type of economic disaster.

This time, the central banks have gone and done this themselves and they are trapped. They cannot sell the debt they have bought and therefore, we are looking at a crisis when that debt has to roll. The European Central Bank (ECB) holds more than 40% of the government debt for the whole of Europe. Once that matures, who will buy the new debt the next time around?

We are looking at a deflationary impact by default, which can wipe out the central banks. This time, QE programs allowed the money they injected to buy back bonds to go anywhere without restriction. Capital flight from the local economy resulted in deflation as the money never truly stimulated anything domestically either migrating or being hoarded. To then compensate for the QE programs, the politicians have ratcheted up taxes and enforcement of taxes. This has acted in direct opposition to the QE programs and Europe is hopeless lost between these two conflicting policies.

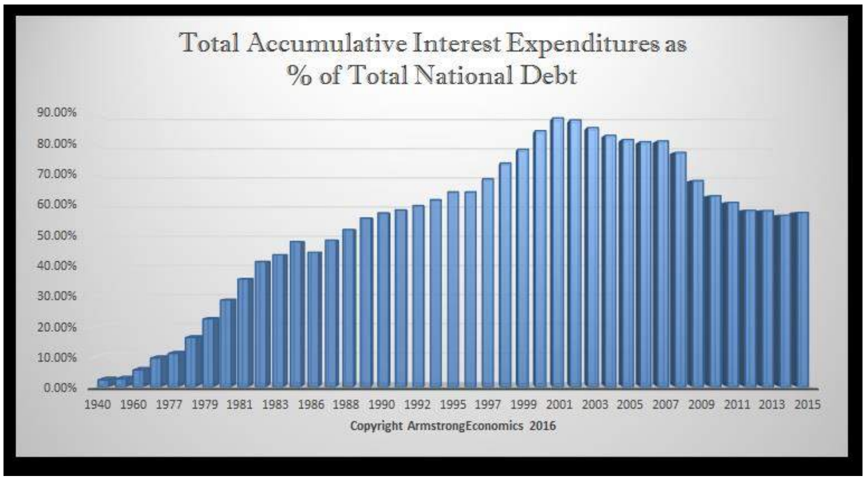
So, when the bonds mature, will the government be able to repay those bonds by selling new ones? Who will be the buyer? The Federal Reserve has recently announced that it would no longer reinvest its gains on government bonds that had matured into new US securities, resulting in a shortening of the balance sheet. Bills of $426 billion will be due at the Fed in 2018, and again about $357 billion a year later. So if the Fed will not repurchase that debt, then the amount of new debt coming to the market will **DOUBLE**.

The Treasury will be forced to find ways to absorb the additional supply if the Fed wants its cash back, so the Treasury must find a lot of private buyers. The shrinking of the balance sheets represents the continued deflationary trend from a real economic expansion trend. The government will be competing for cash in an ever-growing tighter economy.

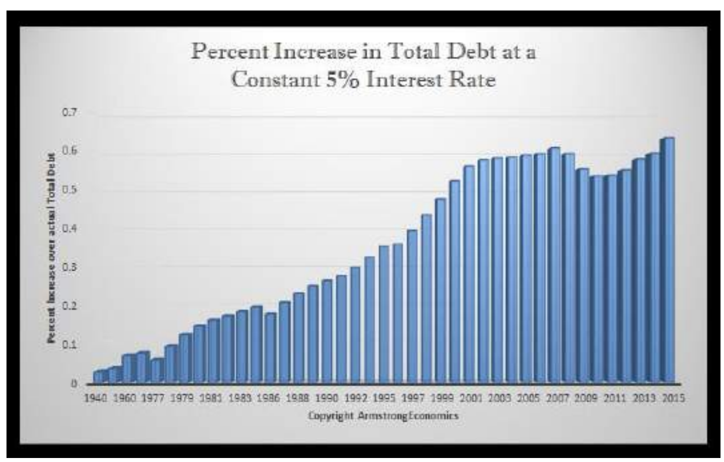
This is becoming the real straw that will break the back of the ECB. The coming **Sovereign Debt Crisis** is magnified by the simple fact that what they have already bought, about 40% of all government debt in the Eurozone will have to be replaced. Can the ECB simply turn its back?

The question of when will the central banks fail is a question that is no longer absurd. The ECB cannot sell the debt it holds and when it matures, what happens? If the ECB does not replace what it currently owns, then the amount of debt going to the marketplace will be nearly **DOUBLE** any previous offering.

Suffice it to say, the turmoil will hit Europe first. While so many people blame the Fed for all sorts of things, you must realize that the Fed is in the best position of all central banks. The demand for the dollar assets will only rise in the middle of a **Sovereign Debt Crisis** emerging in Europe.



Today, the real crisis is what happens when interest rates rise? Governments have not reduced spending but increased their spending and borrowing. Even if we look at the United States, the total accumulative interest expenditures peaked in 2001. They declined perfectly for 13 years into a low formed in 2014. The Fed began to raise rated as soon as the Economic Confidence Model turned on October 1st, 2015. With that first-rate hike, the trend in accumulative interest expenditures rose in 2015.



We can easily see the next crisis coming. Here is what would happen using a hypothetical 5% rate of interest. If we saw rates rise just to 5% compared to the historical norm of 8%, the interest expenditures would balloon to new highs.

As rates rise, the national debts will explode. Governments will be unable to reduce spending and will simply raise taxes dramatically causing greater unemployment. It becomes a fantasy to think government will reform to prevent a crisis. They are reactionary and only respond to the crisis, which will be too late.

Today we have **Quantitative Easing** when central banks buy government paper attempting to "stimulate" which is indirect and unlike the original design behind **Elastic Money** theory. Government debt is simply never ending for it is perpetually rolled. Private corporate paper expires – government dent constantly rolls over. Obviously, this is a major distinction compared to the practices that preexisted the Federal Reserve with respect to the New York Clearing House Certificates. This current scheme of Quantitative Easing never puts money directly in the pockets of consumer or workers in the private sector and does not help corporations retain workers.

The New York Clearing House Certificates were redeemed and those from 1873 no longer even exist today because they were used among institutions. The conspiracy advocates never blame the right person or group. They do not understand the economics behind **Elastic Money** as it previously existed prior to 1913 and the creation of the Fed. Their entire argument against **Elastic Money Theory** has been prejudiced by the whole **Quantity Theory of Money**.

We need a central bank and **Elastic Money** which is an excellent tool to ease the contraction in the **Velocity of Money** during a crisis as people hoard their cash and refuse to spend. In order to restore this vital tool, government debt must be excluded. **Elastic Money** should be restricted to private sector business – never government.

When we turn to the ECB and compare its powers to that of the Federal Reserve, we arrive at a stark understanding of the difference in powers. Where the Federal Reserve shares are technically owned by private banks because it was to be a funded bailout system operating like the New York Clearing House pre-1913, the ECB also has shareholders. The ECB is set-up like a corporation whereas if has shareholders and capital stock. Its capital is €11 billion held by the national central banks of the member states as shareholders. This once again reflects the fact that the EU refused to consolidate the debts of member states and this left them in the same position regarding their state debt. The initial capital allocation key was determined back in 1998 on the basis of the states' population and GDP, but the capital key has been adjusted. Shares in the ECB are not transferable and cannot be used as collateral.

Meanwhile, the Governing Council is the true main decision-making body of the Eurozone system. It is composed of the six members of the Executive Board and the governors of the National Central Banks of the Eurozone member states. However, since January 2015, ECB publishes on its website a summary of the Governing Council deliberations, but it refuses to disclose the individual voting records of the governors seating in its Council. This is to protect the Euro from being exposed with respect to discontent.

Therefore, the Fed was created with the power to create **ELASTIC** money that made sense because corporates (unlike government) have to pay back. This was all based upon the system of Clearing House Certificates that had pre-existed during the 19th century. The Clearing House would issue its own money during a

crisis to ease the storage in cash and then after the crisis, that money was retired – hence the term **ELASTIC**.

So how does this contrast with the ECB? Here in lies the problem. The ECB is **NOT** authorized to create an **ELASTIC MONEY SUPPLY**. Germany would never allow that. Consequently, the ECB cannot continue to just buy-in sovereign debt of member states as the market forces come down upon them. The ECB, unlike the Fed, will run out of money and then there will be a very public crisis whereby the ECB will have to be recapitalized.

Something will have to give in Europe. The ECB was granted a ceiling to buy in government bonds. It cannot just print money with no end in sight. It must get approval, which the Fed does not require from Congress. The two are completely different animals.

On top of this, each member state retained its own central bank. Each member bank issues euros in their domestic economies. You can collect euro coins from each central bank – the ECB does not issue them. There are no two-tier levels of central banks in the USA. The Federal Reserve has no such competition.

Then the reserves of the European banking system had to be politically correct and the reserves were composed of all member bonds. Why? Germany opposed a single European debt issue and to this day they object to the issue of any federal debt by Brussels.

Now, the Fed bought in $4 trillion against a $22 trillion national debt including Excess Reserves and the debt was only federal amounting to $2.4 trillion. The ECB bought the worst debt and now owns 40% of the total debt of the Eurozone member states and its debt holding relative to GDP is 20% compared to 10% for the Fed. Why is the ECB in danger of default?

If there is a disagreement in Brussels, then the ECB runs out of cash. As interest rates rise, the value of its balance sheet will collapse. The ECB cannot sell the debt back to the market for there is no bid. To try to support the debt market, Brussels made it illegal to short government debt. Hence, there is no free market in European sovereign debt. If the ECB bought 40% of all debt, who is going to buy it when they stop?

This is a completely different perspective for the ECB v the Federal Reserve which will just let its US federal debt holdings mature and expire reducing its balance sheet. They too cannot sell the debt or interest rates would explode.

Welcome to the reality of the crisis. **NOT** all central banks were created equal. Those who paint them all with the same brush know nothing about what they are talking about. The ECB claims it cannot go bankrupt because it will just issue more money. The fact that they have even stated that demonstrates there is a huge problem. That depends upon one thing – approval from the politicians to issue more money.

Governments are **NOT** a single entity. Central Banks are far too often on the opposite side of the table with the Political side of government. It is far more complicated than most people would ever guess. So, all the people who blatantly say a central bank cannot default because they create money on a wholesale basis, do not understand the system and are making broad assumptions without knowing the story behind the curtain.

Country codes

(1) Uncirculated euro banknotes issued by the Banque centrale du Luxembourg bear the code of the central banks of the countries where the banknotes for Luxembourg are produced.
(2) Belgium Z
(3) Germany X
(4) Estonia D
(5) Ireland T
(6) Greece Y
(7) Spain V
(8) France U
(9) Italy S
(10) Cyprus G
(11) Latvia C
(12) Luxembourg (1)
(13)
(14) Malta F
(15) Netherlands P
(16) Austria N
(17) Portugal M
(18) Slovenia H
(19) Slovakia E
(20) Finland L

Each national central bank within the Eurozone commissions the printing of a banknote. The country issuing the note is indicated by a letter or country code preceding the serial number, as shown here. This particular banknote, bearing the letter ‘S’, was printed for the Banca d’Italia.

2018 Central Bank Reserve Ratios

ALBANIA	10.00%
ANGOLA	19.00%
ARMENIA	2.00%
ARGENTINA	44.00%
ARUBA	11.00%
AZERBAI	0.50%
BANGLADESH	5.50%
BARBADOS	5.00%
BELARUS	7.50%
BULGARIA	10.00%
CAMEROON	5.88%
CAPE VERDE	15.00%
CEN.AFRICA REP	0.00%
CHAD	3.88%
CHINA	14.50%
DEM.	2.00%
REPUBLIC	5.88%
COSTA	15.00%
CROATIA	12.00%
CZECH REP	2.00%
CURACAO	18.00%
DENMARK	2.00%
EGYPT	14.00%
EQUATORIAL	5.88%
EUROZONE	1.00%
FIJI	10.00%
GABON	5.88%
GAMBIA	15.00%
GEORGIA	5.00%
GHANA	10.00%
HUNGARY	1.00%
ICELAND	2.00%
INDIA	4.00%
INDONESIA	6.50%
IRAQ	15.00%
ISRAEL	6.00%
JAMAICA	12.00%
JORDAN	8.00%
KAZAKHSTAN	2.50%
KENYA	5.25%
KYRGYZ REP	4.00%

LITHUANIA	3.00%
MACEDONIA	8.00%
MALAWI	15.50%
MALAYSIA	3.00%
MALDIVES	10.00%
MAURITIUS	9.00%
MOLDOVA	42.50%
MONGOLIA	10.50%
MOROCCO	5.00%
MOZAMBIQUE	14.00%
NEPAL	4.00%
NICARAGUA	10.00%
NIGERIA	22.50%
PAKISTAN	3.00%
PERU	5.00%
PHILIPPINES	18.00%
POLAND	3.50%
QATAR	4.50%
ROMANIA	8.00%
RUSSIA	5.00%
RWANDA	5.00%
SERBIA	5.00%
SOUTH	2.50%
SRI LANKA	6.00%
TAIWAN	10.75%
TAJIKISTAN	3.00%
TANZANIA	8.00%
TRINIDAD/TOBAGO	17.00%
TUNISIA	1.00%
TURKEY	8.00%
USA	10.00%
URUGUAY	25.00%
UZBEKISTAN	15.00%
VENEZUELA	19.00%
VIETNAM	3.00%
WEST	3.00%
ZAMBIA	5.00%

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Elastic Money & Global Banking Reserves

The creation of money electronically in the banking system has long been part of the conspiracy theories that believe central banks can just create money at will without limit. The actual **Reserve Requirement Ratio** at the Federal Reserve was increased on January 18th, 2018. It required that all banks with more than $122.3 million on deposit maintain a reserve of 10% of deposits. Banks with $16 million to $122.3 million must reserve 3% of all deposits.

It is true that banks create money through lending and book entries that is really leverage. It is purely electronic, and it does not actually form a part of the official creation of money. I deposit $100 and they lend it to you. Now we both have $100 on deposit as a book entry, not physical paper dollars. The reserve requirement will be $20 for most banks. They then lend it out a third time and there is now $300 on deposit requiring $30. They cannot create entries out of thin air. They are audited and the reserve ratio is strictly enforced in the USA. The Fed will raise/lower that reserve ratio as they see fit based upon economic conditions.

In the Eurozone, banks are required to hold minimum reserves in accounts at their **National Central Bank** (NCB) – not at the **European Central Bank** (ECB). A bank's minimum reserve requirement is set for six-week maintenance periods. The level of reserves is calculated on the basis of the bank's balance sheet before the start of the maintenance period.

Again, once more we have the same problem of refusing to consolidate the debts. This is also when each member state then retained its own central bank. In reality, the Euro was simply the creation of a currency that member states all agreed to use. Each central bank prints its own Euros whereas the ECB does not print any currency or mint coins.

Legally, both the ECB and the NCBs of the Eurozone countries have the right to issue the seven different euro banknotes. In practice, only the NCBs of the Eurozone physically issues and withdraws Euro notes. The ECB does not have a cash office and is not involved in any cash operations. The ECB governs electronic transfers and book entries. Thus, the ECB is responsible for overseeing the activities of National Central Banks in order to harmonize cash services in the Eurozone.

There is a substantial difference between the Federal Reserve and the ECB. The accounting at the Fed allows for it to **CREATE** money as needed. Now the fiat crowd will argue that the Fed can just create money in a very **ELASTIC** money supply. During an economic contraction, confidence collapses, and people immediately hoard their money. This reduces the velocity of money. Therefore, creating **Elastic Money** during a crisis is necessary but it **ONLY** functions when it is a direct injection of capital into the private sector that automatically expires.

UNCLE SAM'S NEED OF AN ELASTIC CURRENCY

PRESIDENT ROOSEVELT: "You see, those galluses ought to have rubber in them, so that when Uncle Sam stoops to move the sheaf there won't be much strain on the buttons."

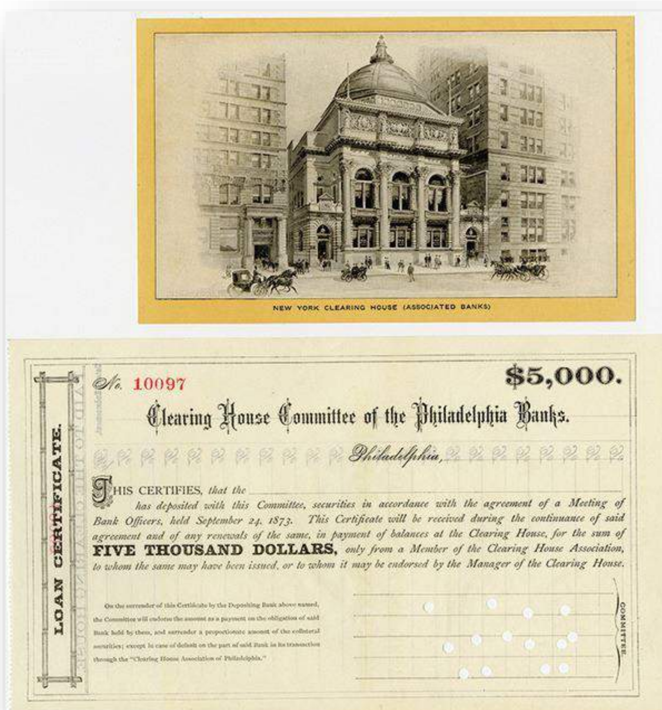
From the *Pioneer Press* (St. Paul)

The New York Clearing House was organized officially on October 4th, 1853

Originally, the money was created not by bailing out banks, but by purchasing corporate paper directly to prevent layoffs. Hence, the shortage of money resulted in defaults **BECAUSE** banks would not lend, and assets decline in currency value in proportion to the contraction in the money supply.

The entire use of "elastic money" was not invented by the government or the Fed. It began in 1853 with a little-known group to try to help in the middle of a crash for what you are advocating is precisely what Europe has done – impose austerity.

The **Panic of 1873** saw the government make a small gesture to try to calm the panic. They did the same thing as **Quantitative Easing** back then – Yes, not even that is new. The US Treasury injected cash by purchasing government bonds. It did **NOTHING** to help the economy. Why? When confidence crashes, people **HOARD** money and will not spend it if they fear the future. The cash they injected was hoarded by the banks just as it has been post-2007. Quantitative Easing in this manner **NEVER** produces inflation nor does it stimulate the economy.



LOAN CERTIFICATE.

No. 10097 $5,000.

Clearing House Committee of the Philadelphia Banks.

Philadelphia,

THIS CERTIFIES, *that the*
has deposited with this Committee, securities in accordance with the agreement of a Meeting of Bank Officers, held September 24, 1873. This Certificate will be received during the continuance of said agreement and of any renewals of the same, in payment of balances at the Clearing House, for the sum of **FIVE THOUSAND DOLLARS,** *only from a Member of the Clearing House Association, to whom the same may have been issued, or to whom it may be endorsed by the Manager of the Clearing House.*

On the surrender of this Certificate by the Depositing Bank above named, the Committee will endorse the amount as a payment on the obligation of said Bank held by them, and surrender a proportionate amount of the collateral securities; except in case of default on the part of said Bank in its transaction through the "Clearing House Association of Philadelphia."

COMMITTEE.

The creation of "elastic money" was in fact swapped for private assets that distinction which was a critical function. The problem which has emerged since is when the assets swapped became government debt which is never paid off.

The banks effectively banned together to create their own **"Elastic Money"** using the New York Clearing House. Failing to increase the money supply meant that the value of money in purchasing power rises and all assets decline. This is the hallmark of **EVERY** recession or depression. During the **Panic of 1873**, the national banks of New York pooled their cash and collateral into a common fund and placed this in the hands of a trust committee at the New York Clearing House, which had been founded on October 4th, 1853.

The New York Clearing House then issued loan certificates that were backed at the Clearing-house against this collateral. These certificates were absorbed like cash and could be used to pay off debt balances. Ten million dollars' worth of these certificates were issued at first, but the sum subsequently doubled. This Clearinghouse paper served its purpose admirably as elastic temporary money.

By October 3rd, 1873 confidence had been returned and $1,000,000 of these certificates was called in to be canceled. The next day, another $1,500,000 more of these certificates were recalled. In the end, not much of this issue was outstanding very long. The Clearing-house scheme was successfully applied also in Boston, Philadelphia, Pittsburgh and other cities, but not in Chicago.

1907 Clearing House Scrip San Francisco

The tool of creating an "Elastic Money" supply that was private was also used during the Panic of 1907 very successfully. This is where we begin to see small denomination notes in circulation as this one in San Francisco.

This was the birth of **"Elastic Money"** that makes sense. This prevents wholesale liquidation of assets to get cash in short supply. It was used nationally in financial centers during the **Panic of 1907**. The problem is neither the Fed nor the concept of **Elastic Money**. The Fed was originally established in 1913 to act like the New York Clearing House but for all assets outside of Wall Street. Then came World War

I the next year in 1914 and Congress ordered the Fed to buy only US government bonds. They never returned the structure of the Fed to what it was originally designed to do.

This was the birth of **"Elastic Money"** that makes sense. This prevents wholesale liquidation of assets to get cash in short supply. The problem is neither the central bank nor the concept of **Elastic Money**. In the United States, the Fed was originally established in 1913 to act like the New York Clearing House, but for all assets outside of Wall Street. This design had been tested and worked brilliantly since the **Panic of 1873** reducing the deflationary contraction in financial assets that would spill over into the real estate market. The Fed was designed to buy corporate paper in a crisis when banks would not lend. This was the "Elastic Money" and it worked because the Fed would buy corporate paper, which naturally was paid off thereby contracting the **"Elastic Money"** supply it created.

The problem emerges with World War I the very next year in 1914 after the Fed was created. Congress then ordered the Fed to buy only US government bonds ending the very purpose of **"Elastic Money"** to buy corporate paper in an effort to ease the contraction by deflation. They never returned the Fed structure to what it was originally designed to do.

Therefore, the Fed's power to create Federal **"Elastic Money"** no longer aided the private sector. This is the primary distinction that has proved to be devastating to the management of central banks ever since because everyone has just copied the Fed design as it stood after World War I.

Furthermore, the Panic of 1907 was caused in part by the internal capital flows being upset with the San Francisco Earthquake in 1906. The claims were on the West Coast and the Insurance Companies and bankers were in New York. The cash flowed from East to West creating shortages in the East when the crisis hit.

The second structural cornerstone of the Federal Reserve was in fact that of the establishment of branches around the country. The entire reason for the branch network was to help manage the capital flows within the nation. When crops were being planted, bank loans flowed from East to the Great Plains. When the crops were harvested, the loans would be repaid reversing the capital flows. It was the interest rates that were established as the tool to vary capital flows between regions excess or a shortage of cash in that region. Rates would be lowered to deflect money or raised to attract it naturally from other regions.

Federal Reserve August 1927
Discount Rate

Atlanta.............	4.0%
Boston...............	4.0%
Chicago..............	4.0%
Cleveland...........	4.0%
Dallas.................	4.0%
Kansas City........	3.5%
Minneapolis......	4.0%
New York...........	4.0%
Philadelphia......	4.0%
Richmond..........	4.0%
St. Louis.............	4.0%
San Francisco.....	4.0%

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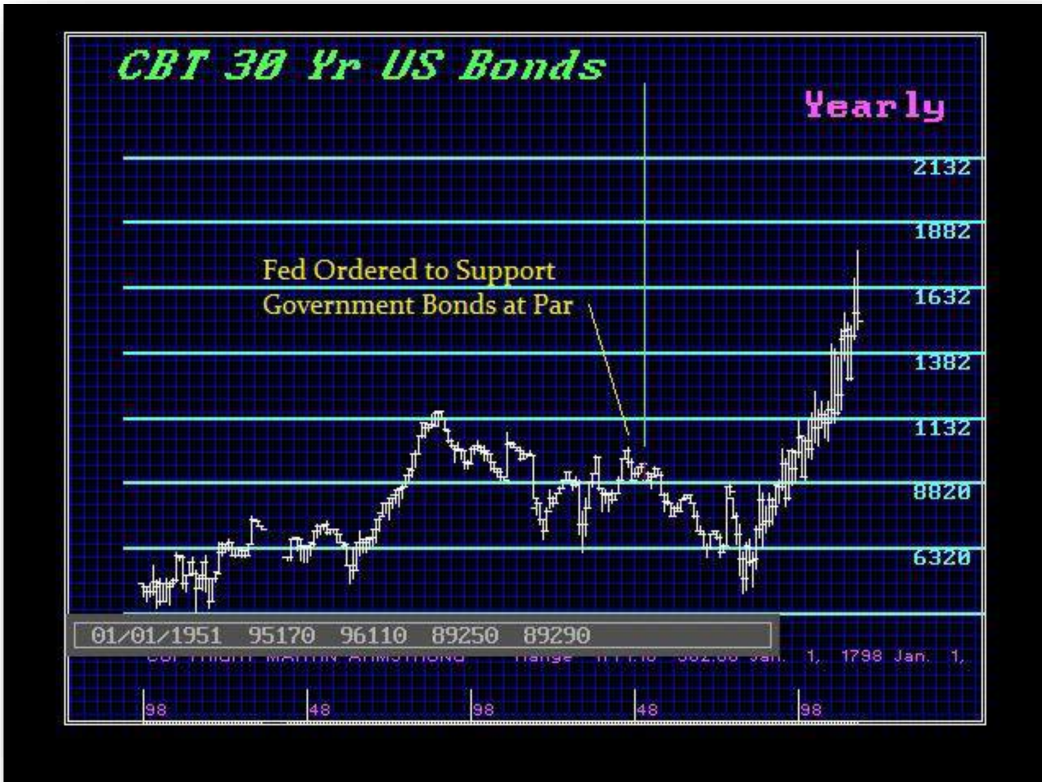
It was when Franklin D. Roosevelt (FDR) came to power when he too altered this cornerstone of the Federal Reserve making it really irrelevant to have branch offices. FDR, in order to impose socialism upon the nation required economic totalitarianism – achieved with central planning. FDR used the Great Depression as his excuse and usurped all the power to Washington, eliminating the very purpose of the Fed to manage the regional capital flows. The nation was now under a single national interest rate – one size fits all.

Consequently, these two primary structural changes to the Federal Reserve have eliminated the government's power to properly manage the economy – elimination of private "***Elastic Money***" and usurping individual interest rates making branches redundant.



Once FDR took control of the Fed away from the banks, it did not take long to abuse that power. It was during April 1942, when the Department of the Treasury requested the Federal Reserve formally to commit to maintaining a low interest-rate peg of 3/8% on short-term Treasury bills. The Fed also implicitly capped the rate on long-term Treasury bonds at 2.5%. This became known as the **"peg"** with the express goal to stabilize the securities market and allow the federal government to engage in cheaper debt financing for World War II, which the United States had entered in December 1941.

At the time, in order for the Fed to maintain the peg, it was ordered to give up control of the size of its portfolio as well as the money stock. That is also what has happened today with **Quantitative Easing** among all central banks. Frankly, the Fed back then maintained the low interest rate by buying large amounts of government securities, which also increased the money supply domestically at the time. Because the Fed was committed to a specific rate by the peg, it was compelled to keep buying securities even if the members of the Federal Open Market Committee (FOMC) disagreed.

After the war, politicians were afraid a new depression would emerge as they always fight the last war. They ordered the Fed to maintain the peg even after 1945. The United States entered the Korean War in June 1950. The problem was inflation not deflation. The FOMC of the Fed argued strongly that the continuation of the peg would lead to excessive inflation. A real confrontation with the politicians was brewing all year and they were opposed by the Treasury who naturally wanted to keep borrowing at cheap rates for its own expenditures as we will see today.

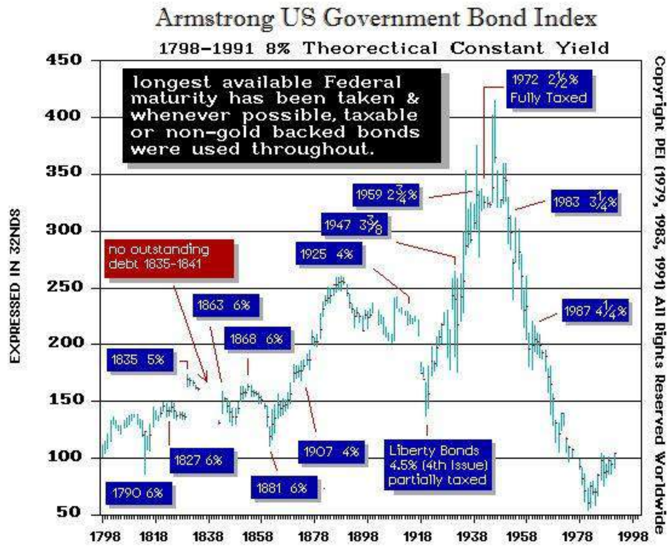
Everything exploded by February 1951. Inflation had soared reaching 21%. As the Korean War intensified, the Fed faced the possibility of having to monetize a substantial issuance of new government debt coming out to fund that war. This only intensified inflation. Nevertheless, **Harry S. Truman** became president in 1945 and it was his administration that continued to urge the Fed to maintain the peg.


Harry S. Truman (1884 – 1972)
33rd President of the United States (1945 – 1953)

The financial crisis erupted into a major conflict when Truman invited the entire FOMC to a meeting at the White House. Truman then issued a statement saying that the FOMC had ***"pledged its support to President Truman to maintain the stability of Government securities as long as the emergency lasts."*** In reality, the FOMC had made no such pledge. Conflicting stories began to appear about the dispute in the press. The Fed then made an unprecedented move – they released the minutes of the FOMC's meeting with the president.

The conflict erupted in full view. The Fed revolted against the politicians. Shortly thereafter, the Fed informed the Treasury that as of February 19th, 1951, it would no longer ***"maintain the existing situation."*** The Treasury was caught in a crisis for it needed to refund existing debt and issue new debt, a situation all governments are still in today. **They never pay off debt, they simply roll forever.**

The government had no choice but to negotiate a compromise under which the Fed would continue to support the price of five-year notes for a short time, but after that the bond market would be on its own. It was on March 4, 1951, when the Treasury and the Fed issued a statement saying they had ***"reached full accord with respect to debt management and monetary policies to be pursued in furthering their common purpose and to assure the successful financing of the government's requirements and, at the same time, to minimize monetization of the public debt."***



It was this accord that created a free market in government securities. The likelihood that government debt becomes extinct will appear by 2023. We can see that the bond market began to crash as interest rates were at last free to move after 1951 (*note the blue late is the issue date used to create the perpetual contract*).

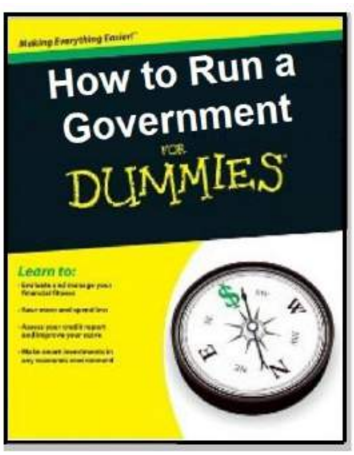
Helicopter Money

Therefore, the typical term **"Helicopter Money"** has been applied to **Elastic Money**. Most are clueless of what this tool was even created for no less do they comprehend the dynamics of the process. As explained, **Elastic Money** was merely the creation of emergency money which bought corporate short-term paper which matured and expired. In that sense it was clearly "elastic" for it was only temporary. That was a significant difference from the permanent increase in the money supply implied by the term **"Helicopter Money"**.

Because the Federal Reserve during the Great Depression practiced austerity and refused to increase the money supply, more than 200 cities began issuing their own money called Depression Scrip. The 1931 **Sovereign Debt Crisis** destroyed capital for the debts were never repaid. This crisis was omitted from the history books. John Kenneth Galbraith blamed corporations in his book **"The Great Crash"** and never wrote about the government defaults because he supported socialism.

Since there was no "**helicopter money**" on a federal level, the money supply contracted with all the sovereign debt defaults. This contraction produced massive **DEFLATION**. The only **"Helicopter Money"** was limited to local "Depression scrip" which did not circulate outside of that particular city.

Therefore, if the central bank allows the debt to mature and expire, then it remains simply Elastic Money. The difference unfolds when a central bank is doing what the ECB is currently doing. When they reinvest expiring bonds and continue to buy more sovereign debt, the this can meet the distinction we would term **"Helicopter Money"** for it only expands, and never contracts.



This is most likely the outcome for the ECB **Quantitative Easing** because there is no end in sight and no intention of shrinking the balance sheet. It is just the permanent creation of money.

Understanding the Central Banks within Europe

The actual monetary structure of the central banking system within Europe remains primarily shrouded in misconception. Many people look to the European Central Bank and assume it is a carbon-copy of the Federal Reserves. In reality, it is nothing like the Federal Reserve and its structure is once again a reflection of the failure to properly design the Eurozone from the very beginning.

In the United States, there is only one central bank – the Federal Reserve. In Europe, each member state retained its central bank and they in turn retained the authority to issue euros. The ECB actually does not print currency nor does it issue coins unlike the Federal Reserves/US Treasury. The original idea that the ECB would be able to dictate interest rates for all members because of a single currency has been a total failure. As in the United States, each state pays a different interest rate to borrow based entirely upon its own economic conditions. The Federal Reserve only sets interest rates relative to federal short-term debt. The ECB, in contrast, can set only a base interest rates and each member pays interest based upon its own economic conditions.

The head of the ECB is appointed for a 7 year term and thus does not stand for election and overrule of all central bank policies within Europe. In the United States, Janet L. Yellen took office as Chair of the Board of Governors of the Federal Reserve System on February 3, 2014, for a four-year term ending February 3, 2018. However, Yellen also serves as Chairman of the Federal Open Market Committee, the System's principal monetary policymaking body. Prior to her appointment as Chair, Janet Yellen served as Vice Chair of the Board of Governors, taking office in October 2010, when she simultaneously began a 14-year term as a member of the Board that will expire January 31, 2024. Therefore, her service on the board is a 14-year term while holding the Chair runs for just four years. The great distinction between the Fed and the ECB remains the fact that the Fed does not compete with central banks of 50 states, whereas each member state in the Eurozone retains its central bank.

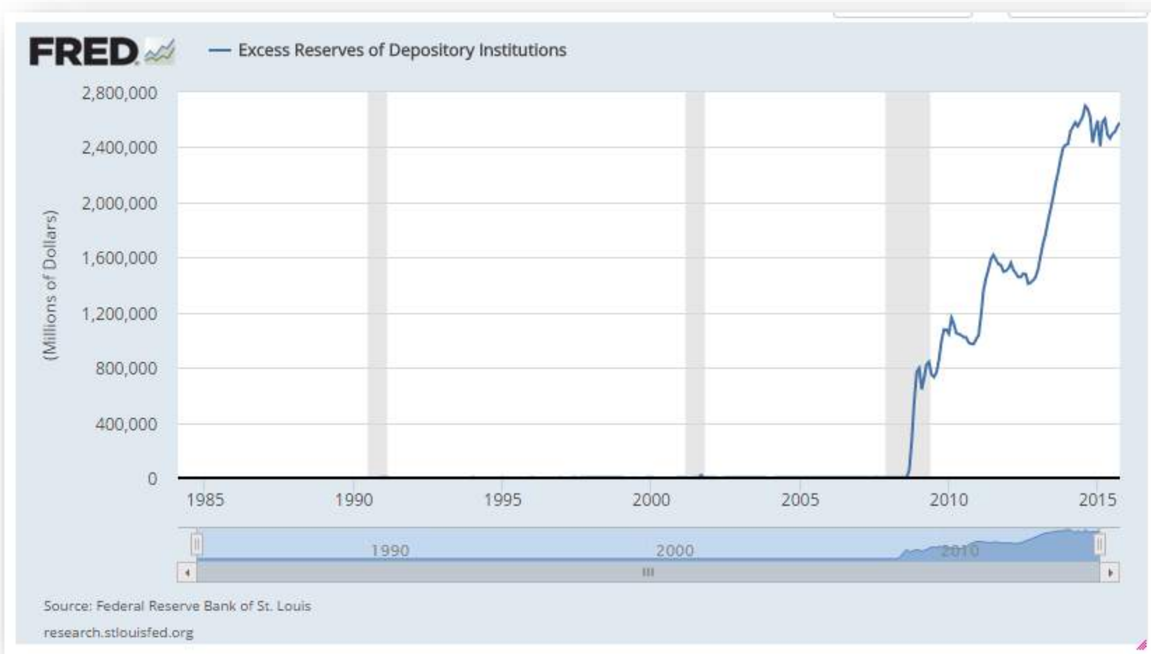
The ECB is run by Mario Draghi, who is ex-Goldman Sachs. Mario Draghi faces a currency that is collapsing and a power structure that is fundamentally flawed. This is entirely different from the problems facing the Fed. Europe is in deep recession that is intensely deflationary. That is not the case yet in the USA.

Janet Yellen inherited a nightmare created by the academic Ben Bernanke taught at the Stanford Graduate School of Business from 1979 until 1985, and was a visiting professor at New York University. He then went on to become a tenured professor at Princeton University in the Department of Economics. He chaired that department from 1996 until September 2002, when he went on public service leave. He resigned his position at Princeton July 1, 2005.

Bernanke had no experience in banking, only acedemics. He came up with the absurd ***"Bernanke Doctrine"*** and first discussed ***"the Great Moderation"*** which was the theory that traditional **business**

cycles have declined in volatility in recent decades through structural changes that have occurred in the international economy, particularly increases in the economic stability of developing nations, diminishing the influence of macroeconomic (monetary and fiscal) policy. He was confronted with the worst economic decline of a far greater volatility level that in many respects shocked the financial system to a greater extent than the Great Depression.

Bernanke lowered rates, bought in long-term bonds the Fed cannot now sell and must wait for them to simply mature. Yellen is trapped, for she cannot reverse QE and sell the bonds Bernanke bought and she is facing a meltdown in pension funds because rates are too low for too long. Yellen has no escape and must raise rates. She has constantly been warning that rates must be "normalized."



Bernanke bought in 30-year bonds to help reduce the competition with mortgages and to inject cash into the system from a very book-smart perspective looking at the economy in theory, not in reality. The bankers then complained that they needed the Fed to create an excess reserve facility to earn money if they had no more bonds to invest their capital. Creating this facility defeated the very purpose of QE and ensured that there would be no inflation for the banks did not lend the money out.

On the one hand, Bernancke was supposed to be **"stimulating"** the economy by injecting cash for liquidity, but the banks never lent the money out and hoarded it at the Fed. Therefore, the money created did not stimulate for two reasons. First, Excess Reverses defeated the whole idea of injecting cash to increase the liquidity. Second, the Chinese sold their long–term debt holdings and reduced their maturity. Buying the 30–year bonds was a nice idea, but it failed to understand that the bonds were not exclusively in the hands of Americans. Buying in the bonds sent excess cash outside the domestic economy also diminishing any domestic stimulation.

It is clear that Ben Bernanke lacked any experience in academics to run the Fed. This is like a man trying to write a book on how it "feels" to go through childbirth. You can be a doctor and read all the books, but if you have not experienced it, how can you be an authority on how something "feels"? Book smart does not cut it in finance.

Yellen has realized the trap created by Bernanke and the Fed has become the central bank for the world since global central bank reserves include US Treasury bonds. Yellen realized that the Fed was in danger of losing its sovereignty, allowing itself to delay its domestic policy objectives for international concerns.

Yellen has tried to talk sense into Draghi, but he cannot bring himself to admit what he has done is seriously wrong. From 1984 to 1990 Draghi was the Italian Executive Director at the World Bank. In 1991, he became general director of the Italian Treasury, an office he held until 2001. Draghi was also a former board member of several banks and corporations in Italy, not for his expertice, but political position (Eni, Istituto per la Ricostruzione Industriale, Banca Nazionale del Lavoro and IMI).

Draghi also became the vice chairman and managing director of Goldman Sachs International (2002–2005), but once again for political connections rather than qualifications. Draghi had worked on the firm's European strategy and development with major European corporations and governments. However, following the revelation of off-market swaps used by Greece with the help of Goldman Sachs, Draghi then denied he participated as the managing director no less. He said he "knew nothing" about this deal and "had nothing to do with" it. He added that "the deals between the Greek government and Goldman Sachs had been undertaken before [his] joining of [the company]."

That is not a true statement. Yes, it was in 2001, when Greece was looking for ways to disguise its mounting financial troubles. The **Maastricht Treaty** required all Eurozone member states to show improvement in their public finances, but Greece was heading in the wrong direction. Then Goldman Sachs came to the rescue, arranging a secret loan of €2.8 billion for Greece, disguised as an off-the-books "cross-currency swap"—a complicated transaction in which Greece's foreign-currency debt was converted into a domestic-currency obligation using a fictitious market exchange rate.

As a result, about 2% of Greece's debt magically disappeared from its national accounts. Christoforos Sardelis, then head of Greece's Public Debt Management Agency, later described the deal to Bloomberg Business as ***"a very sexy story between two sinners."*** Goldman received a an outrageous €600 million in fees. That single transaction was about 12% of Goldman's entire revenue in 2001. It is doubtful that Draghi, who joined the firm in 2002 would have been so blind not to see that Goldman made 12% of its 2001 revenues from this transaction with Greece.

The Goldman/Greece currency swap turned sour immediately following the 9/11 attacks in New York as bond yields plummetted. This resulted in a huge loss for Greece because of the formula Goldman had used. There was no way Greek politicians understood the complexity of the Goldman deal and Goldman did not explain the risk fully in the event of a major financial shock.

By 2005, Greece now owed almost double what it had put into the deal, pushing its off-the-books debt from €2.8 billion to €5.1 billion. Then. in 2005, the deal was restructured and that €5.1 billion in debt was locked in, but Mario Draghi was still there and only left to take the position as the head of the Italy Central Bank in December 2005. He became head of the ECB later in November 2011.

Mario Draghi was the head of the Italian Central Bank from December 2005 until 2011. Banca Monte dei Paschi di Siena S.p.A., the oldest surviving bank in the world, was expanding and became the third largest Italian commercial and retail bank by total assets by 2015. So granted, he was not there when they lost a fortune and used swaps to hide their losses in 2012.

Draghi was also a member of the Board of Directors of the Bank for International Settlements and also governor for Italy on the Board of Governors of the International Bank for Reconstruction and Development and the Asian Development Bank. I have sat on the board of a bank, but it has nothing to do with real experience. It is about accounting mostly and superficial decisions. Banks fail because the board is always ignorant of the trend.

Mario Draghi lacks the real world experience of a trader. Draghi has been quick to quash talk of end to his negative rates policy that is devasting the European banks and the economy. He has come out making political statements that he cannot possibly effect such as saying the Euro single currency is "irrevocable". Draghi is seriously trapped. Draghi cannot now reverse his policies, for that means they have to admit that they have failed to reverse the deflation since 2008 in almost 10 years of Quantitative Easing. Draghi now owns about 40% of all government debt throughout the Eurozone member states.

Draghi also said at the press conference last July 2016, that there was a change in policy because the ECB rule prevents them from buying negative yielding bonds. With German 10-year moving negative, that meant Draghi cannot buy anything from Germany. Draghi came out and said that if necessary he will use all ***"available instruments"*** meaning private corporate debt as well, but he has bought the distress corporate debt, which again is not stimulating the economy, merely trying to keep it on life-support.

The International Monetary Fund (IMF) last September 2016 warned at the G20 summit in Hangzhou, China, that in the face of crises, the refusal to reform how things are functioning will lead to economic weakness in the global economy. ***"The latest data shows subdued activity, less growth in trade and a very low inflation, suggesting an even weaker global economic growth this year,"*** the IMF told G20 leaders.

Indeed, we are looking at 2016 coming in as the fifth consecutive year in which global growth fell below the average of 3.7%, which prevailed between 1990 and 2007. The IMF said: ***"Without strong political countermeasures the world could suffer a disappointing growth"*** for several years to come. Christine Lagarde told world leaders: ***"Even in the longer term the outlook remains disappointing."***

The European Banking Crisis

At the European Central Bank, things are substantially different than people expect. Eurozone banks are required to hold a specified amount of funds as reserves on **AVERAGE** in their current accounts at their national central bank in each member state which are called "minimum reserves". Remember, each member retained its own central bank! A bank's minimum reserve requirement is set for six-week periods called maintenance periods.

This minimum reserve level is therefore calculated on the basis of the bank's balance sheet prior to the start of each six-week maintenance period.

Banks have to make sure that they meet the minimum reserve requirement only on an AVERAGE over the course of the maintenance period. This introduces serious risk. The bank can dip below the minimum reserve in the middle of a crisis and at the end of the six-week period, there can be no reserves remaining. So, they do not have to hold the total sum in their current accounts at the central bank on a daily basis! Therefore, this is a flexible arrangement that allows the banks to react to short-term changes in the money markets, but it exposes them to tremendous risk in a financial panic. The design was claimed to help stabilize the interest rate banks charge each other for short-term funds. I totally disagree with this concept.

The ECB requires credit institutions established in the Eurozone to hold deposits on accounts with their national central bank. These are called "minimum" or "required" reserves (MRR). The ECB requires credit institutions established in the Eurozone to hold minimum reserves. In addition, the following rules apply:

1) branches in the euro area of credit institutions established outside the euro area are also subject to the Eurosystem's minimum reserve requirements;
2) branches of euro area credit institutions which are located outside the euro area are not subject to the Eurosystem's minimum reserve requirements.

The ECB may exempt credit institutions from fulfilment of the Eurosystem's minimum reserve requirements upon request (to be submitted via the correspondent central bank) if:

1) the institution has a special function that would make the imposition of a minimum reserve requirement run counter to the purpose of the system; and
2) the institution is subject to re-organizational measures.

The ECB may also exempt credit institutions from fulfilment of the Eurosystem's minimum reserve requirements (without the need for a request to be submitted via the correspondent central bank) in the reserve maintenance period in which the institutions will cease to exist:

1) because its banking license is being withdrawn or surrendered, or
2) because it is subject to winding–up proceedings.

Up until January 2012, European banks had to hold a minimum of only 2% of certain liabilities, mainly customers' deposits, at their national central bank. As the economic crisis has continued in Europe, this 2% level has been reduced to 1%! The total reserve requirements for Eurozone banks stand at only around 113 billion euro currently.

Perhaps now people will understand why there is a serious risk of a **MAJOR** financial crisis starting in Europe and spreading thereafter around the globe. The general media and the public will **NOT** understand the reserve ratio disparity so a banking crisis in Europe will be assumed to be the same around the world.

Unfortunately, what happens in Europe will **NOT** stay in Europe. This is also why Europeans should create an account in the US banks for now since the US banks are not part of the **Common Reporting Standard** (CRS) which requires banks outside the USA to report on their clients to tax authorities.

The ECB is seriously looking at creating a cryptocurrency to defeat hoarding just canceling Euro notes. That will end hoarding and they will be able to then enforce negative interest rates. However, Draghi is beginning to see that negative interest rates have not helped to stimulate the economy. From the ECB view, they are concerned about the coming bank crisis in Europe so the best way to prevent a bank run is to eliminate cash! Europeans should open accounts outside the Eurozone before it is too late.

The **Common Reporting Standard** (CRS) is an information standard for the automatic exchange of tax and financial information on a global level. It was put together by the **Organization for Economic Co-operation and Development** (OECD) back in 2014. Its purpose was to hunt down tax evasion primarily for the European Union. They took the concept from the US **Foreign Account Tax Compliance Act** (FATCA), which imposed liabilities on foreign institutions if they did not report what Americans were doing outside the country.

The legal basis of the CRS is the **Convention on Mutual Administrative Assistance in Tax Matters.** As of 2016, 83 countries had signed an agreement to implement it. First reporting took place in September 2017. The CRS has many loopholes for countries have to sign the agreement. This has omitted the United States as well as most developing countries. Note that countries that are included are China, Singapore, Switzerland, most tax havens and of course Australian/New Zealand as well as Canada.

<u>As of 2018, the signing nations to avoid are</u>:

Albania, Andorra, Antigua and Barbuda, Aruba, Australia, Austria, The Bahamas, Bahrain, Belize, Brazil, Brunei Darussalam, Canada, Chile, China, Cook Islands, Costa Rica, Dominica, Ghana, Grenada, Hong Kong (China), Indonesia, Israel, Japan, Kuwait, Lebanon, Marshall Islands, Macao (China), Malaysia, Mauritius, Monaco, Nauru, New Zealand, Pakistan, Panama, Qatar, Russia, Saint Kitts and Nevis, Samoa, Saint Lucia, Saint Vincent and the Grenadines, Saudi Arabia, Singapore, Sint Maarten, Switzerland, Turkey, United Arab Emirates, Uruguay, Vanuatu

Excess Liquidity and Bank Lending Risks in the Euro Area

Monetary Dialogue September 2018

Abstract

Low interest rates and excess liquidity in the euro area, which exceeded €1,900 billion in September 2018, might create financial stability risks. We clarify the notion of excess liquidity and highlight that its current level is primarily the result of European Central Bank asset purchases. Overall, we conclude that financial stability risks in the euro area are low, but increased home bias and housing prices necessitate full attention from macroprudential authorities. Monetary policy tools are anyway ill-suited to fostering financial stability objectives.

This document was provided by Policy Department A at the request of the Economic and Monetary Affairs Committee.

The Greek Debt Crisis

You must have been living under a rock if you missed the entire Greek debt crisis. The role of Goldman Sachs undermining the Euro and the Greek economy is a major allegation that prevails. Greece joined the Euro in 2001 under Costas Simitis. At the time, Greece owed about €3.4 billion euros it had borrowed. Goldman Sachs engineered a currency swap whereby the Greek debt, issued in dollars and yen, was exchanged for euros that were priced at a "historical" or entirely fictitious currency rate.

Of course, swapping dollar and yen debt at nearly the low of 2000 when the Euro was only 82 cents to the dollar became a nightmare. Greece's debt doubled in real terms as the Euro then rose from the 82-cents level to about $1.60 by 2008. Obviously, Goldman Sachs offered no advice but structured a deal that only benefited itself by directing Greece to sell the dollar at the low. Goldman also set up an off-market interest-rate swap to repay the loan off the books, which was a currency position and therefore not technically a "loan" outside any reporting requirement as debt.

Goldman Sachs

The trade kept that part of the Greek debt off the books and cleverly hidden from scrutiny masquerading as a currency position rather than a loan. This falsely created the idea that the Greek debt was moving in the right direction to meet the Maastricht rules down the road. Goldman overpriced the deal to such an extent that 12% of their $6.35 billion in trading and investment revenue for 2001 came from restructuring Greece.

In total, Goldman Sachs pocketed a premium fee of $300 million. Goldman also warned, as they typically do, that they would cancel the offer if Greece shopped the deal around for a better price which was designed to prevent any competitive review. Goldman further demanded that Greece pledge landing fees from Greek airports and revenue from the national lottery as part of the transaction to secure their own profits strip-mining Greece assets.

Within just three months of signing the deal, the bond markets took a major swing following the September 11 (911) attack in New York on the world trade center during 2001. Furthermore, the dollar declined, and the Euro soared. Greek officials began to realize that the deal was not going well in the least. The Greek national debt nearly doubled in size, and in real terms (currency adjusted), the debt would double by 2008 just in Euro terms nominally.

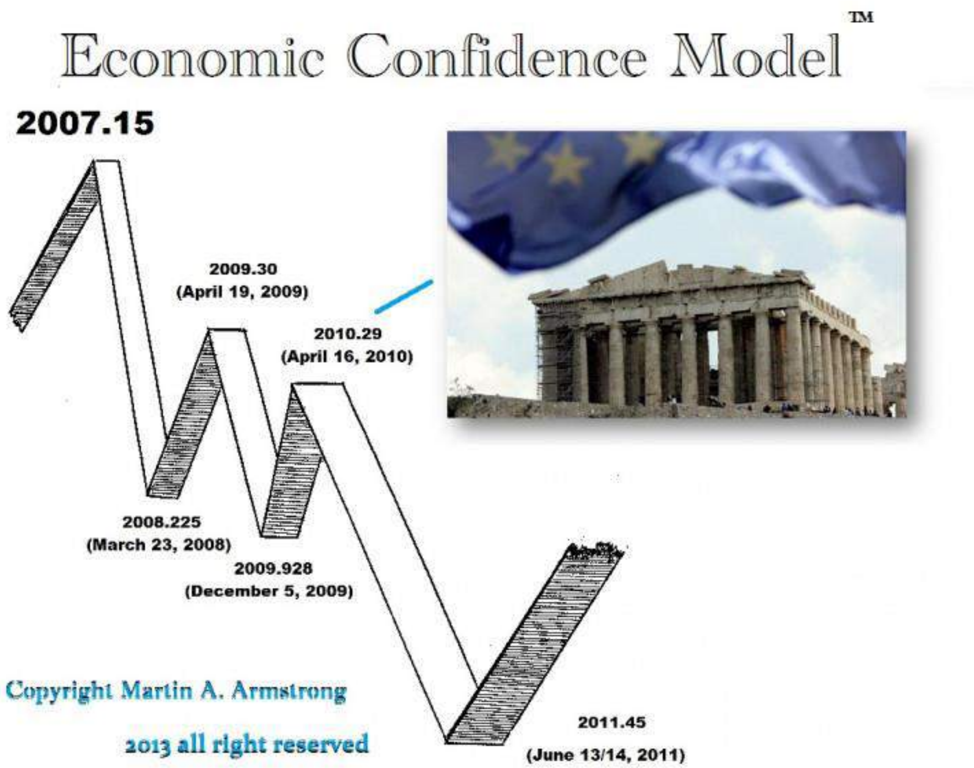
Greece faced another financial crisis in 2005, which few understood. Goldman Sachs "restructured" the deal once again, but this time they were selling the interest rate swap to the National Bank of Greece under the new government that came to power in 2004 under Karamanlis. This increased the debt even further stretching-out the payments beyond 2032. Goldman managed to extract another $500 million from the Greeks, according to numerous press stories (Independent Friday 10 July 2015; Greek debt crisis: Goldman Sachs could be sued for helping hide debts when it joined euro).

Goldman didn't even blink and went to Athens to try to sell another deal. Goldman Sachs' president Gary Cohn personally traveled there and offered to finance the country's health care system debt, pushing that debt even further into the future.

Goldman Sachs did not merely make huge fees, it even allegedly placed a bet on the economy of Greece that it would fail based upon its inside information. Goldman is known as "Government Sachs" and has been apparently beyond the reach of any law anywhere.

Georgios A. Papandreou
Prime Minister of Greece
(October 6, 2009 - Resigned on November 11, 2011)

The Greek President Georgios Papandreou wisely declined Goldman's 2009 deal, and this is when he blew the lid off what Goldman Sachs had done to his country.



Papandreou turned to the IMF and asked for help precisely on the day of our Pi Target of April 16th, 2010. The harsh terms of a bailout imposed upon Greece by the EU were really Draconian and inspired by the German philosophy of Austerity. The London Financial Times deserves the credit for investigating the behind the curtain antics in this matter.

Angela Merkel grew up in East Germany. If anyone should appreciate the absence of the right to vote and freedom, it should be her. The FT learned through participants of the summit that the EU leaders had agreed under the guidance of France, then controlled by Nicholas Sarkozy, to deny the Greek people any right to decide the fate of their own nation by blackmailing the Greek President Papandreou. AT every turn, the EU leaders have consistently sought to deny the people of Europe any right to vote on their future. Greece was no different.

Nicolas Sarkozy (b: 1955)
The 23rd President of France
(May 16, 2007 - May 15, 2012)

President Georgios Papandreou wanted a referendum on the bailout package that one would expect in a real democracy. The EU leaders followed France demanding there would be no such right to vote by the Greek people. Sarkozy moved the EU leaders into denying the Greek people the right to vote fearing the Euro would die if the people could vote denying the EU bailout terms. Sarkozy totally humiliated the Greeks in the most underhanded dictatorial manner unprecedented in a society claiming to be free.

Greece would be punished for its former leaders conspiring with Goldman Sachs to boost their own personal political careers as properly managing the Greek economy to enter the Eurozone.

The Refugee Crisis & the Decline in Population

The **Refugee Crisis** has torn Europe apart. The politicians behind closed doors are also looking at the problem of the long-term decline in population. The have figured out that the entire social fabric is constructed on the original assumption that population would increase. If it declines, then the social system constructed on what is really a Ponzi scheme will collapse in the future.

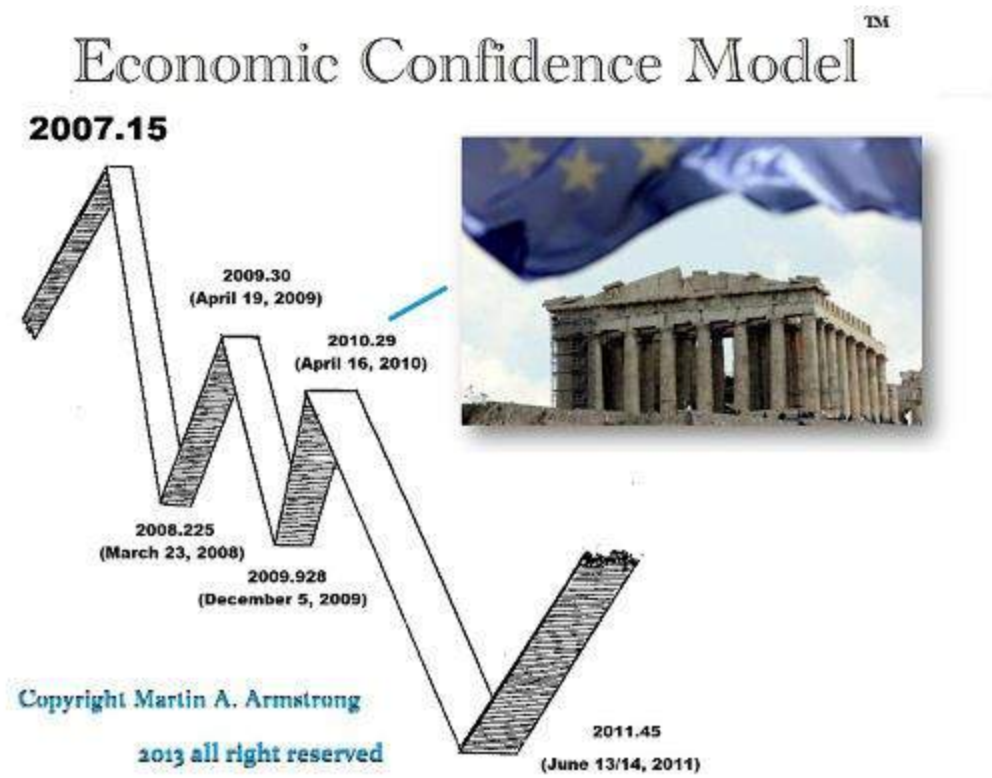
The **Refugee Crisis** began as a pure unilateral decision by German Chancellor Angela because her personal standing within world opinion collapsed in polls internationally after her refusal to yield to Greece during its debt crisis set in motion by Goldman Sachs. She allowed the Greek people to be strip-mined of assets to pay for their corrupt politicians who signed the deal with Goldman Sachs which buried the nation economically.

Merkel's harsh actions toward Greece drew international condemnation. On July 15th, 2015, Time Magazine wrote, ***"Berlin's role as the enforcer in negotiations over Greece's debt could cause lasting damage to Germany's global image."*** Images of elderly Greeks committing suicide in Syntagma central square in front of the Greek Parliament in Athens had been making the front pages in the international press.

Merkel's image was becoming that of a money-grubber without any humanity. Pictures of retired Greeks who were moved to tears after being unable to withdraw any money from banks and unable to buy food ran around the world. A Greek pensioner who was 77-years old committed suicide in central Athens shooting himself with a handgun just several hundred meters from the Greek parliament building in apparent despair over his financial debts.

There have been many such events that do not always make the press for the austerity in Europe has led to suicides even outside of Greece. In Italy, a pensioner also committed suicide after losing his life savings as a result of a controversial move by the government to rescue four banks with bail-ins taking people's money rather than allow money from one state to help failed banks in another.

There was also a 68-year-old who hung himself at his home in Civitavecchia, a port town near Rome, after the so-called "save banks" plan wiped out €100,000 in savings held at Banca Etruria again on a bail-in back on November 22nd, 2015.



The entire EU Crisis began precisely on schedule on the Political **Pi Turning Point** from the major high in 2007. Precisely on the day of the Economic Confidence Model (ECM) turning point, April 16, 2010 (2010.29), Greece notified the IMF it was on the verge of bankruptcy. By April 22nd, the Euro fell to near year-low levels amid concerns about Greece's debt crisis. The IMF activated the loan facility and Greece received its first €45 billion on April 23rd, 2010.

SEC Charges Goldman Sachs With Fraud in Structuring and Marketing of CDO Tied to Subprime Mortgages

FOR IMMEDIATE RELEASE
2010-59

Washington, D.C., April 16, 2010 — The Securities and Exchange Commission today charged Goldman, Sachs & Co. and one of its vice presidents for defrauding investors by misstating and omitting key facts about a financial product tied to subprime mortgages as the U.S. housing market was beginning to falter.

Within weeks, on May 9th, the IMF approved a bailout package for Greece with the largest loan and exceptional, fast-track access. Of course, that turning point of April 16th, 2010 was also the first time the SEC charged Goldman Sachs with outright **FRAUD** in selling its Mortgage Backed Securities. Naturally, nobody ever was charged personally for making those decisions and not one banker ever spent a single hour in jail no less a trial and prison.

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More than half of Germans support Angela Merkel's tough stance on Greece

55 per cent agreed with Merkel's position, but the wide majority doubted whether Greece would actually make the reforms necessary for the bailout

Doug Bolton | @DougieBolton | Wednesday 15 July 2015 19:42 | |

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Most Germans agree with Chancellor Angela Merkel on Greece (MICHAEL GOTTSCHALK/AFP/Getty Images)

A poll conducted in Germany has found that more than half of Germans agree with Chancellor Angela Merkel's position on negotiations with Greece.

In dealing with Greece, the German head of state Chancellor Angela Merkel, had promised the German taxpayers that any loan to Greece would be repaid for she vowed to hold their feet to the fire and forced then to repay. The international polls were turning negative against Merkel while domestically she was seen as strong. The press bashed Merkel because Greece had forgiven Germany's debt after World War II while Germany would not forgive Greece.

Merkel's hardline policy on Greece damaged her image internationally. Merkel, who retained her own polling staff, then summarily announced that she would take the refugees from Syria with open arms. This is what set in motion the entire **European Refugee Crisis.** and Merkel then force the rest of Europe to share the burden she created unilaterally. The entire European Refugee Crisis was created by Merkel, and this has been at the center of the crisis which is tearing Europe apart at the seams. That came as the next ECM wave turned from its peak 2015.75.

Angela Merkel assumed office as Chancellor on the 22nd of November 2005. The next German federal election for the 20th Bundestag will regularly be held between August and October 2021 when Merkel will no longer remain as chancellor after nearly 16 years. The only thing Europe will remember her with shall be animosity.

The legacy Merkel is leaving behind is her argument which has lost its resonance. What's really at stake, Merkel has suggested time and again, that it is not Germany's refugee policy, but the very survival of the EU. The problem with her argument is that she made the decision to accept refugees unilaterally into Europe which was never put to any democratic process. She has tried to support herself claiming that this isn't a debate about the future of the chancellor, it's about the future of Europe.

These types of statements betray an extraordinary fear even among many of Berlin's political elites that Germany's democratic institutions are no longer strong enough to preserve Europe. Merkel has sidestepped the entire democratic process. Her insistence that Greece and other European countries with debt troubles impose tough austerity on their populations has already created tremendous tension in the face of highly questionable long-term merits of such policies.

Merkel has pushed her economic agenda upon the whole of Europe which in and of itself has exacerbated the economic divide within the Eurozone. Protests in Athens against Germany dressing up as Nazis reflected the resentment of German economic might. Many now view that the Euro has been used to dominate Europe for the German economic machine as if they had won the war this time.

When Merkel agreed to take in thousands of refugees stranded in Hungary's main train station in the summer of 2015, she claimed it was both a humanitarian act and a gesture of European solidarity. But she made the decision for Europe unilaterally. Just as Kohl never allowed the German people to vote on joining the Euro, Merkel never allowed Europe to vote on allowing in refugees. Merkel simply expected that other EU countries would **"do their part"** and accept some of the refugees without prior consultation.

When other EU member states refused, Merkel then turned to Brussels to establish quotas that would force countries to accept refugees. Brussels yielded to Merkel's demands simply because Germany was the largest economy. Brussels' attempts to demand compliance with Germany's decision to accept refugees failed. As the influx of refugees into Germany reached record levels, the rest of Europe became even more convinced that they wanted no part of Merkel's popularity mission for personal objectives.

As time passed, having their own refugee problems ignored for years by Merkel, Spain and Italy felt little urge to come to her aid even politically. In Eastern Europe, countries with little experience of migration or Islam wondered why they should sacrifice their cultural homogeneity to help the German chancellor who loved being portrayed as "Mutter Angela".

What is very interesting is that Merkel has warned against unilateral action, when it was her unilateral move in 2015 that landed Europe in the mess it now finds itself. Instead of fostering European unity, Merkel's refugee quotas helped fuel the resurgence of identity politics in countries like Hungary, Austria and Italy. During the U.K. referendum on EU membership in 2016, BREXIT campaigners used images of refugees en route to Germany as an example of everything that had gone wrong in Europe. Indeed, there were many protests on remaining in the EU that took place in London using the refugee issue and calling those in favor of BREXIT were being called racists.

What this entire Refugee Crisis has proven was that a leader in Europe of any state could unilaterally make some decision that then would be forced upon the whole of Europe. This was by no means what the EU was supposed to be about in the first place.

Then, the Washington Times wrote on September 10, 2015, ***"Angela Merkel welcomes refugees to Germany despite rising anti-immigrant movement."*** The entire refugee crisis was created by Merkel as a diversion because Germany was being viewed as the harsh enforcer of loans, which were structured to hide what Goldman Sachs had instituted to get Greece into the Eurozone from the outset. The entire reason for the refugee crisis was a stunt to merely help Merkel and her personal image worldwide. She needed to reshape her image from the loan shark to the caring Mother Merkel. Europe is now paying the price because career politicians were simply concerned about her polls.

The Refugee Crisis did manage to change Merkel's image. She made person of the year on the cover of Time Magazine. That seemed to be her goal. Of course, they grace the cover with her only from the humanitarian view irrespective of the political crisis she unleashed within Europe.

Now Merkel refuses to accept any responsibility and outright denies that the **Refugee Crisis** was even the problem. Police have altered records in Cologne to remove the word ***"rape"*** from criminal reports to support Merkel. Then a leaked document surfaced reporting that 2,000 Refugee men assaulted and raped 1,200 girls across Germany on New Year's Eve. This was not an act of terrorism or some normal crime wave that ever took place in **ANY** western country before Merkel's **Refugee Crisis**. If the refugees were not the issue, then why create flirting courses to show Islamic men how to get lucky with Germany girls without raping them? The entire issue illustrated the problem – a vast cultural divide.

The nightmare in Germany simply became intolerable. Speaking with friends in Germany, many with young children were terrified to send their children to school. Suddenly, young Islamic men, pretending to be under-18 to get into Europe, who look to be in their mid-20s, were sitting in classes with young girls towering over them. They speak nothing of the language but must attend school. Merkel's **Refugee Crisis** has created discontent even within Germany fueling the rise of extreme right movements.

Merkel has even denied that allowing the refugees led to domestic terrorist attacks. Refugees had no papers and were simply admitted. Many were terrorists who carried out major attacks in Paris and various places. It has been this Refugee Crisis which began with the turn in the Economic Confidence Model – 2015.75. This was the turning point that we had forecast would be the peak in government confidence. From here on out, it is now downhill into 2032.

The Misconception of Trade

When it comes to trade, there is no shortage of propaganda and misrepresentations. It took about four years to negotiate TTIP because each of the EU 28-member states has a right to block an agreement. This only highlighted the problem with the structure of the EU whereby on the one hand it presents itself as a unified United States of Europe, but its structure is by far something that is not workable. The major difference would be if the United States could not negotiate a trade deal without the approval of each and every one of the 50 states that make the USA.

Consequently, there is no negotiation with a single political entity. This introduces the structural nightmare whereby any individual member state cannot negotiate their own trade agreement. That means that France can block trade agreements for everyone based upon its particular industry if it desires to protect. This is why it took 4 years to negotiate before it collapsed.

Tariffs are gathered collectively feed Brussels' budget by about €20 billion euros annually of which Germany accounts for 25%. The German economic model is export oriented from the old-world of mercantilism. France, the second largest economic member state, has a perpetual trade deficit and demands higher protectionism because its labor force tend to have the most militant worker unions.

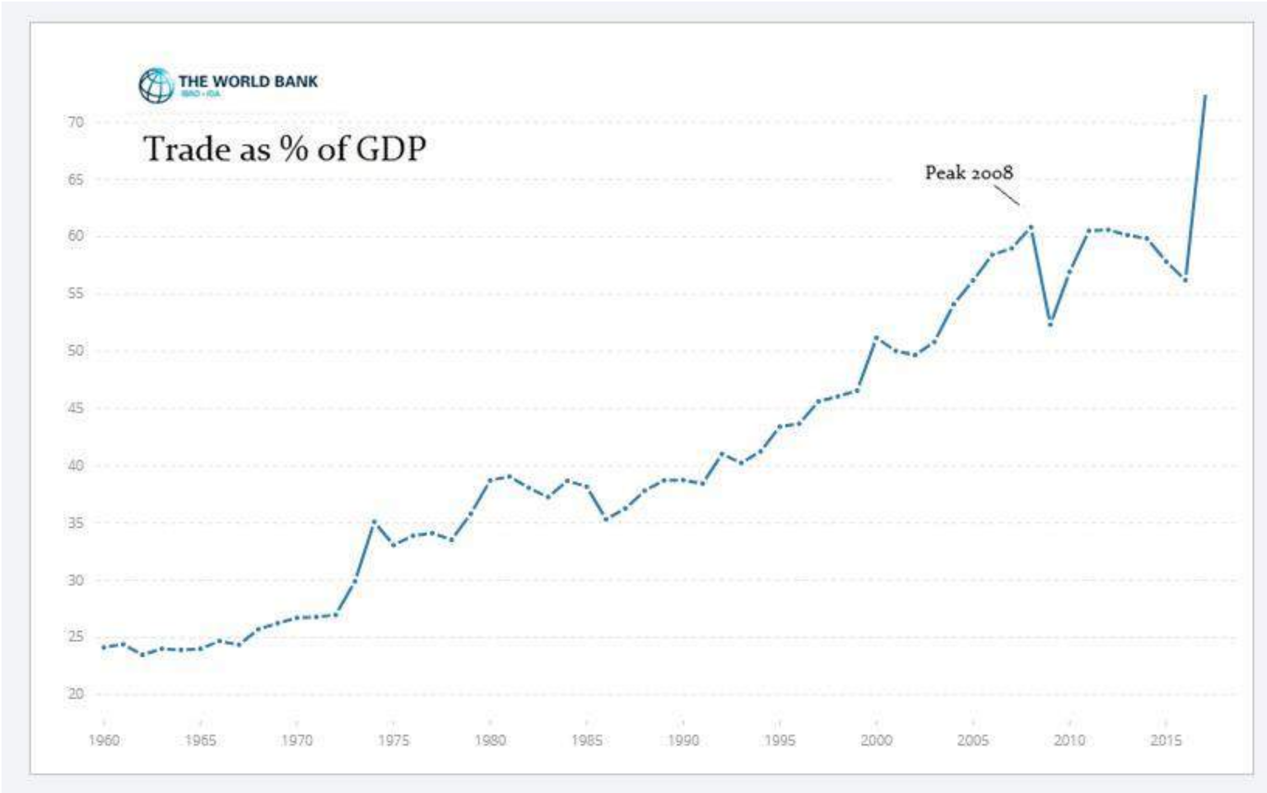
The Trump proposal of eliminating all tariffs was cheered by Germany and blocked by France. What introduces the structural nightmare is highlighted by BREXIT. Unless Britain exits the EU, it cannot negotiate its own trade deal with the USA or even China. Anything they do will be subject to a vote by every member of the EU.

The TTIP agreement was criticized and opposed by particularly French unions, non-governmental organizations (NGOs), environmentalists, and even charities. The central criticism of TTIP has been focused on reducing the regulatory barriers to trade for big business. This has sparked concerns over food safety law, environmental legislation, banking regulations, and the sovereign powers of individual nations. The opponents see TTIP as an assault on European and US societies by transnational corporations.

Then there are also deep concerns that the same anti-democratic structure of the EU itself has been taking place behind the curtain. Many are concerned about the influence of powerful lobbyists on behalf of multinational corporate entities. Critics point to this un-democratic authority of governments to really do the bidding of those who feed the political state.

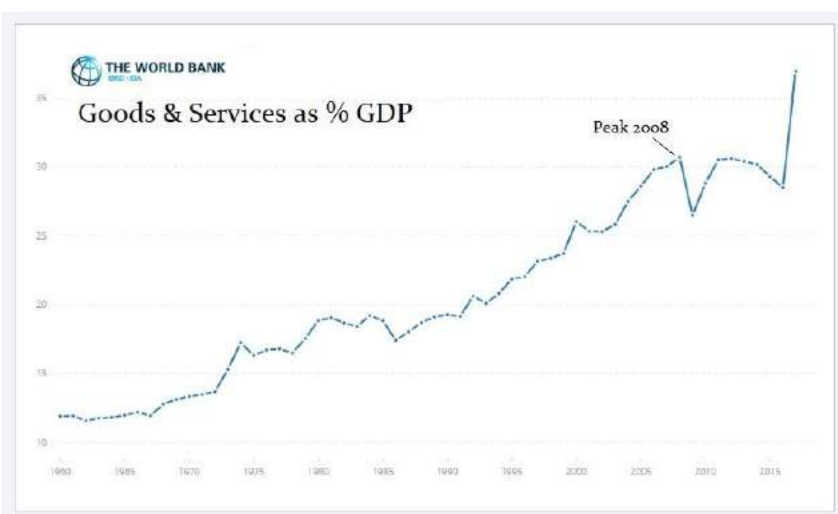
The French unions have argued that TTIP will put European workers into direct competition with Americans. They also argue that the free trade deals with Canada and Mexico would allow them to simply ship products to Europe circumventing and trade deal of their nation with the EU directly.

Of course, this has been the sticking point even in the BREXIT negotiations. The EU is so concerned that goods could enter the EU across the Irish border between North and South that they would lose revenue. This is naturally recast as claiming that food from Britain could enter the EU that would not comply with some new regulation that they impose.

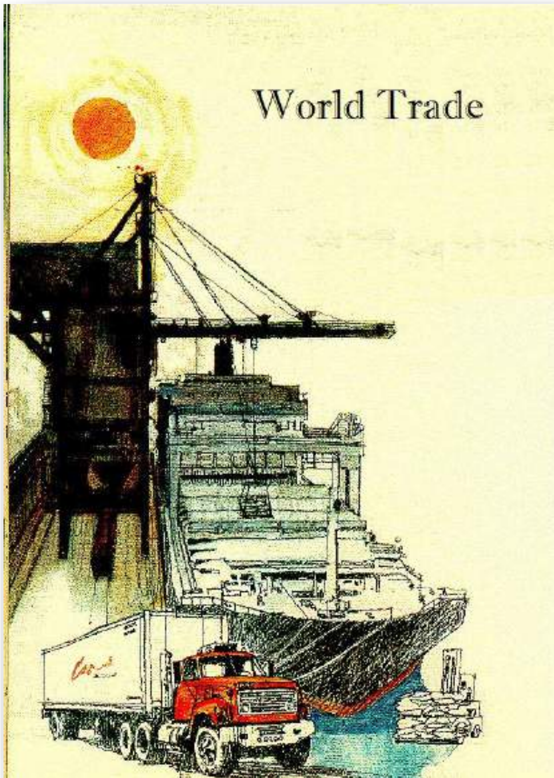


As always, there seems to be zero research into any fundamental issues that people hang their hats on to explain World Trade. Indeed, World Trade, even in nominal dollars, peak in 2008 and has broken-out interestingly when the Economic Confidence Model turned in 2015.75, not merely did the confidence begin to shift from public to Private, but this was reflected in world trade as well.

We must understand precisely what is the definition of trade that is even being discussed. Exports of goods and services as a percent of World GDP is about 36.5%. The gross percent of world GDP in international transactions comes in at nearly 72%. About half of this number really is attributed to investment capital flows.



The trade deficit is offset by the capital account reflecting investment. In fact, if a foreign entity BUYS American debt, that inflow goes into the Capital Account – not



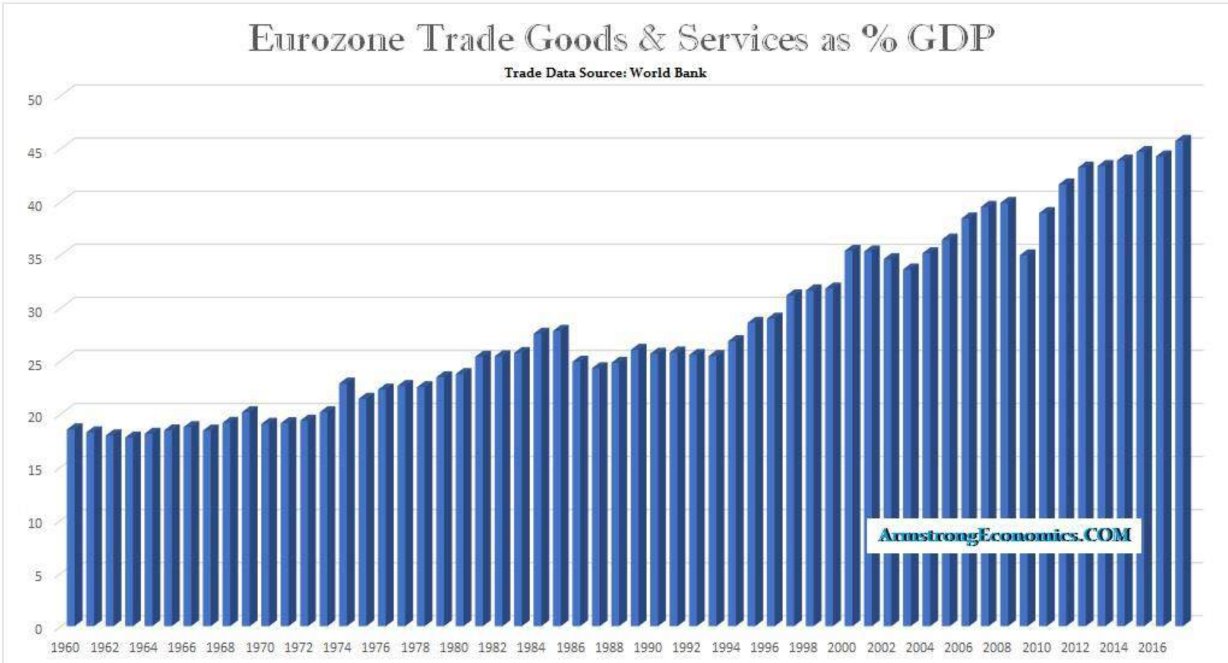
trade or Current Account. However, the interest payments go out in the Current Account commonly called the Trade Account. There is little comprehension of the accounting people believe reflects world trade.

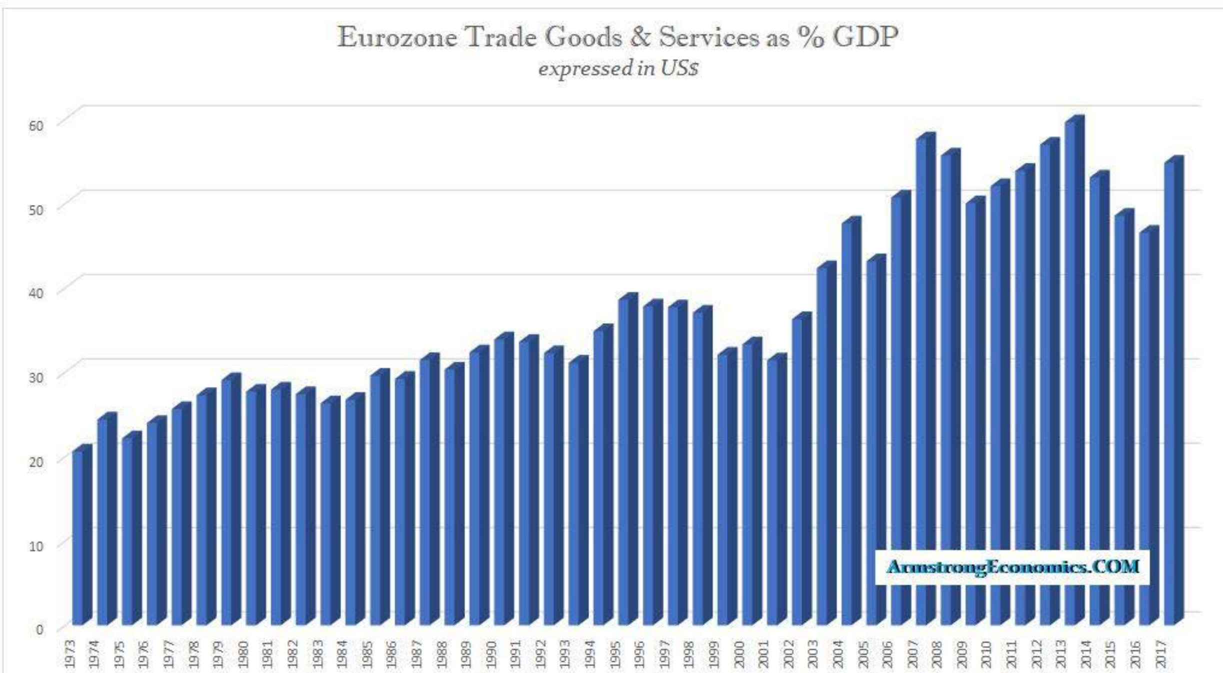
The more foreign investors come into America and the repatriate their profits on equities or bonds making the "trade deficit" appear to increase when it has **NOTHING** to do with trade. During the 1980s, we assisted the Arabs earn interest by buying the physical gold and leasing it out or to trading gold forwards/futures buying say January and selling June contracts earning the difference which was the interest and carrying cost.

We would help the Japanese reduce their trade surplus with the United States by simply purchasing gold on COMEX, taking delivery, and then ship it to London where it would be resold. It did not matter what was purchased in the United States as long as it was exported which in turn would reduce the trade surplus since that transaction would appear in the Current Account.

Recently, the Chinese have been increasing their gold reserves reducing their dollar reserves in an effort to try to prevent the dollar rally which in turn has been behind the trade problems with the Trump Administration.

All of these maneuvers demonstrate that the trade picture among nations is anything other than the press reports. Thanks to Bretton Woods, when the world monetary system was created using a fixed rates system, the accounting only required tracking the currency flows. If more currency left the nation it implied, you must have purchased more goods and services. There were no people at the docks counting the number of Toyotas arriving on every ship.





Nonetheless, when we then look at Trade of Goods & Services in the Eurozone, real trade peaked in 2013 when we look at this in terms of dollars. As the Euro has declined, it creates the illusion that trade is expanding. However, this is simply because the value of the Euro has declined so there are more Euros being collected but fewer goods and services.

The German Philosophy of Austerity

The entire economic structural design behind the creation of the Eurozone was dictated by Germany. Without the German participation, there would never have been the creation of the Eurozone. Unfortunately, Germany has been prejudiced by its misconception of history. Germany has never understood the cause of the German Hyperinflation of the 1920s. It has been this German fear of inflation that has imposed the central policy of Austerity upon the rest of Europe which became the cornerstone of the Eurozone.

This central issue that is tearing the EU apart has been championed by Angela Merkel and her party. Nevertheless, we must explore this reasoning and, in the process, discover a startling revelation – the **Quantity Theory of Money** is antiquated and no longer even functions in the modern era. Then we have the rising solution known as the **Modern Monetary Theory** which is predicated upon this notion that given the excessive **Quantitative Easing** by central banks creating money, their inability to create inflation has proven that the QTM no longer remains valid.

Helmut Kohl
(1930 – 2017)
ArmstrongEconomics.COM

Helmut Kohl (1930–2017), Germany's former chancellor, admitted before he died that he acted like a "dictator" to bring in the single currency to the country, otherwise he "would have lost" had he held a referendum (see Telegraph; 09 Apr 2013).

Kohl was Germany's longest-serving postwar chancellor. He said to force the Euro upon all of Europe, he had to act like a dictator and deny any democratic vote for he would have lost any such popular vote on the Euro by an overwhelming majority.

> *"I knew that I could never win a referendum in Germany," he said. "We would have lost a referendum on the introduction of the Euro. That's quite clear. I would have lost and by seven to three."*

Kohl described adopting the Euro was in his mind an emblem of the European project, which he said would prevent war on the continent. He further explained:

> *"If a Chancellor is trying to push something through, he must be a man of power. And if he's smart, he knows when the time is ripe. In one case – the Euro – I was like a dictator ... The Euro is a synonym for Europe. Europe, for the first time, has no more war."*

At the core was this belief in a one-world government at least in Europe. We have repeatedly heard this reasoning for creating the Eurozone and the federalization of Europe. To sell the Euro, they used the false promises of savings in currency exchange rates and everyone would enjoy the same interest rate. The interest rate promise has never materialized and on top of that, this European project to federalize Europe is causing old resentments to surface once again with finger-pointing.

Kohl lost the election in September 1998 with the economic crisis of the collapse of Lehman Brothers and the German Reunification led to the doubling of unemployment in Germany. Additionally, there were Germany's tax and welfare reforms. While the CDU/CSU had offered proposals to reduce benefits in healthcare and pensions, the SPD controlled Bundesrat. While Kohl continually pushed the issue of European integration, the issue fell short from voters' minds. The SPD, on the other hand, almost ignored the issue entirely. Many voters in Germany simply had other concerns besides the European Union and the covert plot to federalize Europe behind their back.

The Maastricht Treaty that was signed on February 7th, 1992

Kohl's major political achievement was the signing of the **Maastricht Treaty** on February 7th, 1992. This was the event that brought the European Union into existence and paved the way for the creation of the Euro currency. Whatever else they may have done, the EU and the Euro (replacing the former, less politically integrated European Economic Community) gave Germany the markets and the means to produce a second German industrial and manufacturing miracle. By eliminating all the currencies within Europe, Kohl understood that this would eliminate foreign exchange risk and create the major German economic dominance of Europe.

With the fall of the Berlin Wall in 1989 and the German Reunification/Unity (German: Deutsche Einheit), took place on October 3rd, 1990 federalizing Europe was the next objective. In truth, Margaret Thatcher opposed the reunification on the grounds that she feared German industrial skills would dominate Europe. Nevertheless, when the Berlin Wall fell, Angela Merkel ran for office as the first woman from East Germany. Kohl himself added her as a symbol of unification to his cabinet.

The German Reunification and the signing of the **Maastricht Treaty** had one major side–effect. Germany had indeed the largest economy within Europe. However, it also was living in the past with respect to its economic misinterpretation of its economic history. This side–effect was the adoption of this misconception of the German economic past that is tearing the EU apart at the seams. There are signs of great stress emerging even within Germany over this misinterpretation of the Hyperinflation period.

German Vice Chancellor Sigmar Gabriel told Der Spiegel magazine in 2018 that the breakup of the EU is no longer unthinkable because of Merkel's desperate clinging to austerity. He asked Merkel: ***"[W]hat would be more costly for Germany: for France to be allowed to have half a percentage point more deficit, or for Marine Le Pen to become president?"*** He is still waiting for Merkel to answer that question.

Merkel has been both the face of Europe and that of Germany. While she was named Person of the Year by Time Magazine for letting in the refugees, her economic policies of austerity have sent Europe into an economic depression from which there has been no recovery and even the European Central Bank may collapse in disarray as a result. One must ask, just how long can Europe endure and economic belief in a theory of Austerity predicated upon the **QTM** which has utterly been proven wrong after 10 years of Quantitative easing?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‘We’ve had ENOUGH Merkel’ Rest of Europe gangs up on Germany over crippling EU austerity

ANGELA Merkel cut an increasingly isolated figure in Europe tonight as the rest of the continent ganged up on Germany over its imposition of crippling austerity.

GETTY

The economic stress is beginning to rise to the surface ever since 2013. There is a rising discontent as many member nations begin to ban together against Germany and that includes France. Deflation is raising the real value of loans and makes debtors unable to repay. That was the very essence of the Great Depression. Germany is just focusing on the last event of hyperinflation. As they say, we tend to always fight the last war.

I know that in Germany they do not really teach the details of the rise of Hitler. However, they also do not teach the real global view of the world economy which not merely resulted in Hitler’s rise, but produced the hyperinflation which justified his rise to power. Hitler was actually the ultimate reaction to the events of the 1920s and the hyperinflation. There is a good book on the subject, but it is in German – ***Die Deutsche Revolution 1918/19***. You cannot look at Hitler and his rise to power in isolation. Likewise, it stands as a warning that economics can still feed into a revolution in the face of a failed attempt to federalize Europe by the EU.

Austerity & the Great Depression

This philosophy of Austerity was the dominant economic thinking prior to the Great Depression even in the United States reinforced by the German and Austrian hyperinflations. When Franklin Roosevelt (b 1882; President 1933–1945) came to power following the 1932 election, he created what became known as his **Brains Trust**. They were dead-set on maintaining Austerity for the belief at that time was the outstanding bond holders would lose confidence if the government increased the money supply in times of economic stress. Therefore, the theory was all about government maintaining its credit rating – not the people.

The **Brains Trust** became a term applied to the so-called group of advisers to Franklin Roosevelt during his presidential administration. Roosevelt's speechwriter and legal counsel **Samuel Irving Rosenman** (1896–1973) suggested having an academic team to advise Roosevelt in March 1932. This was really for public show, for being such a member is rarely ever taken seriously by the politicians involved. They have their own ideas and listen to few if any non-political types.

Nonetheless, this concept of establishing a **Brains Trust** was perhaps based on a group of academic advisers that President Woodrow Wilson formed in 1917 to prepare for the peace negotiations following World War I. It was the journalist James Kieran of the New York Times back in 1932 who coined the term **"Brains Trust"** when he applied it to this group of "experts" who Roosevelt actually ignored.

It was on September 6th, 1932, when it was reported about Roosevelt's "brains department" that was helping him create policy positions and make speeches. The *Times* of September 9th, 1932, called this same group a "**Brains Trust.**" Newspapers began to call it a "**Brain Trust**" by at least October 17th, 1932.

Franklin D. Roosevelt's 1933 Brains Trust

Adolf Berle (1895–1971) | Raymond Moley (1886-1975) | Rexford Tugwell (1891–1979)

The core of the first Roosevelt brains trust consisted of a group of Columbia law professors **Adolf Berle** (1895–1971), **Raymond Moley** (1886–1975), and **Rexford Tugwell** (1891–1979). Note that they were lawyers, not market investors, technicians, or economists. They knew how to get around the Constitution, not straighten out the economy.

Still, these were the men who played a strategic role in shaping the legal policies of the First New Deal in 1933 – not the economics. They also never actually met together as a group. They each were solicited for their **LEGAL** opinions by Roosevelt Roosevelt who expanded his **Brains Trust** adding **James Paul Warburg** (1896–1969) who was the son of the famous banker **Paul Moritz Warburg** (1868–1932).

Nonetheless, James lacked the banking experience of his father. **Louis Dembitz Brandeis** (1856–1941) was another lawyer who became a Supreme Court Justice. Another lawyer educated in Chicago also joined the Brains Trust, **Harold Lill Ickes** (1874–1952). There was the social–activist among the time whose philosophy was that created jobs was better than handouts and created the WPA – **Harry Lloyd Hopkins** (1890–1946).

The first woman appointed was **Frances Perkins** (1882–1965) whose background was chemistry and physics and at least had a vision compared to the lawyers and brought in the labor movement becoming the U.S. Secretary of Labor from 1933 to 1945. Another lawyer was **Basil O'Connor** (1892–1972) who went on to become head of the American Red Cross.

Roosevelt's **Brains Trust** was the subject of many newspaper editorials and editorial cartoons ridiculing them as impractical idealists. The image created was that these men where restructuring the economy when in fact they were lawyers. It was beginning to dawn on many that it was the Constitution which was the focus and how to circumvent it – not economic theory.

The core of the **Second Roosevelt Brains Trust** emerged from men associated with the competing Harvard law school **Benjamin V. Cohen** (1894–1983), **Thomas Gardiner Corcoran** (1900–1981), and **Felix Frankfurter** (1882–1965) who became a Supreme Court Justice although he was born in Vienna. These men played a key role in shaping the policies of the Second New Deal (1935–1936). There was also **Hugh Samuel "Iron Pants" Johnson** (1881–1942) who graduated West Point and went on to get his law degree from Berkeley University in 1916.

None of Roosevelt's **Brains Trust** were ever experienced in economics. Most were simply lawyers trying to get around the Constitution. Moley broke away in disagreement with Roosevelt becoming a sharp critic of the New Deal. It was George Warren (1874–1938) who was the ***farmer-economist*** out of the mainstream whose idea was the devalue the dollar. The Brains Trust totally disagreed and they had nothing to do with the devaluation of the dollar.


George F. Warren (1874-1938)

George Warren – The Farmer Economist

In 1932, George Warren had written, Wholesale Prices for 213 Years; 1720–1932. Effectively, this work was a forerunner to Monetary Theory by making observations that prices rose with the gold discoveries and declined when supplies of gold declined. This work was a simplistic monetary view of the world that Franklin Roosevelt could understand.

Warren observed that money was really just a medium of exchange. As its values rises, wages and assets decline in value as expressed in that currency. Consequently, maintaining the gold standard, as Germany insists upon Austerity today, created deflation as prices collapsed and gold became scarce rising in value. Warren's observation thus became a simple relationship that the only way to raise prices and end the deflation of the Great Depression, was to raise the– price of gold, which meant it would be a dollar devaluation relative to gold. Therefore, lower the value of money and assets along with wages will rise as expressed in terms of that currency. This was a first and important step in comprehending the role of money. But to the classical economists and bankers, this was pure heresy since they believed money should be tangible, which created **DEFLATION** (Austerity) and be a mythical store of value.

Roosevelt suspended gold exports on his **FIRST DAY** in office. This was **NOT** formally a suspension of the gold standard, but it was building a Berlin Wall around capital using in effect capital controls. At this point in time, nobody quite understood what effect such capital controls would even have on the dollar and the economy. By April 1934, Roosevelt then announced to his Brains Trust that the country was off the gold standard. He then showed them what was the **Thomas Amendment** to the **Agricultural Adjustment Act** allowing the President to devalue the dollar by 50% and issue $3 billion in currency without gold backing. The entire Brains Trust was horrified. Everything they had come to believe that the gold standard represented, had come to an abrupt end. Some argued there would be riots, civil unrest, and maybe even a revolution. Money just had to be backed by gold in their minds. Nothing of that nature took place. In fact, it was the opposite effect that proved Warren was correct.

It is often not appreciated how much Roosevelt was very much an outsider looking in. He won the election because people wanted change as was the case with Donald Trump. Roosevelt was the governor of New York, not a Washington insider. The entire **Brains Trust** was nothing more than a dog & pony show for publicity.

To the dismay of the **Brains Trust**, the stock market took did not collapse to new lows. It rallied at first, then pulled back largely due to the number of bank failures and the Bank Holliday. The eventually the stock market rallied as the devaluation of the dollar indeed sparked inflation.

To the total amazement of the economists and bankers, this was the **ONLY** act that made any real difference in turning the economy. The stock market continued to advance rising sharply nearly doubling over the subsequent three months. The rally continued into 1937. Even wholesale prices began to rise as did orders for industrial goods. Suddenly, it made no sense to hoard cash when it would perceive that it would buy less tomorrow.

The only thing that lagged behind was unemployment. This was a structural problem. Back in 1900, 40% of employment was in agriculture. With the Dust Bowl, there was simply no jobs available. Where we face a similar structural problem with the advancement of technology, this was also the employment crisis during the Great Depression. Tractors replaced manual labor in farming.

Credit Anstalt - 1931 Austria

In 1931, the sovereign debt crisis and banking system collapse began in Austria with the failure of Credit Anstalt (Creditanstalt), which was partly owned by the Rothschilds. The bank was forced to absorb another bank and a secret loan was created in London off the books to hide the insolvency to do the merger for political purposes not unlike what Goldman Sachs did for Greece.

When the behind the curtain manipulation failed to be enough funds to save the bank, the whole scam was exposed. Credit Anstalt had to declare bankruptcy on May 11th, 1931. This set off a **CONTAGION** that spread as people wondered if the Rothschilds went broke and what government would fail as a result. Smart money realized it had been a shotgun wedding and the government's manipulating behind the curtain to hide the truth meant that government itself could not be trusted. Suddenly, investors began to panic withdrawing money from all banks related to the Rothschilds. This set–in motion the Great Depression Sovereign Defaults.

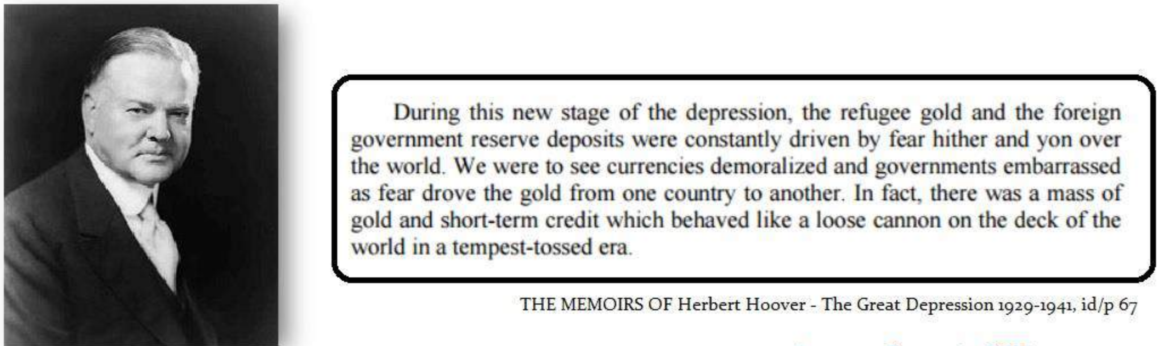
Governments were being forced to default on their national debts. They could no longer pay in gold. The entire European economy was devasted. This merely sent capital flows fleeing to the United States where the dollar was pushed to record highs. That in turn led American politicians to seek protection against imports.

Obsession with a Single Currency

Clearly, the traditional economists and bankers failed to understand the role of money. They did not understand what really happened. They did not understand capital flows, nor did they understand currency values. The world had been on a fixed exchange rate based upon gold most of the time ever since Napoleon. First authorized by the Monetary Ordinance of March 28th, 1803. The 20–franc gold pieces which he authorized in 1803, where the basis to standardize the monetary system according to a specific gold weight.

This Napoleonic model for a monetary system in Europe was sort of the real first idea of creating a Euro. This monetary system later became the Latin Monetary Union which prevailed in Europe until 1914 and World War I.

The downside of this monetary system was the simple fact that by creating a standard exchange value that was fixed among nations, there was no understanding of a floating exchange rate system. Nothing along these lines was ever taught in universities keeping the idea that money had to be standardized and thus Austerity prevailed.


During this new stage of the depression, the refugee gold and the foreign government reserve deposits were constantly driven by fear hither and yon over the world. We were to see currencies demoralized and governments embarrassed as fear drove the gold from one country to another. In fact, there was a mass of gold and short-term credit which behaved like a loose cannon on the deck of the world in a tempest-tossed era.

THE MEMOIRS OF Herbert Hoover - The Great Depression 1929-1941, id/p 67

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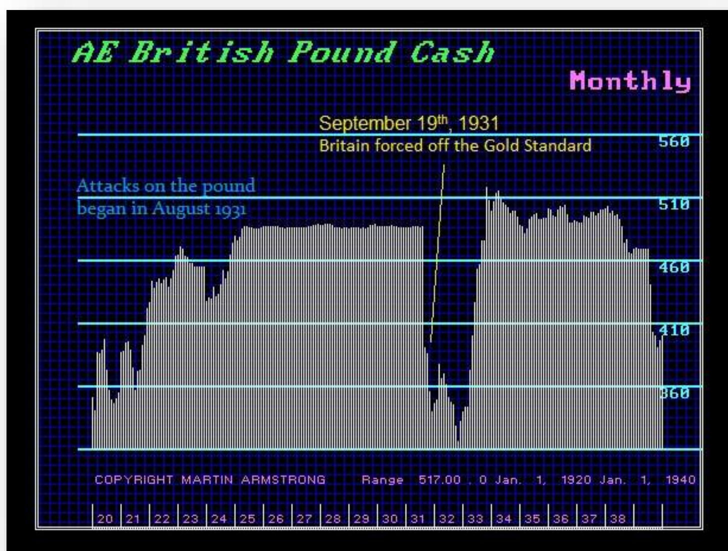
Herbert Hoover
(1874 - 1964)
(President 1929 - 1933)

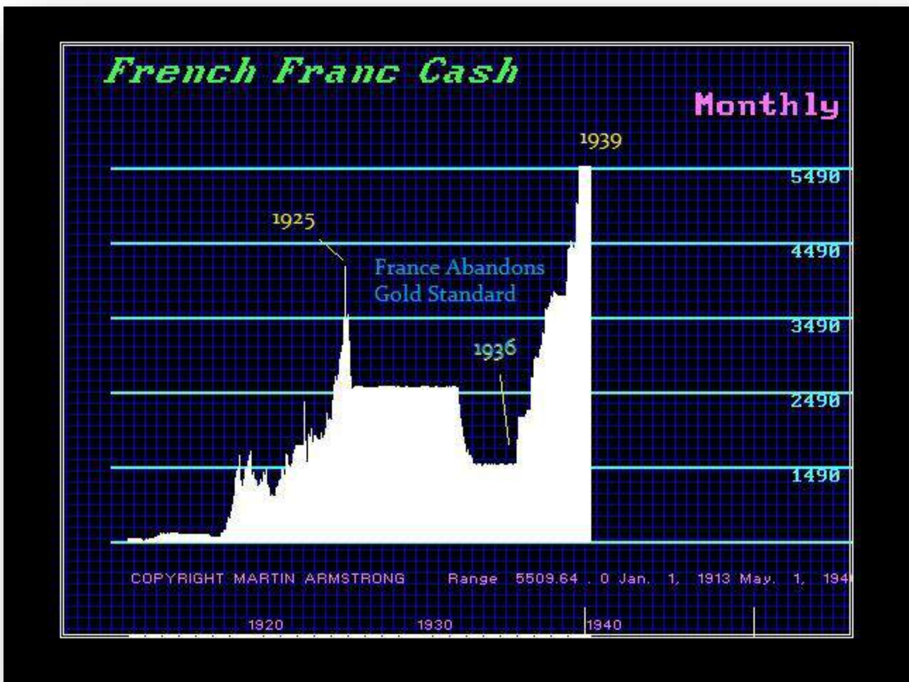
The contagion that began in Austria during May 1931 finally spread to Britain by September 1931. President Herbert Hoover (1874–1964) wrote about the contagion in his memoirs. He wrote: "We were to see currencies demoralized and governments embarrassed as fear drove the gold from one country to another." He was describing what we still see today in modern times as he explained that capital "behaved like a loose cannon on the deck of the world in a tempest–tossed era."



In Britain was forced to abandon the gold standard on September 19th, 1931. The speculative attacks on the pound really grew with intensity during August 1931. Britain tried to defend the pound, but no government is capable of such a move. This is also why pegs have always broken as in the case of the Swiss peg to the Euro in 2015. The Swiss National Bank (SNB) stunned markets when it abandoned its three–year–old peg of 1.20 Swiss francs per Euro. In a chaotic few minutes after the central bank's announcement, the Swiss franc soared by around 30% in value against the Euro. Any such peg is a guaranteed trade. If you are wrong, the government guarantees your money back at the fixed rate.

The devaluation of the pound marked the end of the depression for Britain as prices began to rise. This was the reality observed by Warren and he began to understand that maintaining a strong currency meant that wages and prices declined.

George Warren was approaching everything from the fringe making truly a groundbreaking evolution in the concept of money, but that is where all major change comes from in every field. Only those with creative minds can think out of the box whereas the field promotes conformity to gain respect of the industry. This has always led to the simple maxim that the majority are always wrong.



France, who had worked so hard to gather gold and seeing this as the means to European dominance, was now left alone clinging to its gold reserves, the second largest in the world and the largest in Europe. France made its people endure hardship by austerity for the image of a future greater glory. Finally, in 1936, Bank of France abandoned the gold standard only when it became so obvious that their economy was now becoming isolated, unable to export due to an overvalued currency plagued by deflation. The value of the French franc plummeted going into 1939 as Germany began to flex its muscles.

The traditional economic thought was that of Austerity and as such they considered Warren a crackpot. The conventional wisdom simply failed to comprehend what is even money or its role within the scope of our collective society. Money had been fixed in value except during periods of war. The traditional economic beliefs missed the entire point that money declines in purchasing power during economic booms and rises in purchasing power as assets decline during economic recessions and depressions. This also causes the cost of labor to rise creating unemployment.

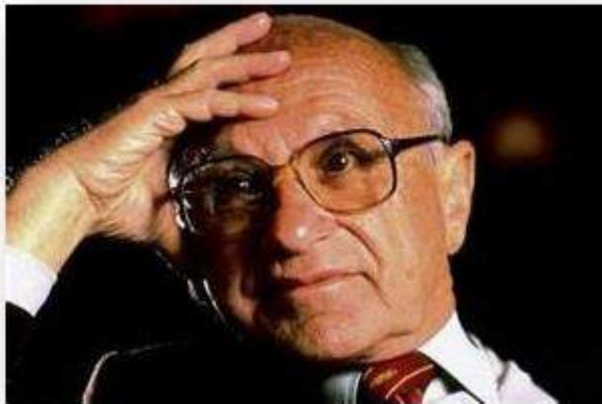
The assumption that money had to be tangible was just not correct for money rises and falls in value with economic booms (inflation) and recessions (deflation). The ultimate object of the medium of exchange is the exchange of one thing (object or labor) for another (object or labor). What constitutes "money" is simply the medium of exchange like words that relay concepts between two parties. At the core, lies the perception of value and that fluctuates according to demand and supply.

Therefore, Warren demonstrated that if you wanted prices to rise, the value of the dollar had to decline. Thus, the only way to do that was to abandon the gold standard which was t6he fixed exchange rate system.

Gold was merely one recognized object of value. Its advantage has simply been that it is movable compared to real estate. It is internationally accepted as a valuable object and thus it is free of opinion regarding quality such as diamonds.

Consequently, it was George Warren who saved the day and contrary to the **Brains Trust** moved toward creating inflation to end the Austerity. The confiscation of gold was a whole other issue. This was primarily done to ensure that the government would make the money on the revaluation of gold and not the public. It was also the idea of preventing the hoarding of money that was a serious issue at that point in time of the Great Depression just as it has been in modern times under **Quantitative Easing** in Europe.

Clash of Economic Theories

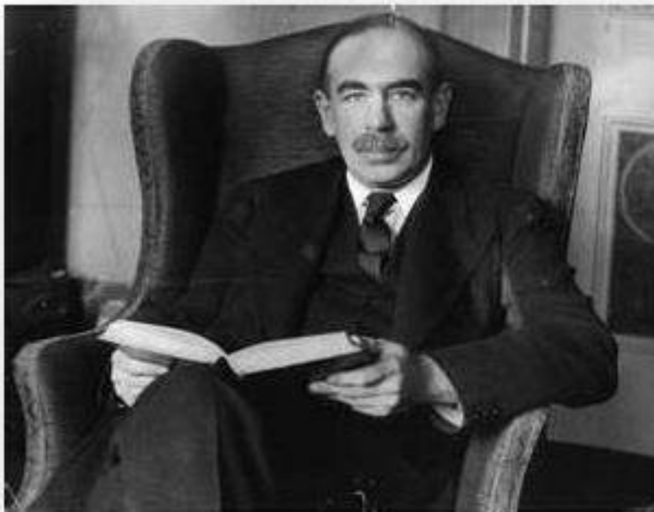


Milton Friedman (1912–2006)

In "A Monetary History of the United States," published in 1963, Friedman and Anna Jacobson Schwartz famously argued that the Great Depression was due to the failure of the U.S. Federal Reserve to expand the country's monetary base and thereby keep the economy on a path of stable growth. Had there been no decline in the money stock, their argument goes, there would have been no Great Depression.

United States Depression Scrip
1934 The City of Long Branch, New Jersey
ArmstrongEconomics.COM

What was taking place is the natural human response. People hoard money and do not spend when a recession unfolds. They hold back and save. The velocity of money then declines, and this contributes to the scarcity of money itself. In fact, there was such a shortage of money that over 200 cities began to issue their own known as Depression Scrip just to be able to allow a local economy to function. Milton's interpretation was clearly valid. There was such a shortage of money that private issues appeared around the nation.

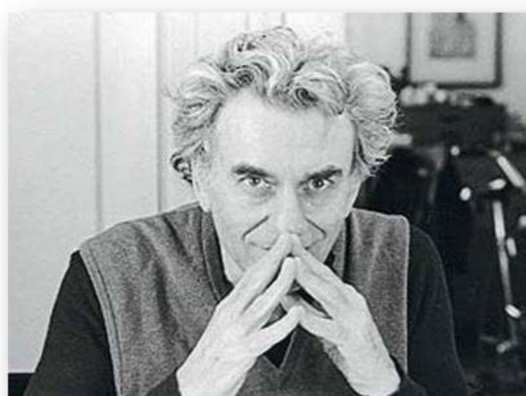


John Maynard Keynes (1883-1946)

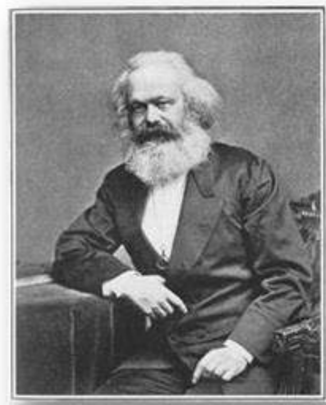
Keynesian economics, on the other hand, was developed by the British economist John Maynard Keynes (1883–1946) during the 1930s in an attempt to understand the Great Depression. Keynes advocated for increased government expenditures and lower taxes to stimulate demand and pull the global economy out of the depression.

Of course, there is also the argument of Hyman Minsky (1919–1996) which really offered nothing insofar as a solution. Minsky was of the "Keynesian" school of economics and he believed that much of the economics community of his era had misinterpreted and diluted much of Keynes' original message.

Minsky's most notable contribution was his financial instability hypothesis – in essence, a view that suggested the natural course of the economy was to breed its own endogenous instability until eventually it reached a tipping point. This is what has been called a "Minsky moment" that results in a financial crisis. He believed that government must force intervention to prevent a subsequent debt deflation and deep depression by regulation.



Hyman P. Minsky
(1919-1996)



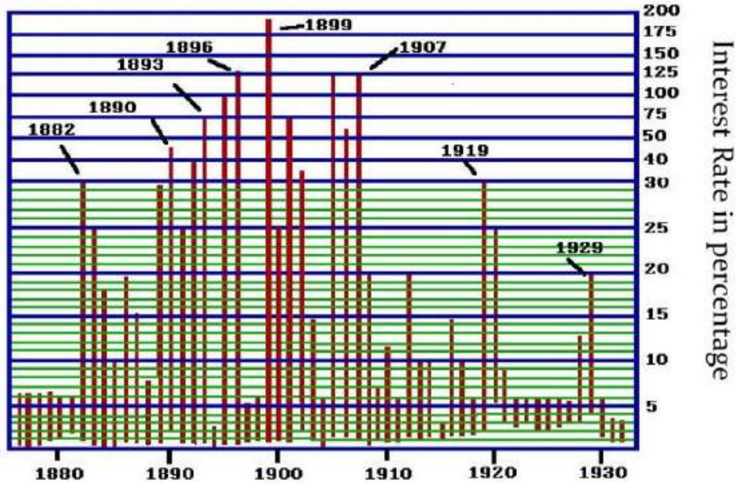
Karl Heinrich Marx
(1818-1883)

The problem with government intervention has always been corruption and the inability of centralized planning to ever manage an economy. This very idea was first propagated by Karl Marx (1818–1883) and justified the Communist Revolutions. In essence, the liberty and freedom of the individual is subservient to that of the state.

Clearly, the Monetarist cure was one that retained the individual freedom and liberty of the people. The Keynesian solution followed along the proposition that the government possessed the wisdom and ability to manipulate the demand of the people to inspire them to save or spend. The idea was based upon the inadequate understanding of the economy whereby lowering interest rates will **NEVER** stimulate demand unless the people see an opportunity to invest and have the confidence in the future. As long as they remain skeptical of the future, they will neither borrow nor spend.

A simple look at the Velocity of Money demonstrates that even increasing the supply of money does not “stimulate” if people hoard and refuse to spend. It is all a matter of faith and belief in the future.

US Call Money Rates (1876-1932)



(Source: Contemporary newspaper reporting of rates at NYSE)

The stock market and economy have **NEVER** peaked with the same level of interest rates twice. This is simply because it is a complex issue of human expectations at that moment in time. If people expect the stock market to double, they will pay a 20% annual interest rate. If they do not expect a 3% rise, they will not borrow at 3%. It is always the differential between the rate of interest and the expectation of the future.

However, it would be 1971 when the Bretton Woods system of a fixed rate also failed which then led to the development of the **Floating Exchange Rate** system in August 1971. It was Milton Freidman who argued that fixed exchange rates could not be maintained and that a Floating Exchange rate would automatically balance against the economic trends within a nation and eliminate the major crisis when currencies were forced to default.

The Prelude to War & The Rise of the Weimar Republic

World War I (WWI), was dubbed the "the war to end all wars" but as we know, it was really the war to begin all world wars. It is true that it was also known as the First World War or the Great War. Nonetheless, it was a global war originating in Europe that lasted from July 28th, 1914 until November 11th, 1918. It became a world war that led to the mobilization of more than 70 million military personnel, including 60 million Europeans, making it one of the largest wars in history.

WWI was also one of the deadliest conflicts in human history, with an estimated nine million combatants and seven million civilian deaths in the process. There were wholesale genocides, it was also followed by the 1918 great influenza pandemic which caused yet another 50 to 100 million deaths worldwide.

Emperor Wilhelm II (1859-1941)
King of Prussia, ruling the German Empire
(June 15th, 1888 to November 9th, 1918)

The German Emperor or Kaiser Wilhelm II (1859–1941; Kaiser 1888–1918) advocated what became World War I when he, along with the head of the Austrian-Hungary Empire in Vienna, responded following the assassination of the archduke of Austria to destroy its Balkan rival Serbia. This resulted in the July crisis of 1914 that even pitted Wilhelm II and King George V of Britain against each other who were royal cousins.

It is questionable whether Serbia was truly a rogue state that was pitted against Austrian-Hungarian Empire. And I do not believe Russia desired a European war in 1914 since it was not ready but was in the process of building its rearmament program.

The Rise of Anarchists

The very idea of creating political change assassinating leaders did not begin in 1914 assassination of Austrian Archduke Franz Ferdinand, the heir to the throne of Austria-Hungary, on June 28, 1914 at Sarajevo. The arrest of the assassin Gavrilo Prinzep (1894–1918), seen here second from the right, inspired the reaction which led to war. Even in the United States there had been the assassination of President Lincoln and President McKinley which was also part of an international political trend that began during the 19th century based upon the theory that some dramatic deed was necessary to spark a revolution.

June 28, 1914 Arrest of Gavrilo Prinzep assassin of Archduke at Sarajevo

The movement itself became known as that of the Anarchists. Their theory of the assassination of a leader became known as the **"Propaganda of or by the deed"** that was believed would inspire an uprising if the physical violence was carried out in a dramatic provocative public act. This was a political philosophy which was part of the radical thought process that was emerging as a derivative and in parallel with Marxism and the desire for revolution.

Perhaps the first to be associated with this new radical political-philosophy was born the same year as Marx. He was the Italian revolutionary Carlo Pisacane (1818–1857), who wrote in his ***"Political Testament"*** (1857) that ***"ideas spring from deeds and not the other way around."***

Mikhail Alexandrovich Bakunin
(Михаил Александрович Бакунин)
(1814–1876)

Another anarchist of the period who was perhaps the most influential figure of the anarchism movement and one of the principal founders of the "social anarchist" tradition, was Mikhail Bakunin (1814–1876). Bakunin gathered tremendous prestige during the period as an activist that made him one of the most famous ideologues throughout Europe.

Bakunin gained substantial influence among radicals throughout Russia and Europe and in one of his surviving letters from 1870 to a Frenchman concerning what he labelled the "Present Crisis", Bakunin clearly stated that ***"we must spread our principles, not with words but with deeds, for this is the most popular, the most potent, and the most irresistible form of propaganda"***.

Bakunin's words were popularized by the French socialist-anarchist Paul Brousse (1844–1912), who in 1877 cited as examples the 1871 Paris Commune and a workers' demonstration in Berne provocatively using the socialist red flag. By the 1880s, the slogan had begun to be used to refer to bombings and tyrannicides. Reflecting this new understanding of the term, the Italian anarchist Errico Malatesta (1853–1932) years later in 1895 described ***"propaganda by the deed"*** as violent communal insurrections designed to ignite an imminent revolution. Against political tyranny and injustice, Revolution is having always been a weapon.

Therefore, it would be unjust to claim that Germany or Austria-Hungary were on a power trip of pure conquest. The anarchist movement was not a single random act by a deranged man that they used as an excuse to begin war. Serbia very much bares the greatest responsibility for the outbreak of WW1. There was a strong Serbian nationalism and expansionism that was profoundly disruptive and combined with Serbian backing for the **Black Hand** terrorists was exceptionally irresponsible. These risks are to this day being flamed once again by the attempt to create the one government within Europe by suppressing the culture and rights of the various member states. The assassination of the Archduke was not an official state act, yet it did fan the flames of old prejudices that manifested into war.

The Rise of Military Power over Imperial

Emperor Franz Joseph I
(b 1830; 1848 – 1916)
Austro-Hungarian Empire 1914 Gold Dukat / ducat 1914

Wilhelm did not know at the time that the military had convinced the Emperor of the Austro-Hungarian Empire, Franz Joseph I (b 1830; 1848 – 1916), to sign a declaration of war against Serbia. As a direct consequence, Russia began a general mobilization to attack Austria in defense of Serbia. Wilhelm wrote a lengthy commentary containing his observations:

> ***"… For I no longer have any doubt that England, Russia and France have agreed among themselves —knowing that our treaty obligations compel us to support Austria—to use the Austro-Serb conflict as a pretext for waging a war of annihilation against us … Our dilemma over keeping faith with the old and honourable Emperor has been exploited to create a situation which gives England the excuse she has been CONTACT seeking to annihilate us with a spurious appearance of justice on the pretext that she is helping France and maintaining the well-known Balance of Power in Europe."***

The question of whether Britain was obliged to join the European conflict which became inevitable by August 1st, 1914 cannot be divided into an entirely separate issue. Clearly, neutrality was not truly a credible option given that a German victory on the continent would have been a formidable rival at the time when Britain was the Financial Capital of the World which still dominated the oceans and as they were fond of saying, the sun never sets on the British Empire.

The German Kaiser Wilhelm II distinctly feared that Russia would enter WWI. The rising communist movement in Russia was anti-war. Germany strategy saw a chance for victory in Europe if it kept Russia out of the war. Thus, began the German interference in the Russian Revolution which became instrumental in its victory.

Lenin's return to Russia on April 16th, 1917

Hence, Germany supported the Communist anti-war sentiment of the Bolsheviks in Russia. Germany permitted Vladimir Lenin (1870–1924) to travel in a sealed train wagon from his place of exile in Switzerland through Germany, Sweden, and Finland to Petrograd. Since the start of the February Revolution in Russia, Lenin was trying to figure out a way to get back into Russia. Germany aided his return assuming he was anti-war and would thus keep Russia out of World War I.

Lenin returned to Russian on April 16th, 1917. Within months of arriving, Lenin led the October Revolution in Russia and the Bolsheviks seized power and indeed Russia withdrew from the world war. According to Leon Trotsky, the October Revolution would not have succeeded without Lenin.

Germany lost WWI because it was outnumbered. Germany entered WWI with the advantage of one of the largest, well-trained, and very well-equipped armies of the period. Germany could have defeated any other country in the world in a one-on-one confrontation. However, the allies banned together which then not just outnumbered their troops, but they could tap into far greater resources by bringing in America. Germany's only hope of winning the war was to launch a rapid knock-out blow before the Allies could muster a proper invasion. The German strategy was to destroy their enemies' armies quickly and then forcing a peace. They did not wish to conquer all of Europe. They did realize that if the war dragged out, this would result in a stalemate that they could not win lacking less resources. The Allies would simply win through attrition. This is precisely how WWI defeated Germany.

Helmuth von Moltke
Chief of the German General Staff
(1848-1916; General: 1906-1914)

Although Wilhelm II signed the order for German mobilization following pressure from Chief of the German General Staff Helmuth von Moltke (1848–1916; General: 1906–1914), Germany declared war against Russia and France during the first week of August 1914, he is reported to have said, ***"You will regret this, gentlemen."*** He was just a figurehead for the military was the real power as would be the case in Japan during World War II.

Erich von Falkenhayn
Chief of the German General Staff
(1861–1922; General 1914 - August 29, 1916)

On November 3rd, 1914, Wilhelm II fired Helmuth von Moltke and appointed Erich von Falkenhayn (1861–1922) was the Chief of the German General Staff from November 1914 until 29 August 1916. Helmuth was sacked due to the failure of the Schlieffen Plan which allowed the French army to escape.

By the fall of 1918, it was apparent to the military leaders of Germany that defeat was inevitable. After four years of terrible attrition, Germany no longer had the men or resources to resist the Allies, who had been given a tremendous boost by the infusion of American manpower and supplies.

In order to avert a full-scale Allied invasion of Germany, the German government contacted U.S. President Woodrow Wilson in October 1918 and asked him to arrange a general armistice.

Earlier that year, Wilson had proclaimed his "Fourteen Points," which proposed terms for a "just and stable peace" between Germany and its enemies. The Germans asked that the armistice be established along these terms, and the Allies more or less complied, assuring Germany of a fair and unselfish final peace treaty. On November 11, 1918, the armistice was signed and went into effect, and fighting in World War I came to an end.

The New York Times.

"All the News That's Fit to Print."

ARMISTICE SIGNED, END OF THE WAR!
BERLIN SEIZED BY REVOLUTIONISTS;
NEW CHANCELLOR BEGS FOR ORDER;
OUSTED KAISER FLEES TO HOLLAND

WAR ENDS AT 6 O'CLOCK THIS MORNING

The State Department in Washington Made the Announcement at 2:45 o'Clock.

ARMISTICE WAS SIGNED IN FRANCE AT MIDNIGHT

GEORGIA DYE SITES BEING WIPED OUT

MORE WARSHIPS JOIN THE REDS

The Prussian Kaiser Wilhelm II (1859–1941) found himself in the midst of troubling economic and social disorder. A series of mutinies by German sailors and soldiers undermined Wilhelm II's government and he lost the support of his military which enabled the German people to revolt.

General Erich Ludendorff
(1865–1937)

Paul von Hindenburg
(1847–1934)

The Marxism spread and engulfed Germany from every side. Wilhelm's role in wartime was really one of being in charge of handing out awards and holding ceremonies. The military high command was in control. By 1916 the German Empire had effectively become a military dictatorship under the control of Field Marshal Paul von Hindenburg (1847–1934) and General Erich Ludendorff (1865–1937). Nevertheless, Wilhelm did retain the ultimate authority in matters of political appointment, and it was only after his consent had been gained that major changes to the high command could be implemented.

In 1917, Hindenburg and Ludendorff decided they wanted to remove the Chancellor and told Wilhelm to appoint Georg Michaelis, who he scarcely knew. The Kaiser's support collapsed completely in October–November 1918 in the army, in the civilian government, and in German public opinion, as President Woodrow Wilson made clear that the Kaiser could no longer be a party to peace negotiations. Wilhelm also fell victim to the worldwide 1918 flu pandemic, which infected about 500 million people or one-third of the world's population. The number of deaths was estimated to be at least 50 million worldwide with about 675,000 occurring in the United States alone.

Nonetheless, Wilhelm survived the pandemic, yet he perhaps suffered the most politically. He was at the Imperial Army headquarters in Spa, Belgium, when the uprisings in Berlin erupted in late 1918. Then mutiny sprung up among the imperial navy, which took him be surprise. The discontent emerged as a German Revolution and Wilhelm's decision process was paralyzed. He came to realize that he would likely have to give up the imperial crown, yet he hoped to retain the Prussian kingship. The constitution actually had merged the imperial crown with the Prussian crown, meaning that an abdication would involve both.

The revolutionary period in Germany lasted from November 1918 until the adoption in August 1919 of the Weimar Constitution. The causes of the revolution were obviously the extreme suffering of the population during the four years of war. The impact of the defeat on the German Empire was extremely profound. Social tensions between the general population and the elite who held power rose to a boil. The social tensions simply came to a head.

The revolution began when the Naval Command wanted to stage a final battle against the British Royal Navy. They ordered preparations on October 24th, 1918, but the sailors revolted on October 29th, 1918 and the battle never took place. This was followed by an outright Kiel mutiny in early November. Like a contagion, the discontent spread which erupted in a widescale civil unrest across Germany. The revolution was Communist and inspired by the Marxist idea of utopia which became a contagion from Russia. However, the leadership of the Social Democratic Party of Germany (SPD) opposed the outright communist creation. The SPD opted instead for a national assembly that would form the basis for a parliamentary system of government taking a socialist approach. Fearing an all-out civil war in Germany between militant workers and reactionary conservatives, the SPD did not plan to strip the old German upper classes completely of their power, privileges, or wealth as was the case in both the Russian and French Revolutions.

Instead, the SPD during the election of 1919 sought to integrate the extreme left into the new social democratic system that was more Socialist compared to Communist. In this manner, SPD leftists sought an alliance with the German Supreme Command. Avoiding the confiscation of assets as in Russia, this allowed the army and the Freikorps (nationalist militias) to support the SPD and to quell the communist Spartacist uprising January 1919 by force who even asked for the Russians to invade and take Germany. The same alliance of political forces succeeded in suppressing uprisings of the left in other parts of Germany, with the result that the country was completely pacified by late 1919. And elections were held on January 19th, 1919.

Wilhelm's Abdication

Wilhelm consented to the abdication only after Ludendorff's replacement, General Wilhelm Groener, had informed him that the army would not defend his throne. Hindenburg had been his last and strongest support and now even he to advise the Emperor to give up the crown. With the army abandoning the crown, he had little choice. Ironically, Wilhelm had visited back in December 1897 Otto von Bismarck for the last time. It was then when Bismarck had warned Wilhelm about the rising influence of military establishment, especially of the admirals who were pushing to construct of a battle fleet.


Otto Eduard Leopold von Bismarck
(1815–1898)
First Chancellor of the German Empire (1871-1890)

Bismarck's last warning was not unlike President Eisenhower's parting speech. It was Chancellor Prince Max of Baden who announced Wilhelm's abdication of both titles on November 9th, 1918. The then Prince Max was also forced to resign later the same day. Then it was starkly clear that the Marxists had won and that then only Friedrich Ebert, leader of the SPD, was in control.

Later that same day, November 9th, 1918, one of Ebert's secretaries, Social Democrat Philipp Scheidemann (1865–1939), then proclaimed Germany a republic – the Weimar Republic as it would become known to the crowds below.

November 9th, 1918 Social Democrat Philipp Scheidemann proclaimed Germany was now a republic.

The next day, Wilhelm II crossed the border by train and went into exile in the Netherlands. The Weimar Republic allowed Wilhelm to remove twenty–three railway wagons of furniture, twenty–seven containing packages of all sorts, one bearing a car and another a boat, from his Palace at Potsdam.

Wilhelm II remained neutral throughout the war and control had been in the hands of the military. Still, the vindictiveness of the French was beginning to surface as they insisted that the **Treaty of Versailles** must contain Article 227 which expressly provided for the prosecution of Wilhelm II "for a supreme offence against international morality and the sanctity of treaties." Many viewed this as retribution for the prosecution of Napoleon.

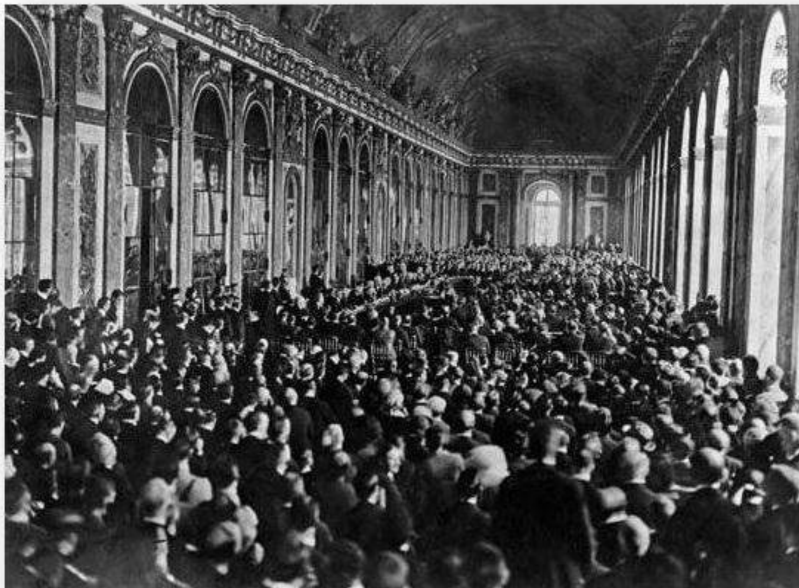
Nonetheless, the Dutch government refused to extradite Wilhelm, despite even appeals from the European Allies, to which the Americans also objected. King George V of Britain wrote that he looked on his cousin as ***"the greatest criminal in history" but*** opposed Prime Minister David Lloyd George's proposal to "hang the Kaiser". It was at that moment that the French were looking to just vindicate their hatred of the Germans.

With hindsight, the scheme of the Imperial German government had to return Lenin to keep Russia out the war backfired. It not only was instrumental in creating the Soviet Union supporting the Marxist transformation in the hands of the Bolsheviks, but its plan led to the overthrow of its own hold on power. This is all recorded in contemporary newspapers (see New York Times Nov 11, 1918).

Friedrich Ebert
(b 1871; 1919 – 1925)
Leader of Social Democratic Party of Germany (SPD)
& the first President of German Weimar Republic

To this day, the SDP has remained as a major party in Germany standing for socialistic policies. Then in December 1918, German elections were held for a National Assembly with the goal of creating a new parliamentary constitution. On February 6th, 1919, the National Assembly met in the town of Weimar and formed the Weimar Coalition. They also elected SDP leader Friedrich Ebert (1871–1925) as President of the Weimar Republic who served from 1919 until 1925.

Behind the Treaty of Versailles

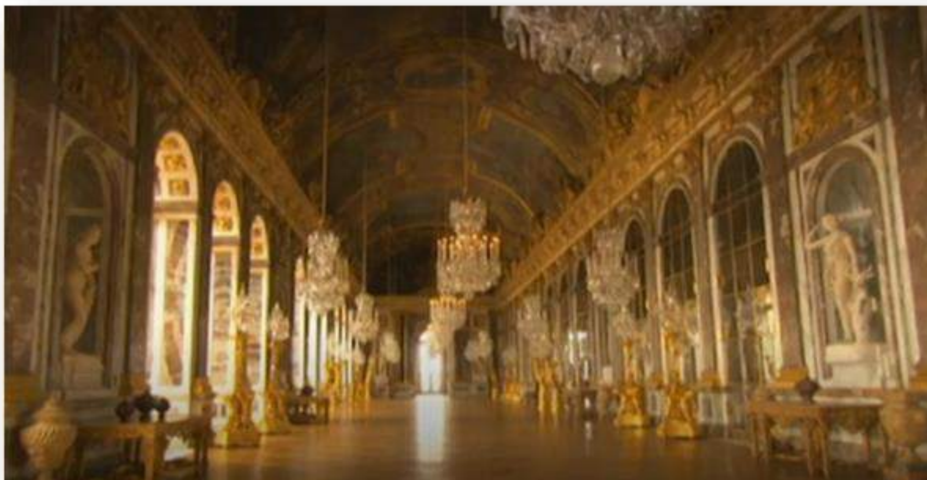


The Treaty of Versailles signed on June 28th, 1919

It was at the Palace of Versailles outside Paris where Germany signed the **Treaty of Versailles** on June 28th, 1919 with the Allies, officially ending World War I. The **Treaty of Versailles** commanded Germany to reduce its military, take responsibility for the World War I, relinquish some of its territories and pay exorbitant reparations to the Allies. It also prevented Germany from joining the League of Nations at that time. Thus, the treaty punished the German people for the sins of its government and military leaders. Indeed, the military created World War I for it is generally accepted that Wilhelm II was largely just a ceremonial figurehead. During the Sarajevo crisis with the assassination of the Archduke Franz Ferdinand of Austria on June 28th, 1914 It was in the wake of that event when Wilhelm offered to support Austria-Hungary in crushing the opposition who assassinated the Archduke, who was his personal friend.

Wilhelm went on his annual cruise of the North Sea July 6th, 1914. He returned to Berlin on the 28th of July that year and eagerly read a copy of the Serbian reply. Wilhelm wrote his comment on it:

"A brilliant solution—and in barely 48 hours! This is more than could have been expected. A great moral victory for Vienna; but with it every pretext for war falls to the ground, and [the Ambassador] Giesl had better have stayed quietly at Belgrade. On this document, I should never have given orders for mobilization."



The French Prime Minister Georges Benjamin Clemenceau (1841–1929), chose the location for the signing of the **Treaty of Versailles**. He wanted the Hall of Mirrors in Versailles Palace, because this had been site of the **Treaty of Versailles of 1871** which ended the Franco–Prussian War. It was signed by Adolphe Thiers, of the French Third Republic, and Otto von Bismarck, of the German Empire on February 26th, 1871. This was only the preliminary treaty which was used to solidify the initial armistice of January 28th, 1871 between France and Germany It was later ratified by the **Treaty of Frankfurt** on May 10th, of the same year.

The 1871 **Treaty of Frankfurt** made the decline of France militarily and economically obvious to the rest of the continent. However, it simultaneously not only demonstrated the economic and military power of Germany, it was also the birth if the German empire. This is when we begin to see coinage of the German Empire become dominant in Europe. France also had to pay reparations for invading Germany initially.

Prussian Wilhelm I
(1871-1888)
1873 20 Gold Mark

Jérôme Napoléon
King of Westphalie (1807-1813)
Taler, 1811C Cassel
Younger Brother of Napoleon

The Franco–Prussian War was the invasion by France to prevent the unification of Northern and Southern Germany. The transition from 18th to 19th centuries was marked by succession of conflicts known collectively as the Napoleonic (1792–1815). Those Germans states which opposed Napoleon suffered severely and others which acquiesced to the French found themselves absorbed by artificial entities and to provide men for the French Army. Germany emerged the wars changed forever.

In 1806, Napoleon officially ended the Holy Roman Empire and Austria became just another large state in the makeup Europe. He installed his younger brother, Jérôme–Napoléon Bonaparte (1784–1860) as King of the German province of Westphalia in 1807 who held that rule until 1813. Through the process of mediatization, the smaller sovereign states were added to the larger ones, reducing their number from over 300 to less than fifty. Secularization of the many ecclesiastical states added further territory to the principalities still in existence.

Friedrich the Great (1712–1786)
King of Prussia (1740-1786)

The French particularly wanted to crush Prussia being the former power under Friedrich the Great (1712–1786) who had been King of Prussia from 1740 until 1786. Ironically, the attempt to destroy Prussia by the French led to reforms and Prussia rose again and became quite powerful once more over all of Germany.

In 1864, Prussia fought a war with Denmark over the question of Schleswig Holstein and annexed that territory upon emerging victorious. Lingering differences with Austria over who should rule the duchies of Schleswig and Holstein led to war between France and Prussia in 1866. Prussia crushed the Austrian army in Bohemia and the war came to a quick end. The result was another large acquisition of territory as Prussia annexed Hannover, Hesse–Cassel, Frankfurt am Main, Nassau and Schleswig–Holstein. Other states which had opposed Prussia, such as Bavaria, Württemberg, Saxony and Baden, were forced to pay indemnities to the victor, as did Austria itself. Obviously, memories that France was made to pay reparation payments were not forgotten.

Therefore, it was against this backdrop of rivalry between France and Germany which colored the absurd reparations and terms forced upon the Germany people which had already revolted against its former monarchy. While war are always instigated by governments, the people themselves are always blamed as the culprits even if they rise up and overthrow their own political state.

The English economist John Maynard Keynes (1883–1946), attended the peace conference known as the **Treaty of Versailles.** However, Keynes left in protest for it was all about France getting back a Germany for past wars. of the treaty, was one of the most outspoken critics of the punitive agreement. In his The *Economic Consequences of the Peace*, published in December 1919, Keynes predicted that the stiff war reparations and other harsh terms imposed on Germany by the treaty would lead to the financial collapse of the country, which in turn would have serious economic and political repercussions on Europe and the world.

John Maynard Keynes
(1883-1946)

The Treaty as originally expressed to Germany stated that there shall be **"no contributions"** and **"no punitive damages."** France insisted that the preamble to paragraph of the Armistice Terms stated, **"that any future claims and demands of the Allies and the United States of America remain unaffected,"** wiped out all precedent conditions, and left the Allies free to make whatever demands they chose. Keynes resigned in protest over this interpretation.

European Leaders at Paris Peach Conference 1919
Treaty of Versailles

French General Ferdinand Foch (1851-1929), & Prime Minister Georges Benjamin Clemenceau (1841-1929), British Prime Minister David Lloyd George (1863-1945), Italian Prime Minister Vittorio Emanuele Orlando (1860-1952) & Minister of Foreign Affairs Baron Sidney Costantino Sonnino (1847-1922)

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In January 1919, John Maynard Keynes (1883–1946) traveled to the Paris Peace Conference as the chief representative of the British Treasury. The brilliant 35–year–old economist had previously won acclaim for his work with the Indian currency and his management of British finances during the war. In Paris, he sat on an economic council and advised British Prime Minister David Lloyd George (1863–1945), but the important peacemaking decisions were out of his hands.

Georges Clemenceau (1841-1929)

The real power player was French Prime Minister Georges Benjamin Clemenceau (1841–1929), and to a lesser extent French General Ferdinand Foch (1851–1929), British Prime Minister David Lloyd George (1863–1945), Italian Prime Minister Vittorio Emanuele Orlando (1860–1952) and Italian Minister of Foreign Affairs Baron Sidney Costantino Sonnino (1847–1922).

U.S. President Wilson was really overpowered by the French Prime Minister Georges Clemenceau wielded the real authority. Germany had no role in the negotiations deciding its fate, and lesser Allied powers had little responsibility in the drafting of the final treaty.

Treaty of Frankfurt (May 10th, 1871) Ending the Franco-Prussian War

It soon became apparent that the treaty would bear only a faint resemblance to the **Fourteen Points** that had been proposed by President Wilson and was originally embraced by the Germans to sign the armistice to begin with. Wilson, a great idealist, had few negotiating skills, and he soon buckled under the pressure of Clemenceau, who hoped to punish Germany as severely as it had punished France in the **Treaty of Frankfurt** that ended the Franco–Prussian War back in 1871. This treaty polarized French policy towards Germany for the next 40 years. The reconquest of Alsace–Lorraine, the "lost provinces," became an obsession for the French which would be one of the most powerful motives in France's involvement in World War I despite the fact that the people there spoke German and not French. It purely a territorial claim.

Lloyd George of Britain took the middle ground between the two men, but he backed the French plan to force Germany to pay reparations for damages inflicted on Allied civilians and their property. Since the treaty officially held Germany responsible for the outbreak of World War I, the Allies would not have to pay reparations for damages they inflicted on German civilians.

The treaty that began to emerge truly reflected to accomplish Clemenceau's hope to crush France's old rival once and for all. According to its terms, Germany was to relinquish 10% of its territory. It was to be disarmed, and its overseas empire taken over by the Allies. Most detrimental to Germany's immediate future, however, was the confiscation of its foreign financial holdings and its merchant carrier fleet.

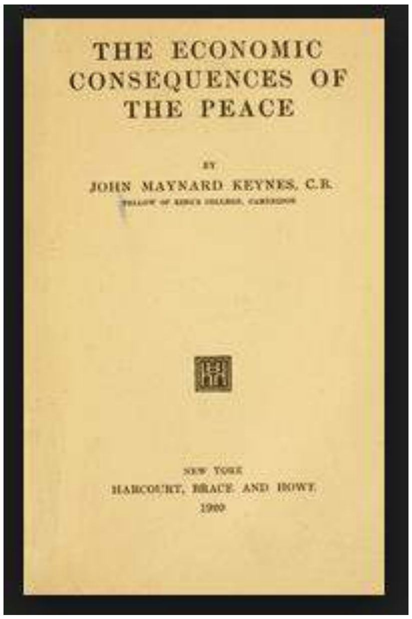
The German economy, already devastated by the war, was thus further crippled, and the stiff war reparations demanded by France which ensured that it would not soon return to its feet. A final reparations figure was not agreed upon in the treaty, but estimates placed the amount in excess of $30 billion, far beyond Germany's capacity to pay. On top of that, Germany would be subject to invasion if it fell behind on payments which seemed to be a pretense for its annihilation by France.

Keynes, horrified by the terms of the emerging treaty, presented a plan to the Allied leaders in which the German government be given a substantial loan, thus allowing it to buy food and materials while beginning reparations payments immediately. Lloyd George approved the **"Keynes Plan,"** but President Wilson turned it down because he feared it would not receive congressional approval. In a private letter to a friend, Keynes called the idealistic American president ***"the greatest fraud on earth."*** On June 5th, 1919, Keynes wrote a note to Lloyd George informing the prime minister that he was resigning his post in protest of the impending **"devastation of Europe."**

Thomas Woodrow Wilson
(1856–1924)

The Germans initially refused to sign the **Treaty of Versailles**, and it took an ultimatum from the Allies to bring the German delegation to Paris on June 28th. It was five years to the day since the assassination of Archduke Francis Ferdinand, which began the chain of events that led to the outbreak of World War I.

At the ceremony, General Jan Christiaan Smuts (1870 – 11 September 1950), soon to be president of South Africa, was the only Allied leader to protest formally the **Treaty of Versailles**, saying it would do grave injury to the industrial revival of Europe. At Smuts' urging, Keynes began work on his work ***The Economic Consequences of the Peace***. It was published in December 1919 and was widely read. In this book, Keynes made a grim prophecy that would have particular relevance to the next generation of Europeans:



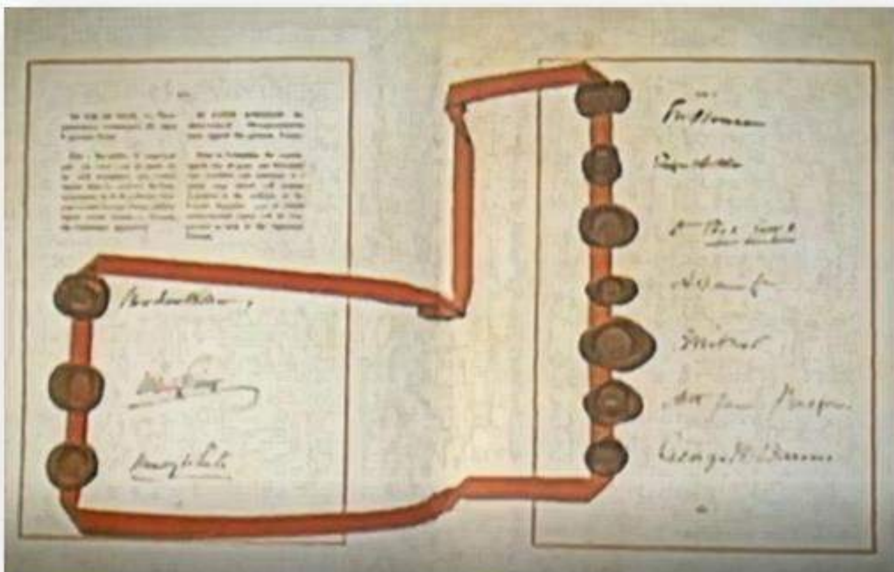
"If we aim at the impoverishment of Central Europe, vengeance, I dare say, will not limp. Nothing can then delay for very long the forces of Reaction and the despairing convulsions of Revolution, before which the horrors of the later German war will fade into nothing, and which will destroy, whoever is victor, the civilisation and the progress of our generation."

Germany soon fell hopelessly behind in its reparation payments, and in 1923 France and Belgium invaded the industrial Ruhr region as a means of forcing payment. In protest, workers and employers closed down the factories in the region. Catastrophic inflation ensued, and Germany's fragile economy began quickly to collapse. By the time the crash came in November 1923, a lifetime of savings could not buy a loaf of bread. That month, the Nazi Party led by Adolf Hitler launched an abortive coup against Germany's government. The Nazis were crushed, and Hitler was imprisoned, but many resentful Germans sympathized with the Nazis and their hatred of the Treaty of Versailles.

A decade later, Hitler would exploit this continuing bitterness among Germans to seize control of the German state. In the 1930s, the **Treaty of Versailles** was significantly revised and altered in Germany's favor, but this belated amendment could not stop the rise of German militarism and the subsequent outbreak of World War II.

It was Friedrich Ebert of the Weimar Republic who had to deal with the Treaty of Versailles on behalf of Germany. When the terms became known on May 7th, 1919, the German people rose in protest. Ebert himself did denounce the treaty as "unrealizable and unbearable" yet he understood that Germany was not allowed to negotiate nor reject the treaty at the demand of the French.

When the terms became known on May 7th, 1919, the German people rose in protest. Friedrich Ebert (1871–1925), representing Germany, Ebert himself did denounce the treaty as "unrealizable and unbearable" yet he understood that Germany was not allowed to negotiate nor reject the treaty. He even asked Hindenburg if the army could put up a defense if the Allies renewed hostilities. Hindenburg said that the army was not capable of resuming the war even on a limited scale. Ebert then advised the National Assembly to approve the treaty, which it did by a large majority on July 9th, 1919.



The **Treaty of Versailles** commanded Germany to reduce its military, take responsibility for the World War I, relinquish some of its territories and pay exorbitant reparations to the Allies. It also prevented Germany from joining the League of Nations at that time. Thus, the treaty punished the German people for the sins of its military leadership. Indeed, the military created World War I for it is generally accepted that Wilhelm II was largely just a ceremonial figurehead.

Clearly, the Treaty of Versailles set the stage for World War II by its very crushing terms that nobody would be able to meet. The Treaty of Versailles set out a plan for reparations to be paid by Germany requiring to them to pay 20 billion gold marks, as an interim measure, with the final amount to be decided upon at later date. In 1921, the London Schedule of Payments set the German reparation figure at 132 billion gold marks divided into various classes, of which really only 50 billion gold marks were required to be paid.

Of course, virtually every account of the German Hyperinflation focuses on the simplistic idea that printing currency effectively reduces money to a worthless state. They have ignored the politics and paid only lip service to the impact of the **Treaty of Versailles**. The German people resorted to a barter economy to survive. Various tangible goods from cigars and artwork to jewels and precious metals were routinely exchanged for the basic staples such as bread. While many portrayed people standing by and watching helplessly as their life savings vanished was a distortion of reality. Germany's descent into economic chaos was not the political consequences of their own Government but was being orchestrated by the vindictiveness of the French who wanted to absolutely crush the Germans and future generations reducing them to the status of an impoverished economy for generations to come.

The complete failure to understand the real story colors our view of even how the manage society today. It has been this distorted perspective of these events that have led to the crushing European economy and the creation of the lost generation.

While the narrow neo-classical economic theory, hyperinflation is rooted in a deterioration of the monetary base, there is little attention paid to the collapse in public confidence that there is a store of value that the currency will be able to command later. Hence, people do not save and the velocity of money increases as people attempt to spend it as fast as they get it. There is a perceived risk of holding currency which rises dramatically at the core.

Interest rates rise because they are the premiums people expect in the future when loans are repaid to make a profit. The hyperinflation that was set in motion by the **Treaty of Versailles** was not limited to Germany. We also saw hyperinflations that I defined as a sharp and sudden doubling in prices (50% decline in the purchasing power of a currency) is less than three months in Austria and Hungary as well during this same period. In the case of Austria, hyperinflation began in October 1921 and continued into September 1922. In Hungary, the hyperinflation unfolded between March 1923 and February 1924.

Raymond Nicolas Landry Poincaré
(1860 – 1934)
French President 1913 to 1920

Both the British and Americans stood by while France sought vindictive retribution which was for past wars, not really merely World War I. The British press heavily criticized the French for their actions invading the Ruhr. The Outlook wrote that the President of France Raymond Poincaré (1913–1920) would be immortalized as "one of the most colossal of idiots, or alternatively the greatest of knaves", while The Spectator said that France was "going to commit the extremity of human folly." The Economist warned that France's actions might lead to another European war.

Indeed, Poincaré was a hardline lawyer who maintained that Armistice should have been delayed allowing the French Army to penetrate and conquer most of Germany. At the **Treaty of Versailles**, Poincaré demanded that Germany must give France the Rhineland and it should have been under Allied military control. Poincaré argued that after the Franco–Prussian War (1870–1871), Germany occupied various French provinces and did not leave until it had received all of the indemnity exacted. He argued that France was now entitled to all reparations for damage caused. He further claimed that if the Allies did not occupy the Rhineland, they would at a later date find that they would need to do so again, and Germany would label them the aggressors.

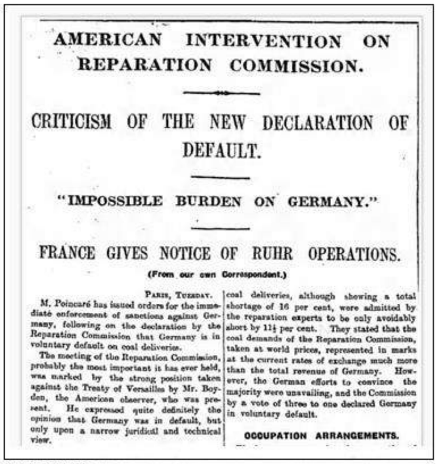
Following the disastrous defeat of Germany in World War I, the French also demanded that the German Empire was to be dissolved and hereditary monarchies were also to be abolished. These demands from the French were clearly retribution for previous wars and the fact that it was at the **1871 Treaty of Versailles** where the German Empire was created. They also wanted to hang Wilhelm II but Dutch government refused to extradite him.

Clearly, the **Treaty of Versailles** set the stage for World War II by its very crushing terms that nobody would be able to meet. This allowed the rise of Hitler for the French politicians were punishing the German people. The **Treaty of Versailles** set out a plan for reparations to be paid by Germany requiring to them to pay 20 billion gold marks, as an interim measure, with the final amount to be decided upon at later date. In 1921, the London Schedule of Payments set the German reparation figure at 132 billion gold marks divided into various classes, of which only 50 billion gold marks were required to be paid.

Meanwhile, the industrialists of Germany's Ruhr Valley lost their factories in Lorraine. Germany had seized Lorraine back in 1870 and now this was to also part of the demands be returned to France. There was also an occupation of the Ruhr industrial area by France and Belgium. The Germans affected by the **Treaty of Versailles** and the seizure of their property by France and Belgium now demanded hundreds of millions of marks as compensation from the German government and they paid the Ruhr Valley industrialists for their losses. This also contributed to the German Hyperinflation crisis and it effectively reduced the ability of the German economy to recover.

France long believed that its "natural boundaries" were the Pyrenees to the southwest, the Alps to the southeast, and the Rhine River to the northeast. These strategic claims led to the annexation of territories located west of the Rhine river in the Holy Roman Empire of the German Nation. This region was German-speaking not French. It has been known as Alsace and was progressively conquered by Louis XIV in the 17th century, while Lorraine was incorporated in the 18th century under Louis XV.

German nationalism prevailed and resurfaced following the French occupation of Germany under Napoleon. This region of German-speaking people long sought reunification into a single nation-state of Germany. As various German dialects were spoken by most of the population of Alsace and Moselle (northern Lorraine), these regions were viewed by German nationalists to be rightfully part of hoped-


AMERICAN INTERVENTION ON REPARATION COMMISSION.

CRITICISM OF THE NEW DECLARATION OF DEFAULT.

"IMPOSSIBLE BURDEN ON GERMANY."

FRANCE GIVES NOTICE OF RUHR OPERATIONS.

(From our own Correspondent.)

PARIS, TUESDAY.

M. Poincaré has issued orders for the immediate enforcement of sanctions against Germany, following on the declaration by the Reparation Commission that Germany is in voluntary default on coal deliveries.

The meeting of the Reparation Commission, probably the most important it has ever held, was marked by the strong position taken against the Treaty of Versailles by Mr. Boyden, the American observer, who was present. He expressed quite definitely the opinion that Germany was in default, but only upon a narrow juridical and technical view.

coal deliveries, although showing a total shortage of 16 per cent, were admitted by the reparation experts to be only avoidably short by 11½ per cent. They stated that the coal demands of the Reparation Commission, taken at world prices, represented in marks at the current rates of exchange much more than the total revenue of Germany. However, the German efforts to convince the majority were unavailing, and the Commission by a vote of three to one declared Germany in voluntary default.

OCCUPATION ARRANGEMENTS.

THE MANCHESTER GUARDIAN, WEDNESDAY, JANUARY 10, 1923.

for united Germany in the future. Since 2016, Alsace–Lorraine territory remains part of the French administrative region of Grand Est. This is a region that will once again rise as turmoil in France continues.

During the first five years after World War I, coal was scarce in Europe. France sought coal for its steelmakers from Germany. But the Germans needed coal for home heating and for their own steel industry, having lost many of their steel plants in Lorraine to the French. As a means of protecting their own growing German steel industry, the German coal producers—whose directors also sat on the boards of the German state railways and German steel companies—began to leverage high costs though shipping rates on coal exports to France.

In early 1923, Germany defaulted on its war reparations payments and German coal producers refused to ship any more coal across the border. In response to this, French and Belgian troops occupied the Ruhr River valley inside the borders of Germany in order to compel the German government to continue to ship coal and coke in the quantities demanded by the **Versailles Treaty**, which, Germany which characterized as onerous under its post war condition (60% of what Germany had been shipping into the same area before the war began).

This occupation by the French military of the Ruhr, the center of the German coal and steel industries outraged the German people. They passively resisted the occupation, and the economy suffered.

Hyperinflation thus unfolded in Germany because those with money saw what Lenin had done in Russia and sent whatever wealth they had to other places, particularly the United States. They got their wealth out through using foreign coins, but also collectibles such as stamps and coins in particular, which were movable assets. By the end of World War II, most German rare stamps and coins were actually located in the United States and were slowly making their way back to Germany during the 1960s and 1970s.

The Weimar Republic then just printed money to pay reparation payments and the entire system collapsed.

The Misinterpretation of the German Hyperinflation

We must also understand the real events behind the German Hyperinflation if we are ever going to save Europe from a complete disaster and possibly World War III. It is the failure to comprehend the truth behind this event which has economically driven the EU creating unnecessary stress. The misconception of the German Hyperinflation has dominated Europe to this very day imposing Austerity (deflation) suppressing economic growth resulting in the establishment of the lost generation – the inability of the youth to find employment as took place during the 1930s.

When the Weimar Republic came to power, they did not cancel the outstanding German Imperial Empire currency. The German 100-mark notes were issued before, during and after World War I by both the German Empire and the Weimar Republic. The blue 100-mark note is always dated 1908 regardless of when the notes were actually printed.

The notes issued by the German Empire have a red seal and serial numbers whereas those issued by the Weimar Republic continued to issue unchanged from 1918 to 1922, but with a green seal and serial number. The 100-mark note features the crowned imperial German eagle on one side with two women holding a large portrait of a woman's head. The actual first issue was not until 1910 despite the date of 1908. By the end of 1922, these 100-mark notes were worth less than one cent, yet they are highly unusual "multi-government" issues.

In Germany, World War I caused a major strain on its monetary system. People hoarded coins of not just Germany, but also foreign gold and silver coins. and large sums were needed to pay for the war effort. The Reichsbank continued to issue some notes that were supposedly backed by gold, they were insufficient to keep with the demand for money needed for the war effort. The generals were only concerned about winning. They never considered the economic impact upon the nation as is always the case when the military dictates the fate of nations.

German World War I Darlehnskassenschein Currency Issue

1 Mark Darlehnskassenschein Note

50 Mark Darlehnskassenschein Note

German World War I 1914 series of notes known as Darlehnskassenschein which had no backing, and were technically an interest-free loan to the government The small 1 Mark note was issued to replace the silver Mark coins that disappeared from circulation due to hoarding

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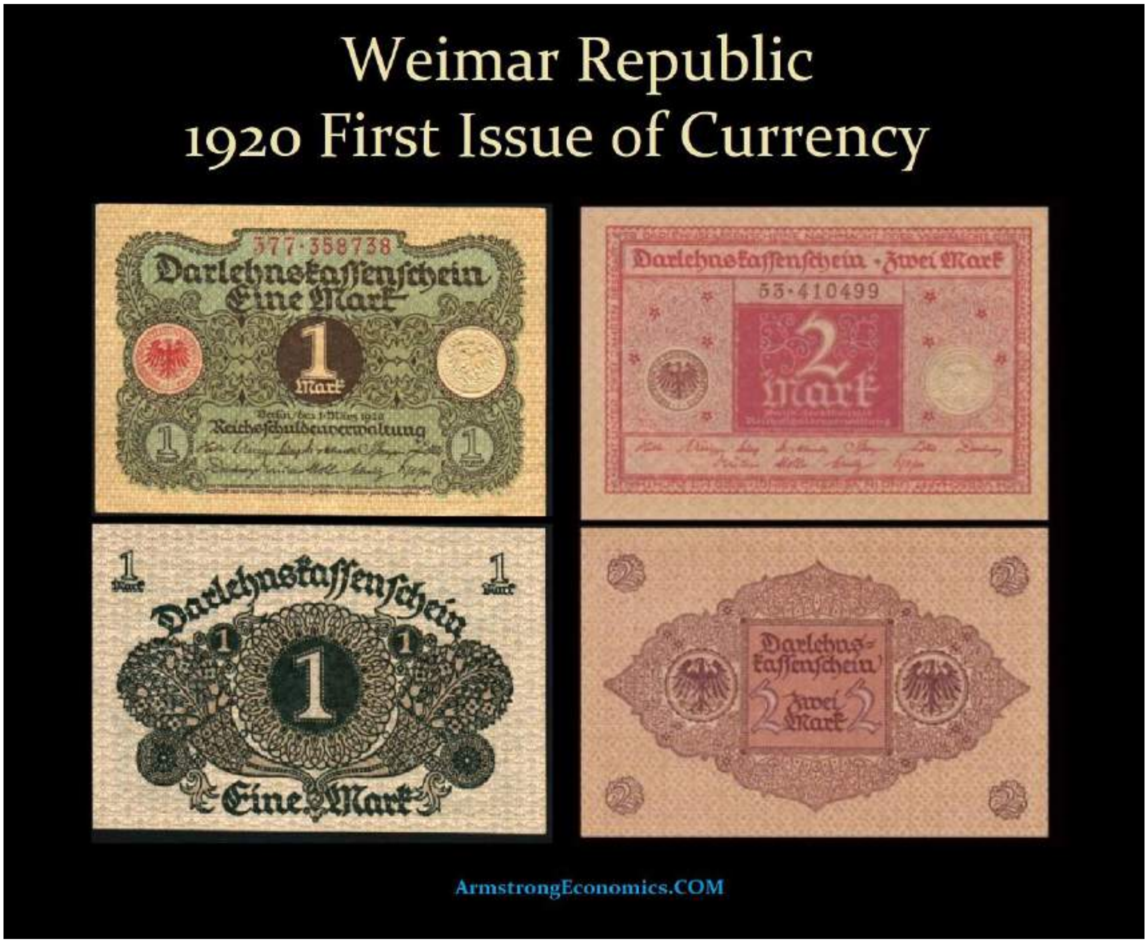
A new series of notes without any backing, called Darlehnskassenschein was then issued. The notes were technically an interest-free loan to the government. They neither paid interest nor were they backed by gold.

The two types of notes circulated together at par. The 1 and 50-Mark Darlehnskassenschein notes are dated August 1914, just a few months after the war had begun. The small 1-Mark note was issued to replace the silver Mark coins that disappeared from circulation due to hoarding. Whenever war erupts, people hoard money just to survive the unknown.

The last Darlehnskassenschein note issued was a 20-Mark note dated February 20, 1918. This final issue really concluded the entire series.



The Weimar Republic actually did not issue new designs for their currency until 1920. Since they never canceled the currency of the Empire, there was no mad rush to replace the money supply as is often the case with a change in government following a revolution.

In early January 1918, the Soviet government suspended payment on foreign debt, and in early February 1918 it decreed that all Tsarist debts were repudiated as were those contracted to continue the war by the provisional government between February and November 1917. At the same time, it decided that all assets of foreign capitalists in Russia would be confiscated.

Since the Russians repudiated all debts of the former government, their credit standing collapsed. In 1918, The Soviets issued state credit notes which were followed in 1919 by currency notes.

In the case of Germany, the Weimar Republic did not confiscate assets and they did not repudiate debts. They also did not cancel the previous currency. Thus, the first issue consisted of a 10–Mark, 50–Mark, and 100–Mark note.

When the Weimar Republic first began following the 1918 Communist Revolution, they issued coins assuming they were now in control. The 50 pfennig coins were struck between 1919 and 1922. There were no precious metal or even bronze coins struck during the hyperinflation that began from August 1922 to November 1923. The coinage of the Weimar Republic between 1922 and 1923 were all struck in aluminum.


Kapp-Lüttwitz Putsch The attempted coup of March 13th 1920 to restore the German Empire and overthrow the Weimar Revolution displaying the GermanReichskriegsflagge

Nonetheless, there were still efforts from the right who sought to overthrow the new republic. The Kapp–Lüttwitz Putsch, named for its leaders Wolfgang Kapp and Walther von Lüttwitz, was a coup attempt on March 13th, 1920 to reverse the German Revolution by overthrowing the Weimar Republic and establishing a right-wing autocratic government in its place. In March 1920, during the right-wing Kapp Putsch of some Freikorps elements, the government, including President Ebert, had to flee from Berlin. It was supported by parts of the Reichswehr (military) and other conservative, nationalist and monarchist factions.

There is probably no greater event in history which has been so distorted than the German Hyperinflation which also spread to Austria and Hungary, the three losers in World War I. I have yet to find any report om the event that ever investigated the causes and effects beyond the simple relationship that it was simply caused by an increase in money supply and has thus been typically used to support the **Quantity Theory of Money** (QTM).

Worse still, is the serious misunderstanding on this event have biased the German philosophy and has come back to plague the European Union and how it has managed the economy imposing Austerity upon the whole continent.

Another serious problem stems from the fact that this event has been reviewed by academics who have confined their analysis to domestic events in Germany. Because they seek to approach an economy from a simple zero–sum game of numbers, they lack the understanding of how capital reacts in anticipation of events that may or may not even happen.

Consequently, they cannot include beliefs in their analysis when they do not materialize. They fail to grasp that capital will move if it believes something will happen and if it is wrong, then it will move back again. Understanding capital flows among nations is absolutely essential for the balance of payments of nations will also be impacted by what external investors believe **<u>might</u>** happen in a given economy. These are the wildcards that cannot be ignored, yet traditional economics is incapable of including in a forecast or analysis of what took place before.

The legacy of the German hyperinflation to this day infects politics, how governments function, and the direction in which our future in being decided. The German mark–dollar exchange rate rose from 4.2 to one in 1914 to a peak of around 4.2 trillion marks to the dollar by November 1923.

Stories abound how waiters had to climb on tables to call out new menu prices in restaurants every half hour. Banknotes became sufficiently useless that workers had to bring wheelbarrows with them to work to collect their daily pay.

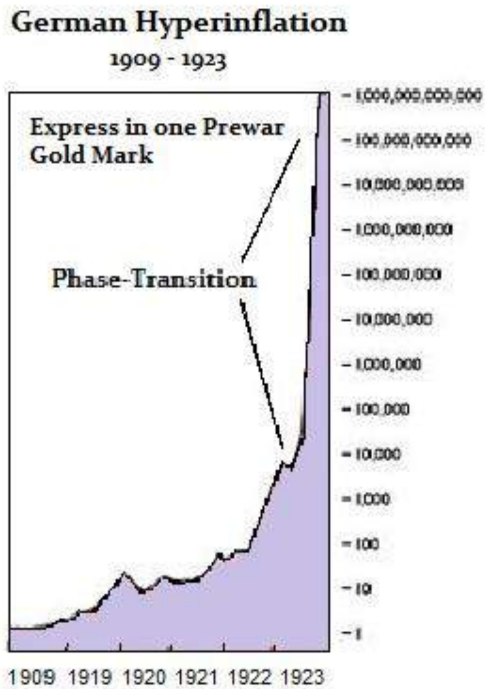
One story was that a man brought a wheelbarrow full of cash to buy something. He stepped away and when he looked back, his pile of cash was still there, but they stole the wheelbarrow. Other stories were that children were given old notes that no longer were worth anything to play with. Some made kites out of them. Are these really true or exaggerations?

To actually understand the German Hyperinflation, we must move beyond the simplistic explanation that it was the direct result of just printing money without restraint. We must tackle the very cause of that trend and ascertain was it the chicken or the egg.

Did the printing of money cause the hyperinflation or was the hyperinflation the result of the inability to meet government expenditures and reparation payments impose at the demands of France? Can we assemble the facts rather than simple opinion? If we are going to address the future, we must really understand the past.

If a child is born and is never told anything of the past even what foods are poison, then there can never be any advancement if every single individual must always start from scratch. The future becomes understandable only by comprehending the past. Without experience, we are nothing but a biological lifeform with nothing to offer in this world except our role in the food chain.

German Weimar Government



Date:	German Marks needed to buy one ounce of gold
Jan 1919	170.00
Sept 1919	499.00
Jan 1920	1,340.00
Sept 1920	1,201.00
Jan 1921	1,349.00
Sept 1921	2,175.00
Jan 1922	3,976.00
Sept 1922	30,381.00
Jan 1923	372,477.00
Sept 1923	269,439,000.00
Oct 2, 1923	6,631,749,000.00
Oct 9, 1923	24,868,950,000.00
Oct 16, 1923	84,969,072,000.00
Oct 23, 1923	1,160,552,882,000.00
Oct 30, 1923	1,347,070,000,000.00
Nov 5, 1923	8,700,000,000,000.00
Nov 30, 1923	87,000,000,000,000.00

Without question, the cause of the German hyperinflation of 1923 was due to both the internal policies and the external factors such as the **Treaty of Versailles**, demanding Germany to pay reparations that were strip mining the German economy punishing the people for the mistakes of their military leadership. Yet as always, far too often human nature prefers to always reduce such an event to a single cause behind every effect. That simply hides the truth which is always far more complex.

The 1919 German Lottery Bond
Deutsche Sparprämien-Anleihe

All attempts by the new Weimar Republic to finance its astonishing need for capital by raising of credit from voluntary creditors was doomed to fail. There were few foolish investors who were willing to buy German bonds. The state of the economy afforded Germany with little opportunity foreign investment or foreign lending. There was tremendous skepticism about investing in Germany given the 1918 Communist Revolution. People feared Germany would go the way of Russia and all wealth would simply be confiscated. There was no interest at that time among foreign investors to buy German debt.

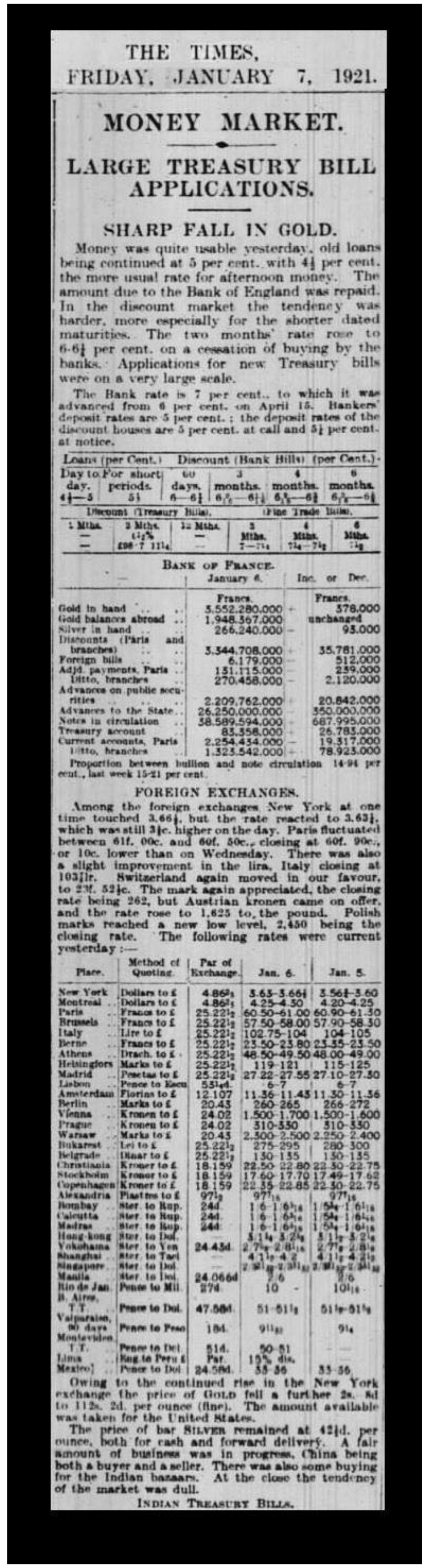
The Weimar Republic created a Lottery Bond bonds to entice the irrationality and hope of desperate people by offering a chance at a large win from a lottery. By signing the first German loan after the war, the Deutsche Sparprämien-Anleihe 1919 at 1000 Mark, investors had the possibility to become millionaires. While the loan did not bear any interest, the owner, however, participated in a half-yearly drawing with 2500 winners, with amount between 1000 Mark (1000 winners) and 1 Million Mark (5 winners). The issue was discontinued however, due to a lack of demand.

The German people were forced, through the **Treaty of Versailles**, to make reparation payments amounting to approximately three times the value of all German property. This extortion simply could not be allowed to continue, and this economic hardship led to the rise of Hitler in the first place. This level of reparation payments was simply retribution by the French for past wars when they lost to Prussia.

The Reparations definitely accounted for about a third of the German deficit from 1920 to 1923. This was one cause behind the effect of creating the hyperinflation. However, blame for the hyperinflation was also hurled upon the bankers and foreign speculators who were shorting the currency. It would be this perception of bankers causing the hyperinflation that supported the rise of Adolf Hitler 10 years later.

Hyperinflation reached its peak by November 1923. But to understand this blame upon bankers and speculators we must also understand the evolution of currency trading during the post–WWI period. There was truly a profound transformation of foreign exchange markets given the abandonment of the gold standard which allowed currencies to float. This led to a real trading boom during the 1920s with respect to currency speculation.

The end of wartime capital controls in 1919 and the beginning of the floating exchange rate financial period led to a resurgence of foreign exchange activity with London becoming the major trading center. At the same time, a large–scale forward currency market was established. It is true, forward transactions in currency had appeared before WWI



THE TIMES,
FRIDAY, JANUARY 7, 1921.

MONEY MARKET.

LARGE TREASURY BILL APPLICATIONS.

SHARP FALL IN GOLD.

Money was quite usable yesterday, old loans being continued at 5 per cent. with 4½ per cent. the more usual rate for afternoon money. The amount due to the Bank of England was repaid. In the discount market the tendency was harder, more especially for the shorter dated maturities. The two months' rate rose to 6-6¼ per cent. on a cessation of buying by the banks. Applications for new Treasury bills were on a very large scale.

The Bank rate is 7 per cent., to which it was advanced from 6 per cent. on April 15. Bankers' deposit rates are 5 per cent.; the deposit rates of the discount houses are 5 per cent. at call and 5¼ per cent. at notice.

Loans (per Cent.)		Discount (Bank Bills) (per Cent.)			
Day to day.	For short periods.	60 days.	3 months.	4 months.	6 months.
4½—5	5½	6—6¼	6 5/16—6 11/16	6 5/16—6¾	6 3/16—6¼

Discount (Treasury Bills).			(Fine Trade Bills).		
1 Mths.	3 Mths.	12 Mths.	3 Mths.	4 Mths.	6 Mths.
—	4½%	—	7—7¼	7¼—7½	7½
—	£98 7 11¼	—			

BANK OF FRANCE.

—	January 6.	Inc. or Dec.
	Francs.	Francs.
Gold in hand	5,552,280,000	+ 378,000
Gold balances abroad ..	1,948,367,000	unchanged
Silver in hand	266,240,000	— 93,000
Discounts (Paris and branches)	3,344,708,000	+ 35,781,000
Foreign bills	6,179,000	— 512,000
Adjd. payments, Paris ..	151,115,000	— 239,000
Ditto, branches ..	270,458,000	— 2,120,000
Advances on public securities	2,209,762,000	+ 20,842,000
Advances to the State ..	26,250,000,000	+ 350,000,000
Notes in circulation ..	38,589,594,000	+ 687,995,000
Treasury account ..	83,358,000	+ 26,783,000
Current accounts, Paris	2,254,434,000	— 19,317,000
Ditto, branches ..	1,323,542,000	+ 78,923,000

Proportion between bullion and note circulation 14·94 per cent., last week 15·21 per cent.

FOREIGN EXCHANGES.

Among the foreign exchanges New York at one time touched 3.66¼, but the rate reacted to 3.63¾, which was still 3¼c. higher on the day. Paris fluctuated between 61f. 00c. and 60f. 50c., closing at 60f. 90c., or 10c. lower than on Wednesday. There was also a slight improvement in the lira, Italy closing at 103¾lr. Switzerland again moved in our favour, to 23f. 52½c. The mark again appreciated, the closing rate being 262, but Austrian kronen came on offer, and the rate rose to 1,625 to the pound. Polish marks reached a new low level, 2,450 being the closing rate. The following rates were current yesterday:—

Place.	Method of Quoting.	Par of Exchange.	Jan. 6.	Jan. 5.
New York	Dollars to £	4.86⅔	3.63-3.66¼	3.56¼-3.60
Montreal ..	Dollars to £	4.86⅔	4.25-4.50	4.20-4.25
Paris ..	Francs to £	25.22½	60.50-61.00	60.90-61.30
Brussels ..	Francs to £	25.22½	57.50-58.00	57.90-58.30
Italy ..	Lire to £	25.22½	102.75-104	104-105
Berne ..	Francs to £	25.22½	23.50-23.80	23.35-23.50
Athens ..	Drach. to £	25.22½	48.50-49.50	48.00-49.00
Helsingfors	Marks to £	25.22½	119-121	115-125
Madrid ..	Pesetas to £	25.22½	27.22-27.55	27.10-27.30
Lisbon ..	Pence to Escu	53¼d.	6-7	6-7
Amsterdam	Florins to £	12.107	11.36-11.45	11.30-11.36
Berlin ..	Marks to £	20.43	260-265	266-272
Vienna ..	Kronen to £	24.02	1.500-1.700	1.500-1.600
Prague ..	Kronen to £	24.02	310-330	310-330
Warsaw ..	Marks to £	20.43	2.300-2.500	2.250-2.400
Bukarest ..	Lei to £	25.22½	275-295	280-300
Belgrade ..	Dinar to £	25.22½	130-135	130-135
Christiania	Kroner to £	18.159	22.50-22.80	22.30-22.75
Stockholm	Kronor to £	18.159	17.60-17.70	17.49-17.62
Copenhagen	Kroner to £	18.159	22.35-22.85	22.30-22.75
Alexandria	Piastres to £	97½	97 7/16	97 7/16
Bombay ..	Ster. to Rup.	24d.	1/6-1/6 1/16	1/5¾-1/6 1/16
Calcutta ..	Ster. to Rup.	24d.	1/6-1/6 1/16	1/5¾-1/6 1/16
Madras ..	Ster. to Rup.	24d.	1/6-1/6 1/16	1/5¾-1/6 1/16
Hong-kong	Ster. to Dol.	—	3/1¼-3/2¼	3/1½-3/2¼
Yokohama	Ster. to Yen	24.43d.	2/7½-2/8 1/16	2/7½-2/8¼
Shanghai ..	Ster. to Tael	—	4/1½-4/2	4/1½-4/2½
Singapore ..	Ster. to Dol.	—	2/3 21/32-2/3 31/32	2/3 21/32-2/3 31/32
Manila ..	Ster. to Dol.	24.066d.	2/6	2/6
Rio de Jan.	Pence to Mil.	27d.	10	10 1/16
B. Aires, T.T. ..	Pence to Dol.	47.58d.	51-51½	51⅛-51⅝
Valparaiso, 90 days	Pence to Peso	18d.	9 11/32	9¼
Montevideo, T.T. ..	Pence to Dol.	51d.	50-51	—
Lima ..	Eng. to Peru £	Par.	15% dis.	—
Mexico ..	Pence to Dol.	24.58d.	35-36	35-36

Owing to the continued rise in the New York exchange the price of GOLD fell a further 2s. 8d. to 112s. 2d. per ounce (fine). The amount available was taken for the United States.

The price of bar SILVER remained at 42¼d. per ounce, both for cash and forward delivery. A fair amount of business was in progress, China being both a buyer and a seller. There was also some buying for the Indian bazaars. At the close the tendency of the market was dull.

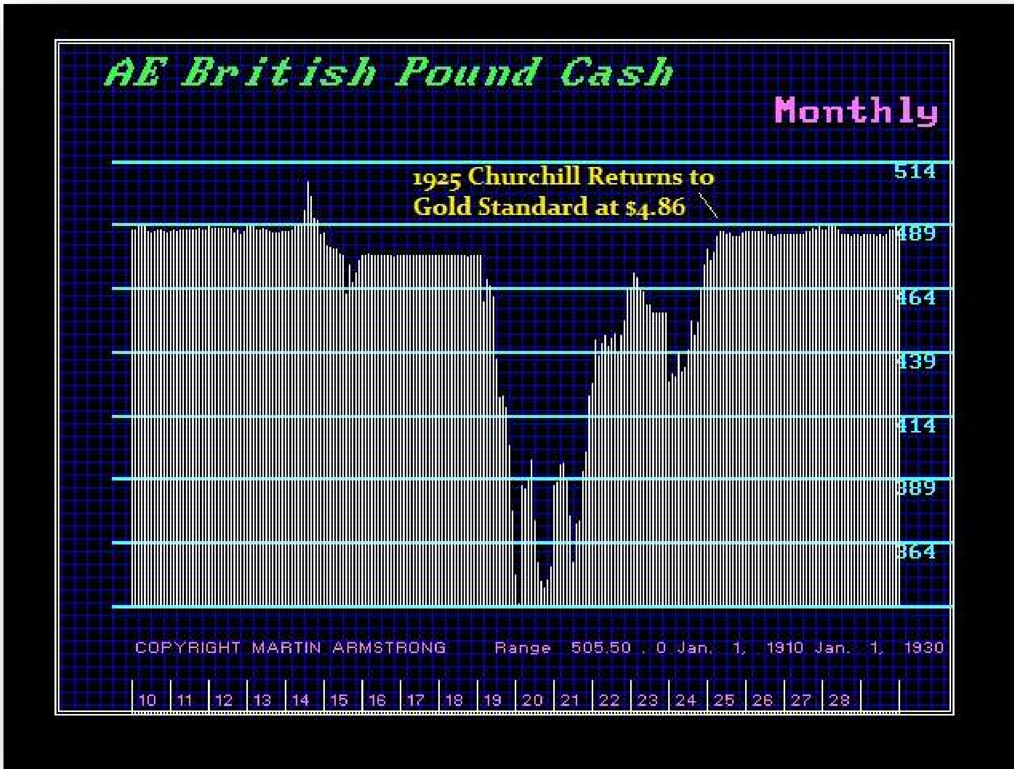
INDIAN TREASURY BILLS.

in Vienna and Berlin. Nonetheless, postwar, there was an explosion in currency speculation that emerged in London.

Currencies were traded by the main British and continental European banks as well as by investment syndicates that emerged similar to modern–day hedge funds, Considerable retail investor interest emerged during the 1920s in currency trading. Notable speculators in currencies in the interwar period included even Winston Churchill and, of course, John Maynard Keynes himself. In the case of Winston Churchill, he was an avid currency speculator during the 1930s (*Mr. Churchill's Profession: The Statesman as Author and the Book That Defined the "Special Relationship"*. Peter Clarke, 2014, p148).

Foreign exchange trading absolutely exploded surging in the first half of the 1920s, when investors used the new forward exchange contracts to exploit the increased exchange rate volatility. The trading volume of activity in currencies rose dramatically surpassing all previous levels in London after 1919.

The emergence of an active forward market in London was accompanied by another major institutional development on currency markets. Transactions in bills of exchange, which were the norm until WWI, were replaced by dealings in telegraphic transfers and the modern spot market with which we are familiar today. Both spot and forward currency deals were now conducted by telephone between banks and foreign exchange brokers executing customer orders undertaken in order to hedge trade or investment transactions in a new era of floating exchange rates. This attracted arbitrage as well as speculation.

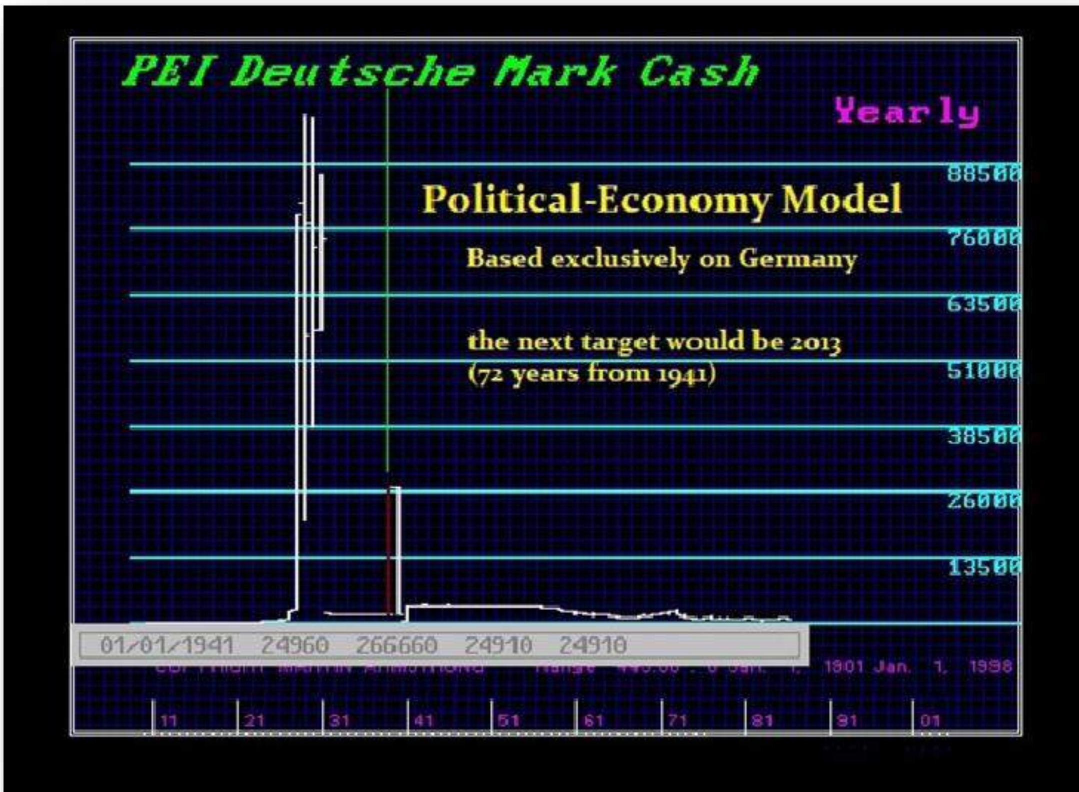


After WWI, Britain sought to return to its former pre-eminence, ignoring the consequences of the war. The London financial markets surpassed those of Europe and became the dominant financial center. Parliament passed in 19209 that the pound should be restored to its former value under the gold standard by 1925. When Winston Churchill was the Ex-checker, the boom in the financial markets led the British to believe that the pound would be able to return to the gold standard fearing that inflation would take hold as in France post-Napoleon and Germany post-1920. The decision was to return to the pre-war rate of $4.86 to the pound. In reality, this was at least a 10% overvaluation of sterling given the decline of Europe


1925 George V Gold Sovereign of Great Britain

and the rising star of the United States. This attempt to reestablish old glory led to deflation.

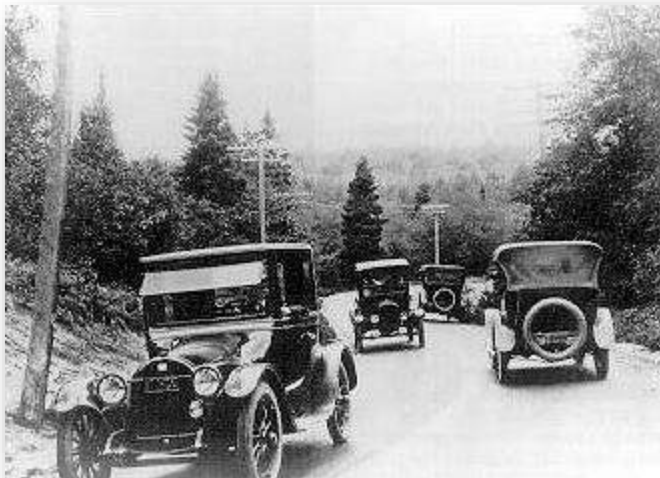
Further proof that this return to the gold standard promoted deflation was the fact that while Britain stopped issuing gold sovereigns in 1917, they resumed for only a single year – 1925. They did not resume the regular issue of gold sovereigns again until 1957 under Elizabeth II.



Aside from the dramatic rise in trading currencies post-1919, also overlooked is always the details when dealing with the Post-Weimar monetary system and the forced bankruptcy of Germany. Germany was entirely stripped of its assets and any colonies to exploit revenue to meet reparations. Most economic textbooks discuss the creation of money by the Weimar government without any reference to the conditions that resulted in the hyperinflation of the Weimar Republic and the destruction of the German economy.

Nevertheless, in the early stages of creating the Weimar Republic in 1919, to kick-start an economic recovery the new government began issuing its own fiat currency. The government's newly created money was be used to fund a large-scale public infrastructure plan. The projects included such as repairing and maintaining public buildings and existing public infrastructure. Additionally, the Weimar Republic created money to build new roads and highways, bridges, canals, and harbors. The budget for the infrastructure program did not exceed one billion units of the domestic currency. To pay for the program, the government issued Treasury Certificates.

One billion non–inflationary bills of exchange, known as Labor **Treasury Notes**, were issued in 1920 to rebuild the infrastructure. Millions of people were put to work on these projects, and the workers were paid with the **Treasury Notes**. The workers then spent the certificates on goods and services, creating more jobs for more people in a ripple effect. Germany embarked on a major road construction project which Adolf Hitler would also later adopt. Through it all, the German mark had actually begun to rise in value from 11.17 to the US$ in January 1920 to 9.17 to the US$ by June 1920.



The Golden Age of Infrastructure

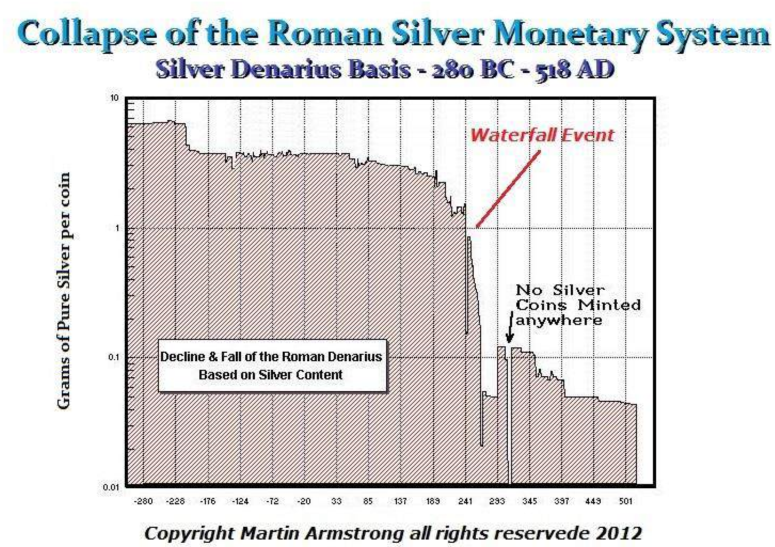
In the United States, the 1920s were also the "golden age" for road building as automobiles were starting to replace horses. In 1922 alone, federal-aid projects in the USA totaled 10,252 miles (16,500 km) were completed at a cost of $189 million, three times as much roadway as had been improved since the start of the federal-aid highway program in 1916. The projects usually involved providing graded earth, sand-clay, or gravel surfaces. During the 1930s, the federal-aid highway program in the USA felt the impact of the Great Depression. Federal funds were diverted from projects that served transportation needs to projects that could provide work for the unemployed.

In Germany, this sovereign credit creation program removed the need for foreign funding and in less than two years the German economy was up and running again. While millions of people in the U.S. and other Western countries were out of work, in Germany the unemployment problem had been largely solved because it was not on a gold standard.

In 1920 and 1921, a floating exchange rate had insulated Germany from deflationary U.S. monetary policy. In those years, German industrial production rose 46 and 20 percent, respectively. In contrast, in Britain, whose commitment to return to the gold standard at the prewar parity overvalued its exchange rate, industrial production fell 32 percent in 1920.[20] At the end of the decade, a revived international gold standard transmitted U.S. deflation to Germany. In the 1920s, capital had flowed into Germany. That is, Germany exported not only goods, but also IOUs.

The 1921 Crisis

1921 was the turning point in Germany. I have previous written how in 260AD when the Roman Emperor Valerian I (253–260AD) was captured by the Persian and turned into a royal slave, the blow to the confidence of Romans was substantial. It also signaled to other barbarian tribes in the north that Rome was indeed vulnerable. From the capture of Valerian in 260AD, the Roman monetary system collapsed to the point all visible silver coinage vanished from circulation dur to hoarding and production by the government.



The most devastating even that sets off hyperinflation is the collapse in confidence in the government on the part of the people. What took place in Rome between 260 and 268AD was a similar crisis in confidence in Germany. Therefore, the year 1921,

Armistice Commission at Spa, Belgium

was for Germany one of complete humiliation. Political life had not yet recovered from the shock caused by the overthrow of a form of government deeply rooted in the history of the people with the Communist Revolution of 1918. Many feared the communists who had even invited Russia to take Germany.

The Protocol of Spa, derived at the Spa Conference meeting between the Supreme War Council and the Weimar Republic in Spa, Belgium on July 5–16, 1920, had threatened Germany with new sanctions in the form of further occupation of German territory if Germany did not continue on its schedule of war reparations. The demand of disarmament was referred to a conference of ministers at Paris at the end of January 1921. This conference not only drew up a plan for Germany's reparation obligations, but also fixed eight dates for the fulfilment of all disarmament demands.

The Paris conference of ministers, which commenced on January 24, formulated a plan by which Germany was to pay 226,000 million Goldmarks in forty-two fixed annuities from May 1, 1921, to May 1, 1963, and in addition forty-two varying annuities each equal to 12% of German exports. This plan was communicated to the German government, along with the announcement that in case of non-fulfilment sanctions in the terms of the Spa Protocol would be applied.

The political crisis in Germany led to the end of monarchy and the newly empowered Reichstag was prey to wild party strife making the established of a stable government extremely difficult. The Weimar Republic was Germany's government from 1919 to 1933, the period after World War I until the rise of Nazi Germany. There were effectively 14 shifts in government during this period. The timeline of 1921 began to turn chaotic from April 27th, 1921 onward when the Allied Reparations Committee leveled 33 billion war reparations debt onto Germany. This amounted to a demand that Germany hand over 26% of all exports for 42 years putting the Germans immediately into 12 billion in arrears.

NEW YORK TRIBUNE, TUESDAY, MARCH 8, 1921

Lloyd George Regrets Move, He Tells Commons

American Force on Rhine Won't Join in Advance

This communication of the Paris conference caused much discontent in Germany. In the Reichstag the foreign minister, Walter Simons, characterized the Paris demands as impossible to fulfill and a breach of the **Treaty of Versailles.** He characterized this as the enslavement of the German people.

The German government was invited to send a representative on March 1st, 1921 to London, to discuss the reparation question. The British Prime Minister David Lloyd George refused to listen and informed the Germans that their proposals would not meet with serious consideration. He then warned if they failed to accept these new terms, George threatened Germany with an Allied reoccupation of Duisburg, Ruhrort, and Düsseldorf, and the auctioning off German private goods in the Allied countries, and the erection of a customs frontier on the Rhine, under the supervision of the Allies. The Americans refused to advance against Germany.

The German government protested to the League of Nations, but without effect. The Allies invaded German once again and engaged in a military occupation of Duisburg, Ruhrort, and Düsseldorf, but they began to expand to other cities. A special customs frontier on the Rhine was drawn up on April 20th and May 10th, 2921. The reparation payments were to begin on May 1st, 1921.

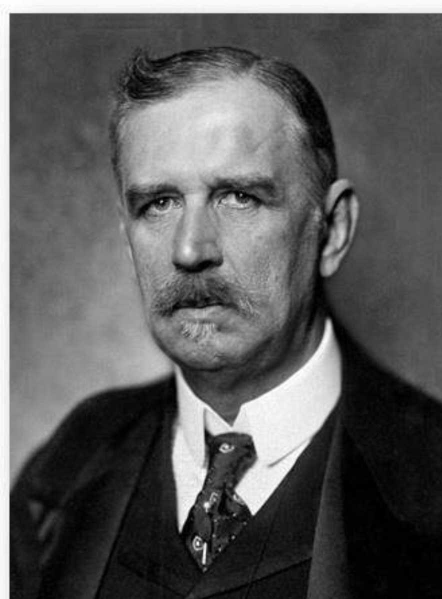
Simultaneously the President of the German Reich Friedrich Ebert issued a proclamation, countersigned by the chancellor, Konstantin Fehrenbach, to the effect that the Allies had occupied areas of Germany in defiance to the **Treaty of Versailles** and that they would not object to outside help in the matter.

Then on May 5th, 1921, this is when the London Ultimatum was delivered setting the total sum of the war indemnity at 132 billion marks. The clause of the **Treaty of Versailles** demanded the surrender of a plebiscite in Upper Silesia. The German government had already declared during the negotiations in London that the possession of Upper Silesia was indispensable to Germany and if this was taken it would impossible to fulfill her obligations in regard to reparations. After some negotiation the plebiscite was fixed for March 20th, 1921.

Consequently, with the ultimate fate of Upper Silesia unclear, fighting erupted in the province between insurgent Polish forces and German militias. The Germanophone section of the population made strong complaints, being firmly convinced that the French division of the Upper Silesian army of occupation was favoring the insurrection by refusing to do anything. The Allied Plebiscite Commission gave about 30% of Upper Silesia to Poland. Large minority populations exist on both side of the boundary felt stranded to put it mildly.

On May 3rd, 1921, Polish insurgents under Wojciech Korfantry rose up in Upper Silesia. By May 23rd, German Freikorps crushed the Polish forces at St. Annaberg. The next day, the Allies declared all German Freikorps units outlawed. There was no regard for ethic cultures or language. Borders were simply draw for political purposes and punishment.

As the Supreme Council was unable to come to an agreement on the partition of the Upper Silesian territory on the lines of the plebiscite, a solution was found by turning the question over to the Council of the League of Nations. On the basis of the reports of a League of Nations commission and those of its experts, the Council awarded the greater part of the Upper Silesian industrial district to Poland.


Prince Hermann von Hatzfeld-Wildenburg (1848-1933)

Occupied Rhineland

In the occupied territories of the Rhineland, the edicts of the occupation authorities, especially the French, led to many conflicts between them and the German administration. The

German commissioner, von Stark, had protested decrees of the Inter-Allied Rhineland Commission. When they threatened to expel him, he resigned voluntarily. His successor, the Prince Hermann von Hatzfeld-Wildenburg (1848–1933), who was a diplomat with experience in Washington, and he represented the Deutsche Reichspartei in the Reichstag for a number of years. The Prince was only admitted after he promised not to protest or obstruct and to cooperate loyally with the Rhineland Commission, which meant accept their demands.

Karl Joseph Wirth
(1879 – 1956)
Chancellor of Germany (1921-1922)
served for only for 585 days

German Government of Fehrenbach Resigns

From the June 1920 high in the German mark at 9.17 to the US$, it began its decline. The German mark fell to the 17.5 level against the dollar but stabilized at that area until May 1921.

The cabinet of Chancellor Konstantin Fehrenbach resigned on May 10th, 1921 in the face of the London Ultimatum. To guarantee the reparation payments the Allies further demanded that the gold reserves of the Reichsbank and of private German banks was to be transported to the occupied territory. Before these claims could be met, they were replaced by the ultimatum of the Allied governments, which gave the German government until May 12th, under threat of occupation of the Ruhr valley.

After many days of trying negotiations, which at times made it seem it would be impossible to form any German government whatsoever, the Minister of Finance of the preceding government, Karl Joseph Wirth (1879–1956), managed to form a coalition cabinet willing to accept the ultimatum as it stood. Members of the Centre, Majority Socialist, and Social Democratic parties constituted the greater part of this new cabinet. Wirth's new government would last only 585 days into 1922.

The War Criminal Trials Begin

Another demand in addition to reparations and disarmament, was the demand to punish Germans as war criminals. This action kept Germany on edge for there seemed to be no standard of justice that anyone could rely on. The Weimar government was also forced to agree to this demand. Nine of these trials took place before the Supreme Court, from May 23rd, 1921 onwards. Several cases ended in an acquittal. This was not acceptable for the Allies. The acquittal of General Karl Stenger, who was accused by the French of having had French prisoners shot, caused the French government to recall its legal mission and the French witnesses.

Articles 46 and 47 of the **Hague Convention of 1907** the United States and many other countries accepted the rules that in an occupied territory of a hostile state "family honour and rights, the lives of persons, and private property, as well as religious conviction and practice, must be respected. Private property cannot be confiscated. Pillage is formally forbidden." The allies themselves were in fact confiscating personal property and violating international law. It would be at the Nuremberg trials of 1945 when the Allies prosecuted people under conspiracy when there was no hard evidence.

The political tensions were rising. Then on July 11th, 1921, Adolf Hitler resigned from the party to force the hand of Anton Drexler not to unite with the DSP. He then rejoined the party 14 days later and assumed the leadership of NSDAP on July 29th, 1921 formerly becoming "Der Fuehrer".

The political chaos continued and culminated in the assassination of the German Finance Minister on the 26th of August 1921 – Matthias Erzberger (1875–1921). He was gunned down by two assassins which proved to be a real vendetta based primarily on his negotiation of the Armistice securing the acceptance of the **Treaty of Versailles**. He was also a Democratic Catholic supporter and, it is said, the political adviser of the Catholic Chancellor of the Reich, Dr. Wirth. He also was instrumental in the preparation during the summer of 1921 of new tax imposing more burdens on the German people.

Matthias Erzberger
(1875-1921)
German Finance Minister of 1920

The assassination of Erzberger while taking a walk with a parliamentary colleague in a lonely part of the Black Forest near Griesbach, caused great political turmoil and increased the political confrontations among the various parties. Then on the 14th of September, Adolf Hitler disrupted the speech by Otto Ballestedt (1887–1934) in Munich in order to prevent him giving a lecture. Hitler achieved this goal by force dragging him out of the Hall and beat Ballerstedt injuring him quite severely.

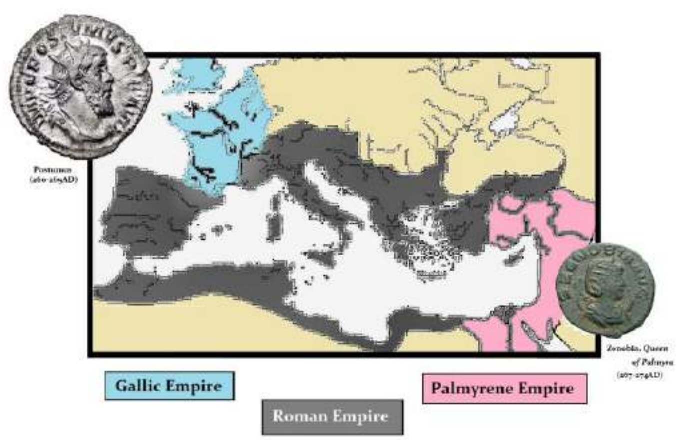
Adolf Hitler, with fellow defendants in the Putsch trial
Gen. Ludendorff (left), Ernst Röhm (right front)

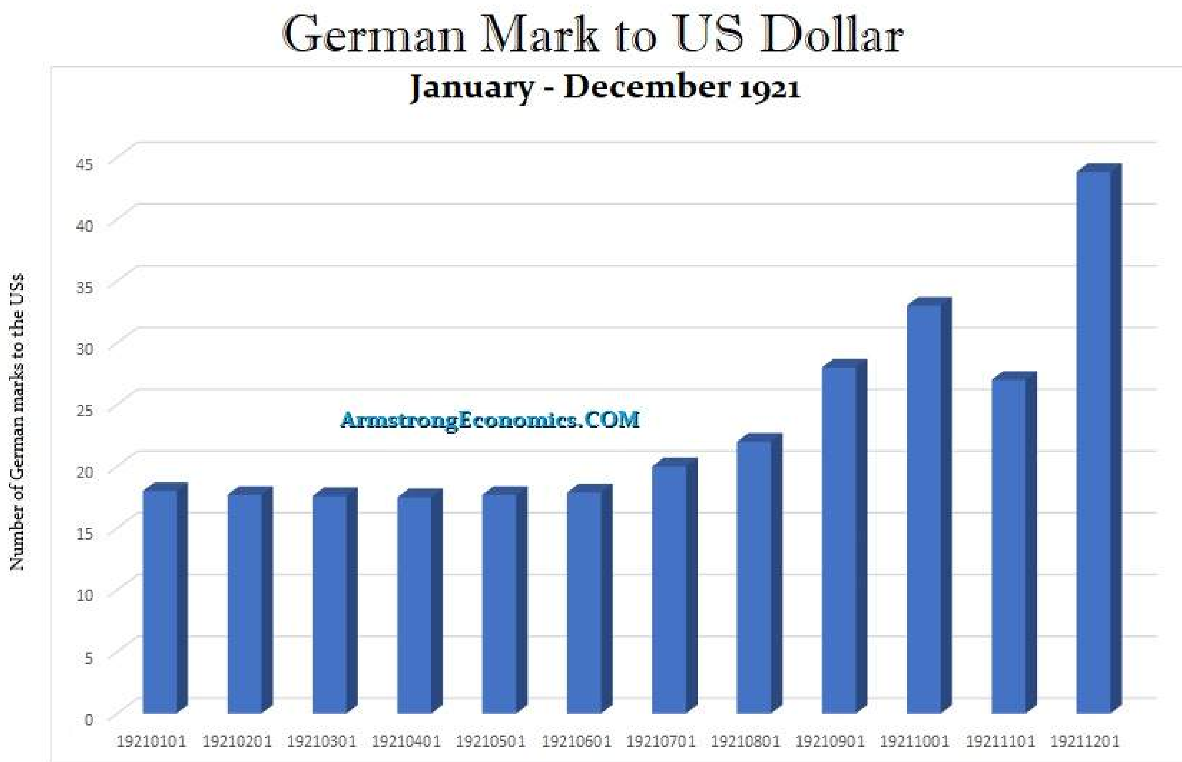
As a result, Hitler was put on trial for four days from January 27 to 29, 1922 on charges of a breach of the peace, public indecency and assault. He was convicted and sentenced to imprisonment for 100 days and payment of 1,000 Reichsmark. The prison sentence was served from the 24th of June to 27th of July during 1922. It would be three years later when Hitter wrote his ***Mein Kampf*** (My Struggle). When Hitler came to power, Ballerstedt was arrested on the evening of June 30th, 1934 by armed SS men in his Munich apartment, a day before going on a planned trip to Austria. He was killed during the **Night of the Long Knives** June 30 to July 2, 1934 when Hitler eliminated his opposition.

Aside from that, there was a calming of tensions that initially appeared to have peaked with concern of the reparations question. The first gold payment was made on August 31st, 1921. Although no further doubt was cast on Germany's will to pay, the Allies failed to repeal the military sanctions of March 9. The trade sanctions came to an end on September 30, but not without a burdensome commission of contract having been instituted in their place.

The political troubles in addition to the continuing economic strife caused by the **Treaty of Versailles's** economic provisions resulted in a collapse in German confidence in the future and an overall fatigue in the German psyche which opened the door to the rise of Hitler. Many academics wrongly attribute hyperinflation to simply the printing of money without limitation. Hyperinflation, they assume, is largely a twentieth-century phenomenon. As I have shown, such inflation has also taken place during ancient empires even long before printing paper money. It is set in motion NOT by an increase in the money supply, but by a collapse in the confidence of the government and the future.

It was also during the collapse of the monetary system in Rome between 260 and 268AD that we also see separatist movements. We have Postumus (260–267AD) split off taking Britain, France, and Spain establishing the Gallic Empire. We also have Zenobia carve out an Eastern Empire taking Syria to Egypt. Political instability is instigated also by the collapse of a monetary system.





What is very clear from the data we have assembled was that the true hyperinflationary trend began in July 1921 which seems to be coinciding with the arrest of Adolf Hitler. It is obvious that the4 German psyche was under sever attack during the first half of 1921. The oppression of the Allies was intense, and one can easily see that it would have left the Germany people in total despair.

Notice that there was a correction during November 291 where the mark strengthened marginally. Before Hitler stood trial in 1992, it was on November 4th, 1921 when the Sturmabteilung or SA (the "Brown Shirts") is formally established by Adolf Hitler. Half way through delivering a speech in the Hofbräuhaus in Munich (Germany), Hitler and his body guards ("brownshirts") were physically assaulted by his opposition and a brawl broke out. Despite being outnumbered, the brownshirts held the opposition off. On November 9th, 1921, The National Fascist Party (Partito Nazionale Fascista or PNF) was founded in Italy. After these events, confidence seemed to take a nose-dive taking the value of the mark sharply lower in December.

The 1922 Crisis

On January 12th, 1922, Adolf Hitler was sentenced to nine months, this seemed to be reflecting more of the rising discontent within Germany. Meanwhile, 1922 began with the British Empire at its largest extent, covering a quarter of the world and ruling over one in four people on Earth, its finances following World War I did not reflect the glory that was once Britain. Clearly, London was emerging as the financial capital of Europe. Currency trading became centered in London thanks to the destruction of Berlin and Paris as financial centers.

While Germany held the center stages, buried deep in the international headlines had been the **Irish War of Independence** which was a guerrilla fought war in Ireland from 1919 to 1921. It was waged between the Irish Republican Army (IRA) and British forces. The British Army used its paramilitary forces the Auxiliaries and thus it prevailed. It was on January 12th, 1922 that the British government finally released the last remaining Irish prisoners captured in the **War of Independence**. The following month on February 28th, 1922, Egyptian Independence was finally granted by the United Kingdom ending its protectorate over Egypt. Then on March 10th, 1922, Mohandas Gandhi was arrested in Bombay for sedition and was sentenced to 6 years in prison. This was perhaps the sign of what was to come – the decline of the British Empire.

Nevertheless, Socialism was spreading across Europe in the wake of the Russia Revolution of 1917. While there had been a Communist Revolution in Germany in 1918 that established the Weimar Republic, fascism was rising in Italy and we even see that on January 8th, 1922, the Social Democratic Youth League of Norway was also founded. On March 26th, 1922, the German Social Democratic Party was founded in Poland. The on May 8th, in Moscow priests were executed for opposing the confiscation of church property.

Genoa Economic and Financial Conference
(April 10 - May 19, 1922)

On April 10th, 34 major powers gathered in Italy to form the **Genoa Economic and Financial Conference** in hopes of reestablishing the world monetary system. The Conference lasted from April 10th to May 19th, 1922 in an attempt to resolve the major economic and political issues that arose postwar. Both Germany and Russia had been excluded from the **Paris Peace Conference** of 1919.

There was great concern over how to allow a defeated Germany to rebuild. Additionally, there was the economic concern for the war torn central and eastern European nations. Then there was also the concern regarding the rising socialism in the wake of the Russian Revolution. It was becoming self-evident that a confrontation was emerged between European capitalist economies and the new Bolshevik regime in Soviet Russia.

There was deep concern that Russia and Germany had signed a separate agreement at Rapallo on April 16th, 1922, in which each renounced all territorial and financial claims against the other and pledged to normalize relations. The Treaty of Rapallo more or less converted the Genoa Conference into a political fiasco. The conference was only able to agree on a proposal for resuming the gold standard to which Britain would do in 1925 to its own detriment.

Walther Rathenau
(1867-1922)

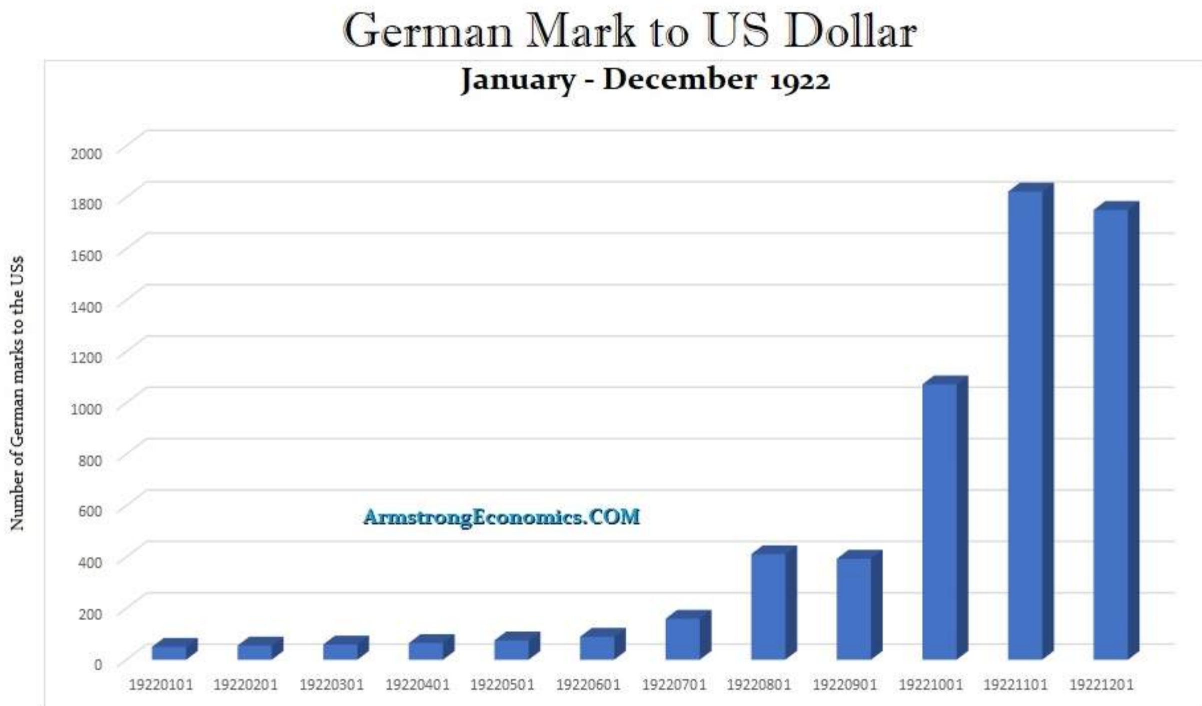
On June 24th, 1922, Walther Rathenau (1867–1922) was assassinated for signing the Treaty of Rapallo with Russia. Rathenau was a German industrialist, banker, intellectual, and politician, who served as German Foreign Minister during the Weimar Republic. But he was also Jewish. He was branded a Communist revolutionary by the extreme right.

Two months after signing the treaty, he was assassinated in Berlin by the right–wing terrorist group **Organisation Consul**. The Nazis banned all commemorations of him during the 1930s. Assassinations of German political leaders was becoming common and served to undermine the confidence in the government. Meanwhile, two days before, the Irish Republican Army agents assassinate British Army field marshal Sir Henry Wilson in London. Assassination was clearly rising as a political tool.

Chancellor Karl Joseph Wirth had signed the Treaty of Rapallo with Rathenau which ended Germany's foreign policy isolation. Following the assassination of Rathenau, Wirth delivered a speech at the Reichstag in which he warned that ***"we are experiencing in Germany a political brutalization"*** that was characterized by ***"an atmosphere of murder, of rancor, of poison," and famously proclaimed, "the enemy is on the right!"***

Within a matter of weeks, during July 1922, Wirth put forth the ***Gesetz zum Schutz der Republik*** which was passed targeting the protecting the republic against its internal enemies. This Republic Protection Act was inspired by the assassination of Rathenau. It banned organizations that directed against the "constitutional republican state form", as well as their printed materials and meetings. Politically motivated acts of violence such as the murder of members of the government were to be punished most severely. This Act also established the state court for the protection of the republic.

On July 20th, 1922, the German protectorate of Togoland was taken from Germany and divided according to the League of Nations mandates creating the French Togoland and British Togoland. Seven days later, Adolf Hitler was released from prison.



We can easily see that from July 1922 onward, following the assassination of Walther Rathenau, the German mark began to decline significantly. In January 1922, the German mark was trading at 50:1 against the American dollar. In July, it moved to 159.6 to the dollar. During August if fell to 410.91 to the dollar and then it stabilized briefly moving back to 393.04 during September 1922.

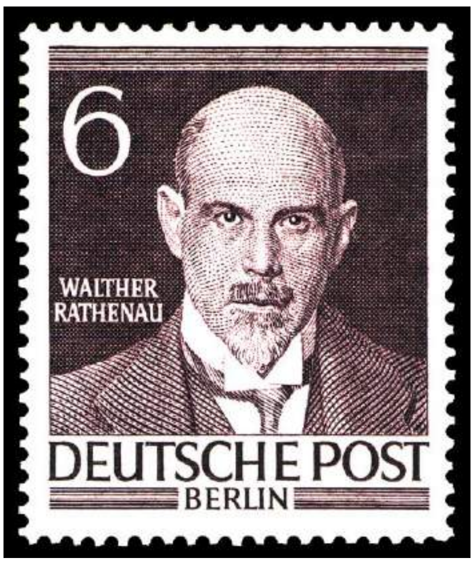
October 1922 brought a real collapse in confidence in Europe as a whole which was reflected also in the collapse of the German mark. On October 28th, 1922, in Italy, there was the **March on Rome** that brought the National Fascist Party and Benito Mussolini to power. The political crisis of 1922 saw Italy fall into a dictatorship with becoming the youngest Prime Minister of Italy at the age of just 39. Meanwhile, in Russia the Red Army captured Vladivostok and the Russian Civil War was over with Russia now firmly in the hands of Communists.

The German mark simply plummeted as the political future of Europe was turning extremely right-wing. American dollar rose from 1071.94 during October to 1822.3 in November and then 1750.83 for December 1922.

From the initiation of reparations, German coal deliveries were below the level that they were instructed to meet. The French desperately needed coal from Germany. In an attempt to rectify this situation, the Spa Conference was held in July 1920 where it was decided that Germany would be paid five marks per coal ton delivered. Despite this, Germany continued to default on its obligations.

By late 1922, the German defaults on payments had grown so serious and regular that a crisis engulfed the **Reparations Commission**. French and Belgian delegates urged the seizure of the Ruhr to encourage the Germans to make more effort to pay, while the British supported postponing payments to facilitate the financial reconstruction of Germany.

To avoid an election campaign at a critical time, the Reichstag extended the term President Ebert on the 24th of October 1922 until June 25th, 1925. This vote was a qualified majority vote which changed the constitution.



However, by November 14th, 1922, Chancellor Wirth believed that the "policy of compliance" (Erfüllungspolitik) with Allied demands had failed and he resigned as Germany was unable to meet its Reparation Payments. The term (Erfüllungspolitik) was actually used in a defamatory context. Given the fact that Germany was politically, militarily and economically too weak resist the **Treaty of Versailles**, Chancellor Wirth and Foreign Minister Walther Rathenau tried to comply with the terms, but it was impossible.

Walther Rathenau was also a close friend of Albert Einstein. Indeed, Einstein and Rathenau would attend several dinner parties which they held, alternately at one, then the other's home in Berlin, between the years, 1917 to 1922. With the assassination of Rathenau on June 24th, 1922, things change. Einstein, who became a German citizen in 1914, did remain in Berlin until 1933 when he renounced his citizenship for political reasons and emigrated to America to take the position of Professor of Theoretical Physics at Princeton becoming an American finally in 1940. The assassination not merely influenced Einstein, but it also was a physiological blow to Chancellor Wirth.

Chancellor Wirth and Rathenau had hoped to demonstrate the complete impossibility of the German economy to meet the terms. Nevertheless, the Allies, particularly France, refused to listen. Germany's request for permission to suspend their payments while their economy recovered was denied by the Allies. The Allies only turned the screws tighter demanding that the steadily rising debt and inflation rate in Germany was unacceptable. They demanded an increase in tax policy and budget restructuring. Thus, on November 14th, 1922, Chancellor Wirth resigned. The German mark collapsed.

In November 1922, when Germany was unable to make its reparations payment as scheduled. The Weimar Republic found itself unable to finance itself to meet the Reparation payments which really amount to three times all the value of property in Germany.

President Ebert then turned to forced loans compelling German citizens to buy government bonds. All people with any wealth greater than 100,000 Marks were obligated to provide finance of up to 10% of the value of their assets. The loan did not bear any interest whatsoever until 1925. After the hyperinflation, between 1925 and 1930 the forced loans bore 4% interest and from 1930 onward this was raised to 5%. Piles of these bonds remain today – worthless beyond merely a collector's value.

The German Forced Loan of December 1st, 1922
Schuldverfchreibung (Debenture Bond)
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When we look at the hyperinflation data, we can easily see that the German mark began to collapse in October 1922, but it capitulated during November 1922. It was more than the simple analysis that people always apply to the hyperinflation attributing the cause to merely printing money and impossible terms from the **Treaty of Versailles.**

The December 1st, 1922 degree of forced loans to the government to meet Reparation Payments was a devastating blow. From that moment on, capital simply fled the country by any means possible. The "rich" would no longer invest helping the economy recover. This single act truly sparked the Hyperinflation. This is what even allowed the forced loan to take place whereby no political party would have to admit to this action. The value of the German currency collapsed clearly being propelled by the forced loans. The invasion of the Ruhr merely added to the demise of the German mark.

Wilhelm Cuno
(1876–1933)

President, Ebert then convinced Wilhelm Cuno to accept the position as Chancellor making use of his wide-ranging powers under Article 48 of the Weimar constitution. Ebert effectively used these emergency powers a total of 134 times.

Wilhelm Cuno (1876–1933) succeeded Wirth as Chancellor taking office on November 22nd, 1922. Cuno had twice previously refused cabinet appointments in governments of the Weimar Republic. Cuno was finally persuaded to accept the chancellorship following Wirth resignation by President Ebert.

Cuno tried desperately to put together a broad coalition of parties for his cabinet. The newly re-unified Social Democratic Party of Germany (SPD) to the German People's Party (DVP) were directly opposed to each other and the SPD refused any coalition with the DVP.

Cuno's alternative attempts to convince other business leaders to join his cabinet also failed. Cuno was simply appointed Reichskanzler on November 22nd, 1922, by a presidential decree of Ebert without a vote in the Reichstag. Therefore, Cuno was the first chancellor in the Weimar Republic who was not a member of a party or a career politician.

Cuno was only able to form a government partly composed of non-party economists – Wilhelm Groener, Heinrich Albert, Frederic von Rosenberg and – a few days later – Hans Luther. Politicians were simply too divided. The balance of the cabinet was made of politicians none of which were SPD members. Thus, the cabinet was not made up of a coalition between the parliamentary parties.

Cuno was simply not able to put his cabinet to an outright vote of confidence. He was forced to simply comply with the last policy of Chancellor Wirth. Thus, the Reichstag merely "took notice" of any government declaration. Naturally, the Communists always voted against Cuno and anything that did not adopt Marxism.

While Cuno brought a creditable international reputation and was viewed as a strong supporter of German business and industry, despite his qualifications, he could not persuade the Allies that their demands were unreasonable. He was unable to stop the hyperinflation. The Cuno cabinet was forced to resign on August 12th, 1923.

The 1923 Crisis

In January 1923, despite quota reductions, the German Government defaulted on coal deliveries for the 34th time in three years following the loss of the Upper Silesian coal fields containing 11% of German coal resources, which had been transferred to Poland.

In response, France and Belgium sent troops into Germany's main industrial area, the Ruhr Valley. Their aim was to confiscate industrial goods as reparations payments. The German government ordered workers to follow a policy of **'passive resistance'** – refusing to work or co-operate with the foreign troops and in return the government continued to pay their wages.

ALLENTOWN, PA., TUESDAY MORNING, MARCH 13, 1923

WILL EVACUATE RUHR AS SOON AS GERMANS BEGIN TO PAY, ALLIES DECLARE

EIGHT GERMANS KILLED IN RUHR DISTURBANCES

Recklinghausen, March 12. (A. P.) —Eight Germans are dead as the result of clashes with French troops in various part of the Recklinghausen district last night.

One French soldier and three Germans were wounded in a riot at Dortmund.

A state of siege has been declared in the entire Recklinghausen district. Additional troops have been sent to preserve order at Buer. A French army officer and a French civilian official were killed there Saturday night and excitement has since been running high. It has resulted in renewed shootings.

Of the Germans who met death two were shot while trying to escape from the gendarmens in the Buer disturbances. Five others were killed and several wounded an hour later when a crowd attacked a French guard post. The eighth German was killed at Dortmund, when a crowd attacked a French detachment.

Deny Political Motives Real Cause for Occupation

POINCARE AND THUNIS ISSUE STATEMENT

No Mention of Rhineland Made—Points Out the Same Principle Would Apply as When Germans Evacuated France After Franco-Prussian War—Premiers Demand "Action, Not Promises."

Many accused France the invasion of the Ruhr and killing of many civilians was politically motivated. France insisted it was only to force Germany to what it owed in Reparations.

On December 26th, 1922, Germany also defaulted on timber deliveries. The timber quota was based upon a German proposal and the default was significant. The Allies were unanimous that the default was in bad faith.

THE BURLINGTON FREE PRESS AND TIMES: FRIDAY, FEBRUARY 9, 1923.

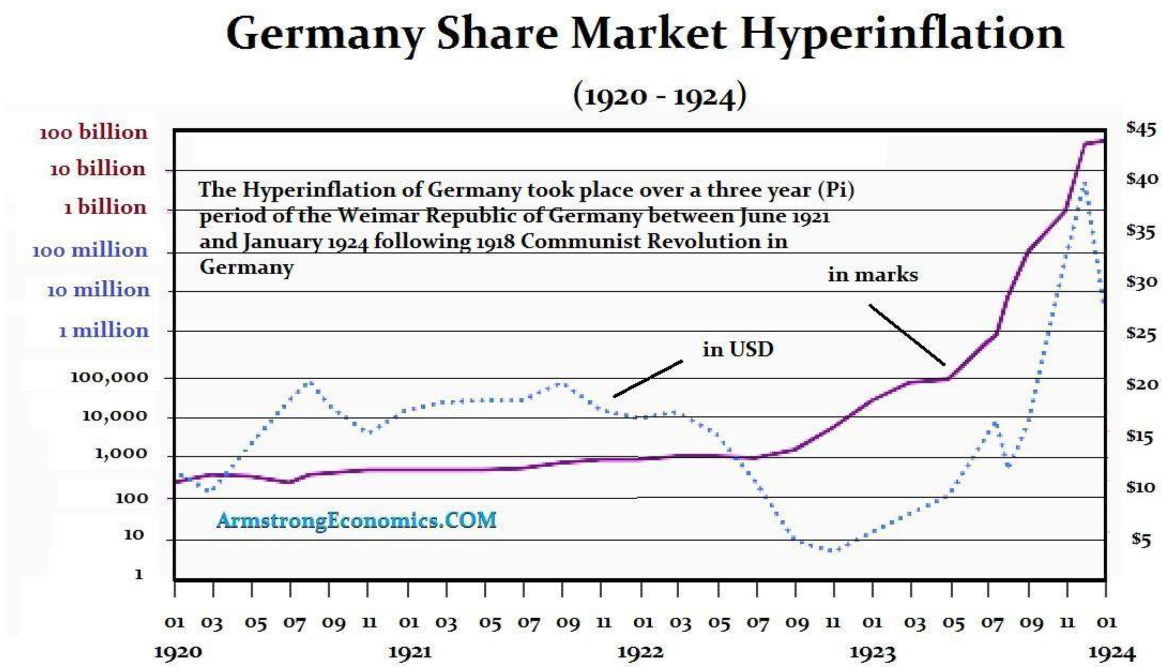
TWENTY GERMANS KILLED IN RUHR CLASH.

Twenty Germans were said to have been killed and several French soldiers wounded when a mob at Rapoch attempted to prevent the expulsion of one hundred officials. Picture shows French guard being doubled outside the station at Bochum following a collision between German mob and the French.

The French occupation of the Ruhr resulted in many confrontations with civilians who were killed by the French troops. Hundreds died in various protests over the course of several months throughout the first quarter 1923.

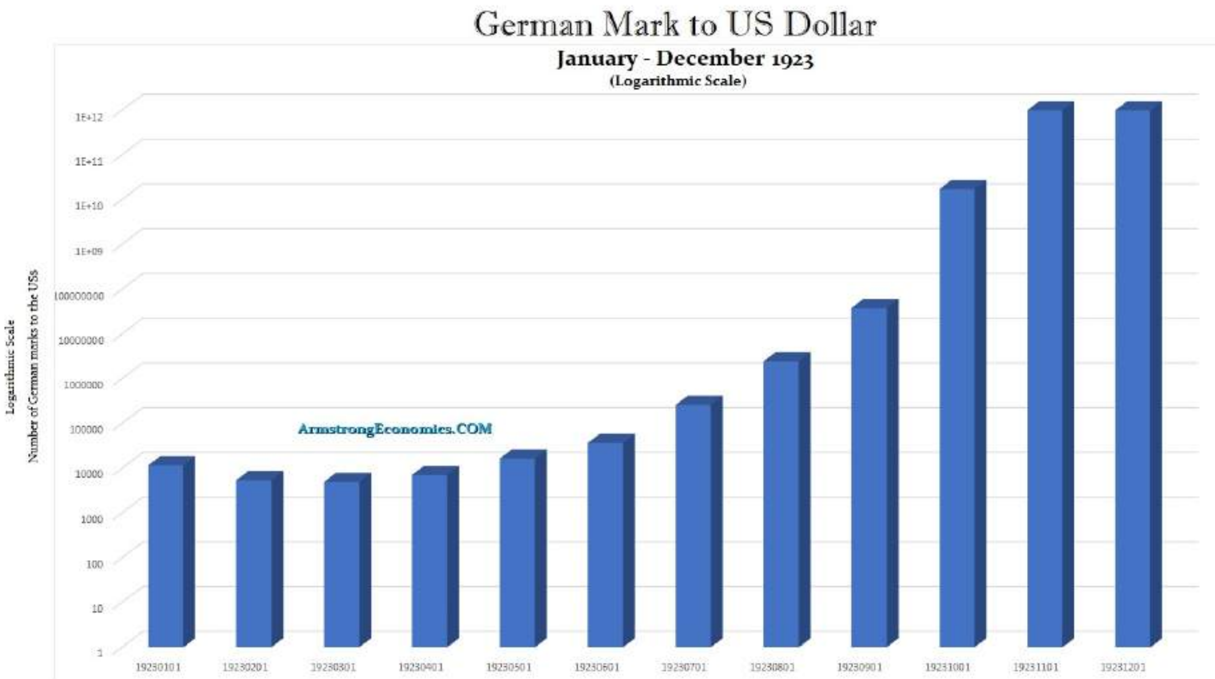
The Inflation in Germany, which had begun to accelerate in November 1922, spiraled into hyperinflation between the French invasion of the Ruhr and the forced loans and the Cuno government which was never a coalition and thus the Reichstag merely "took notice" of actions without a true political vote.

Whatever assets people retained were now driven deeply underground. The economy began to implode and with it, tax revenues. The demand for payments only increased the need to create money. As people hoarded their wealth in anything tangible that was possible from coins, stands, art, and even equities as well as foreign currency and bonds, the greater the pressure top increase the money supply. Confidence collapsed and people would no longer accept German marks as a store of value. For all they knew, the Allies would invade and strip private citizens of any personal goods then retained.



The 1922–1923 German hyperinflation completely wiped out the value of the bonds and left Germans impoverished. The only thing that managed to survive during the hyperinflation was **forms of tangible assets**. That included the German share market. At first, the market decline going into the end of 1922. However, even in US dollars, the German share market began to rise as an alternative to holding German marks. People simply began spending the paper currency as fast as they received it.

With respect to the forced loans, the hyperinflation had a devastating effect upon the issued bonds. The massive depreciation of the currency meant that these loans lost practically all their value. The German Reich Finances benefited for the total debt of the German Reich evaporated into thin air. The German savers lost everything if they believed in their government. Effectively, private assets were practically expropriated. A large part of the population became impoverished. This trauma of the great inflation is still today imprinted into the collective memory of the Germans.



By April 2923, following reports of German citizens being murdered by French troops in the Ruhr, we can see that the German mark began a freefall for the next 8 months into year-end. From March into year-end, the US dollar rose 200,160,127%.

The first issue of 1923 was a 100 million mark note with a portrait of the merchant Glsze issued February 1st, 1923. The second issue had a 100-million-mark note issued February 20th, 1923. The third issue saw a 5-million-mark note issued on June 1st, 1923. The fourth issue included a 50-million-mark note issued July 25th, 1923. The fifth issue included a 100-million mark note dated August 22nd, 1923. The sixth issue was dated September 1st, 1923 containing a 500-million-mark note. The seventh issue was dated September 15th, 1923 with a 10 billion mark note which was supplemented by October 10th, 1923 with a 50 billion mark note and then 5 days later with a 200 billion mark note on October 15th, 1923.

The eighth issue of October 20th, 1923, just five days later, contained a 500-billion-mark note. This was rapidly superseded six days later with a 100 trillion mark note in the ninth issue. Then by November 1st, 1923, the tenth issue came with a 10 trillion-mark note. The final eleventh issue contained a 1 trillion mark note dated November 7th, 1923.


German Hyperinflation Notes of 1923
Highest Denomination of the 11 issues during that year
1st issue February 1st, 1923
100 million mark
2nd issue February 20th, 1923
100-million-mark note
3rd issue June 1st, 1923
5-million-mark note
4th issue July 25th, 1923
50-million-mark note
5th issue August 22nd, 1923
100-million mark note
6th issue September 1st, 1923
500-million-mark note
7th issue September 15th, 1923
10 billion mark
7th issue October 10th, 1923
50 billion mark
7th issue October 15th, 1923
200 billion mark note
8th issue October 20th, 1923
500-billion-mark note
9th issue October 26th, 1923
100 trillion mark note
10th issue November 1st, 1923
10 trillion-mark note
11th issue November 7th, 1923
5 trillion mark note
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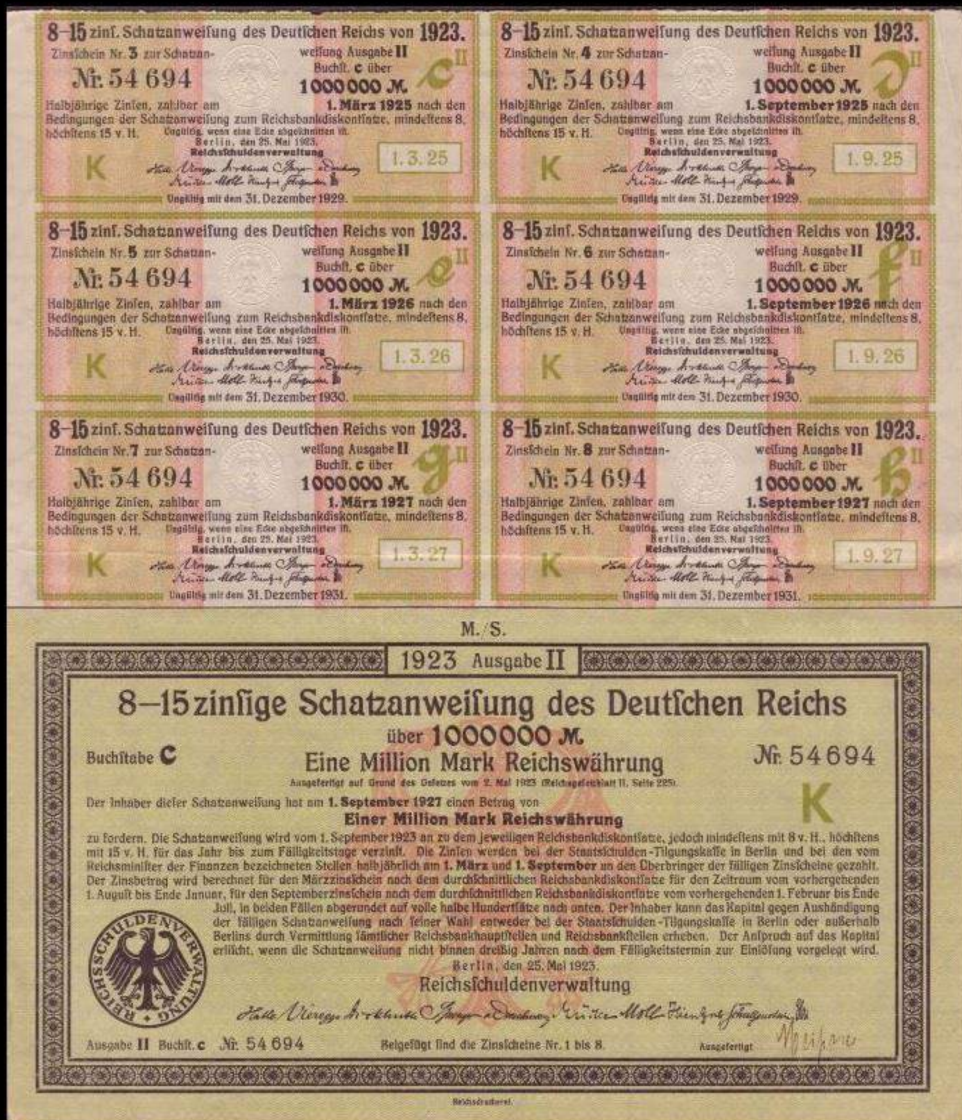
What is interesting is that the Weimar Republic continued to issue government bonds denominated in hyperinflation currency until August 1923. It was amazing that people would even buy them, but on the other hand, what else would you do with money that was depreciating extremely rapidly.



May 25, 1923 Berlin, Germany: 1,000,000 Mark Treasury Bond
(uncancelled, with coupons)

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Many such bonds exist today with the interest coupons intact demonstrating they became so worthless; people did not even bother to collect interest on these Treasury Bonds. Thus, the hyperinflation impoverished Germans who did not understand the role of tangible assets v government. Those that did, emerged as rich. Those who failed, ended up seeing themselves as victims and rallied to the call of Hitler.

The Emergence of Notgeld

Austrian 20 Heller Privately issued Notgeld Currency Note
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During this hyperinflation that ravaged both Germany and Austria, we find a wide variety of private currency issued known as Notgeld meaning "emergency money" or "necessity money". This was indeed private issues of money issued by an institution in a time of economic or political crisis. The issuing institution was typically purely private, and their issues were without official sanction of the central government.

Here we have an Austrian 20 Heller Notgeld note. The Heller was originally a German coin valued at half a pfennig, which took its name from the city Hall. Mints generally produced the coin from the beginning of the 13th century, based on a previously produced silver pfennig. However, its composition deteriorated through the typical debasement issue with the mixing in copper to the point it simply became a copper coin entirely. During the Middle Ages it became a symbol of very low value sparking the saying: "not worth a red Heller (cent)".

The Heller vanished after 1873 when, after German unification, Bismarck's administration introduced the Mark and the pfennig as coinage throughout the German Empire. However, the German Heller saw a resurrection in 1904 when the government took over responsibility for the currency of German East Africa from the German East Africa Company. The Heller was introduced as 1/100 of a rupie instead of the pesa which had so far been a 1/64 of a rupie.

It is interesting that during the Austrian hyperinflation that private issues resurrected the Heller issuing paper currency representing 1/100 of the Austro-Hungarian krone, the currency from 1892 until after the demise (1918) of the Empire. Nearly all issues of Notgeld contained an expiry date, after which time they were invalid. Issues without dates ordinarily had an expiry announced in a newspaper or at the place of issuance.

United States Depression Scrip

1934 The City of Long Branch, New Jersey

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The issue of these private currency occurred when wither there was insufficient state-produced money, as in the United States during the American Civil War as well as during the Great Depression, or in this case of Germany and Austria, when the people viewed the government currency as questionable. Private Notgeld was essentially backed by something tangible furthering what I have explained as the shift in confidence from Public (government) to Private (businesses).

American Civil War Token

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In the case of the American Civil War, there was a shortage of coins as metal was needed for the war effort. Civil War tokens were token coins that were privately minted and distributed in the United States between 1861 and 1864. They became illegal only after the United States Congress passed a law on April 22nd, 1864 prohibiting the issue of any one or two-cent coins, tokens or devices for use as currency after the war ended.

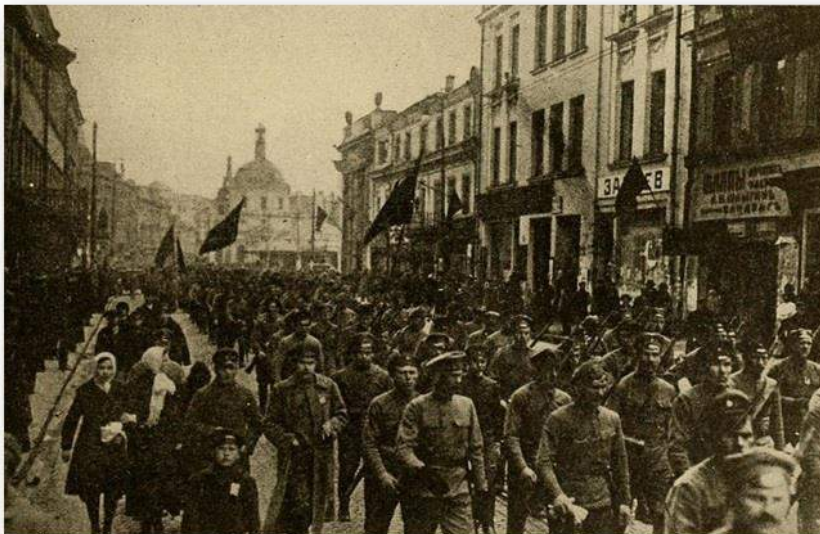
Germany (Westfalia) Notgeld Coins
1 to 50000000 Mark 1921 to 1923

Likewise, in Germany and Austria, Notgeld was mainly issued in the form of (paper) banknotes. However, there were other forms of private currency that were used including coins, leather, silk, linen, wood, postage stamps, aluminum foil, coal, and porcelain and playing cards. Notgeld was a mutually-accepted means of payment in a particular region.

Westphalia, which is a region in northwestern Germany and one of the three historic parts of the state of North Rhine-Westphalia, issued its own coins during the hyperinflation period. The Westphalia pieces were issued in denominations up to 50 Million marks. These issues exist in aluminum or bronze and are often plated in gold.

Coin shortages were common, and municipalities took up the slack by issuing emergency coins called "Notgeld". Their purpose was to ease the coin shortage caused by the war and the hyper-inflation afterwards. Notgeld was issued by transportation and utility companies as well as municipalities.

The Communist Contagion



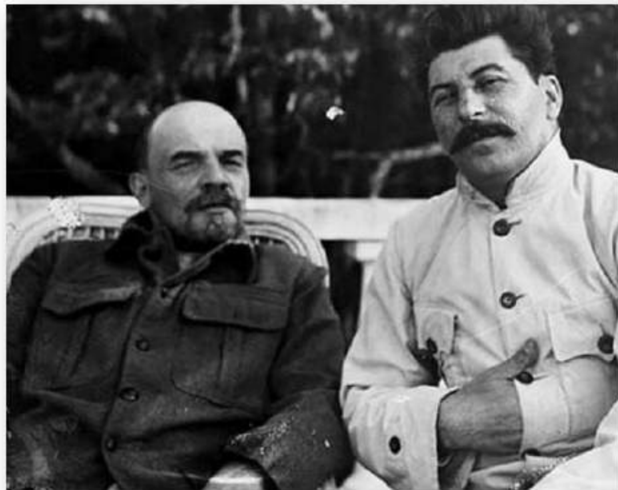
Russian October Revolution in Moscow (1917)

The October Revolution in Russia was truly a profound event. It set in motion a contagion that engulfed a war-torn Europe and preached hope to those who lost everything. The Communists of Russia inspired not just the Communist Revolution in Germany, but also Austria and ultimately in Hungary and throughout much of the Balkans. The contagion that the Russian Revolution set in motion lasted for the next 10 years on a global scale.

Where the American and French Revolutions of the 18th century was the overthrow of monarchy, that trend was still in motion and fed into the idea of the Communist movement. It was the old world that was increasingly falling apart.

Communist Contagion

Russian Revolution (1917)
Free Territory (1918)
Aster Revolution (1918)
Red Week (Netherlands) (1918)
Finnish Civil War (1918)
German Revolution (1918–1919)
Hamburg Uprising (1923)
German October (1923)
Brussels Soldiers' Council (1918)
Slovak Soviet Republic (1919)
Fascist and anti-Fascist violence in Italy (1919–1926)
Tragic Week (1919)
Limerick Soviet (1919)
Canadian Labour Revolt (1919)
Persian Socialist Soviet Republic (1920–1921)
Georgian coup attempt (1920)
Provisional Polish Revolutionary Committee (1920)
Patagonia Rebelde (1920–22)
Mongolian Revolution of 1921
Rand Rebellion (1921–22)
September Uprising (Bulgaria) (1923)
August Uprising (Georgia) (1924)
Tatarbunary uprising (1924)
Estonian coup d'état attempt ("Tallinn Uprising") (1924)
Chinese Civil War (1927–1936/1950)



Vladimir Lenin (1870-1924) Joseph Stalin (1878-1953)

Most people have no idea that Lenin was more of a dreamer who at least thought he was benefiting the people. It was Lenin who warned not to allow Stalin to take power after him. He said: ***"Comrade Stalin, having become Secretary-General, has unlimited authority concentrated in his hands, and I am not sure whether he will always be capable of using that authority with sufficient caution."***

Stalin did everything he could to take power. This has been the curse of the left. They see themselves in a war against the producers and whatever action they take, it is always for the good of the people. This attitude marks the left who always seek to subjugate the right. They portray themselves as the victim always held down by others. The left never believes in human rights and have historically always taken an authoritarian position to subjugate their opponents.

The official state records showed that Stalin killed about 2.9 million people. However, this does not include those who died from famine in places like Ukraine for example, about 7 to 10 million died of starvation. In Ukrainian, they coined a term for what Stain did – Holodomor (Голодомо́р) meaning ***"to kill by starvation"*** has remained at the core of why Ukrainians want independence from Russia. Communism was failing from the outset. Stalin took the food from Ukraine to feed Russians to create the image of the new great success of the Communist State. The reality of Communism was not known. Yet it did engulfed much of the world with lofty promises of utopia.

The Austrian-Hungarian Hyperinflation

Battle of Leipzig October 16 - 19, 1813
Russian, Austrian, and Prussian troops in Leipzig defeat Napoleon

There is little doubt that behind the curtain there was the desire the destroy the old Holy Roman Empire whose capital was Vienna in addition to the Germans. During the Napoleonic Wars, there was the **Battle of Austerlitz** which took place on December 2nd, 1805. It was also known as the **Battle of the Three Emperors:** Napoleon of France, Emperor Alexander I of Russia, and the Holy Roman Emperor Francis II. This battle was a major victory for Napoleon yielding him the reputation as a brilliant military strategist as this being his military masterpiece.

However, in 1813, Napoleon lost to a coalition of Russian, Austrian, and Prussian armies at the Battle of Leipzig October 16-19, 1813. Clearly, the French resentment of both Germany and Austria was profound for the defeat of Napoleon in 1813 led to his abdication of the throne of France. It was a deep satisfaction to bring both German and the Austrian-Hungarian Empires to their knees.

Austrian Gold Metal (10 Ducats) Celebrating the Defeat of Napoleon 1813
Commemorating the Alliance between Russia, Prussia and Austria against Napoleon

The defeat of Napoleon in 1813 was a deep would that France did not forget. Napoleon retreated to France, where in March 1814 coalition forces captured Paris. On April 6th, 1814, Napoleon, still in his mid–40s, was forced to abdicate the throne. With the **Treaty of Fontainebleau**, Napoleon was forced into exiled on Elba, a Mediterranean island off the coast of Italy.

Less than a year later, on February 26th, 1815, Napoleon escaped Elba and sailed to the French mainland with a group of more than 1,000 supporters. On March 20th, he returned to Paris, where he was welcomed by cheering crowds. The King of France, Louis XVIII, then fled for his life and Napoleon seized control of France once again.

Battle of Waterloo - Sunday, June 18th, 1815

During June 1815, the Battle of Waterloo took place dealing the final death blow to Napoleon and France. This time the defeat of Napoleon's forces came with a coalition of the armies of British and Prussia. Clearly, settling old scores was the real priority of punishment inflicted upon German and Austrian–Hungarian Empires.

In the case of Austria, there was a separate treaty known as the **Treaty of St. Germain** which declared that the Austro–Hungarian Empire was to be dissolved. Under article 177 Austria, along with the other Central Powers, accepted responsibility for starting World War I. The new Republic of Austria was to then consist of most of the German–speaking Danubian and Alpine provinces in former Cisleithania. Hungary was now split, and Austria was commanded to recognize the independence of Hungary, Czechoslovakia, Poland, and the Kingdom of Slovenes, Croats, and Serbs. The **Treaty of St. Germain** also included 'war reparations' of vast sums of money that could also never economically be paid.

Like Germany, Austria was also a clash where the old world was increasingly falling apart. The collapse of the Habsburg Monarchy and the proclamation of the republic marked a clear change, but wartime and post–war Vienna showed remarkable parallels. An improvement in the living conditions of the people of Vienna was not in sight. Added to this was the fear or hope, depending on ideology, of revolution and a soviet dictatorship. From the end of October 1918 to June 1919 Vienna was the scene of bloody demonstrations and clashes. The last of the Habsburg emperors, Karl I (Charles I) (1887–1922; Reign 1916–1918), has succeeded to the throne upon the death in 1916 of Emperor Franz Joseph. Karl I forced to abdicate on November 11th, 1918, as the rise of communism sparked uprising in the wake of the Russian Revolution of 1917.


Karl I (Karl Franz Joseph Ludwig)
(Charles I) (1887 – 1922)
Last Emperor of Austria & King of Hungary & Bohemia
Hwas the last monarch of the House of Habsburg-Lorraine
He reigned 1916 - November 11-12, 1918

Upon Karl's abdication, a provisional government of the Social Democrats and the Christian Socials declared Germany–Austria a republic on November 12th, 1918. The Austrian–Hungarian Empire was reduced to 32,370 square miles and 6.5 million people of which one–third resided in Vienna. This became the **Republic of Austria** which was retaliated against for its former rule over neighboring regions. The former regions imposed high tariff barriers and significant trade restrictions that were economically staving the new Republic.

Even internally within Austria, resentment between regions led to trade and tariff barriers from one part of the new Republic upon other parts of the country. This particularly targeted the capital of Vienna. Food and fuel supplies were hoarded, and prices soared. There was a major smuggling economy that promoted black–marketeers. No one in Vienna could purchase basic essentials without the black–market.

The citizens in Vienna were mostly isolated. Countless people of Vienna had to venture out into the surrounding forest to chop down the trees for firewood. The winters were very cold during 1919, 1920, and 1921. Hundreds of starving children were begging for food on the streets of Vienna.

The new **Republic of Austria** was communist/socialist in philosophy. They tried by passing decrees to artificially keep prices of food unrealistically cheap which led to hoarding and black–markets. They even attempted by decree to forced requisition of food for the cities. By 1921 over half the Austrian government's budget deficit was attributable to food subsidies for city residents and the salaries of a socialistic bureaucracy which deemed itself first in line.

Hungarian Aster Revolution in Budapest - October 28th, 1918

The Social Democrats then attempted to impose high taxes on the rich. This merely led to a decline in industry and commerce, while the imposed higher and higher taxes on small business was wiping out the middle class resulting in a contraction in employment. Even the newspapers were calling the bureaucrats "the tax vampires."

Meanwhile, there was the Aster Revolution in Hungary, which led to the November 16th, 1918 proclamation of the Hungarian Republic. Prime Minister Károlyi Mihályi and other representatives of the Hungarian National Council emerged as Hungary's legislative power. They proclaimed the establishment of the Hungarian People's Republic [Magyar Népköztársaság] to succeed the Kingdom of Hungary as the name and form of the Hungarian state.

The First Hungarian Republic lasted for just four and a half months, until a leftist alliance of the Party of Communists in Hungary and the Hungarian Social Democratic Party declared the establishment of the Hungarian Soviet Republic [Magyarországi Tanácsköztársaság] after coming to power on March 21st, 1919.

With respect to the Austrian Hyperinflation, the foreign-exchange value of the Austrian crown reflected the catastrophic depreciation of this event. In January 1919 one dollar could buy 16.1 crowns on the Vienna foreign-exchange market; by May 1923, a dollar traded for 70,800 crowns. According to the provisions of the **Treaty of St. Germain**, the newly created Republic of Austria had to over-stamp the old paper money of the former Austro-Hungarian Empire still circulating in its territory, then had to replace the over-stamped banknotes with new ones, and finally had to introduce an entirely new currency.

To complete the first step, the circulating banknotes had to be over-stamped with the inscription DEUTSCHÖSTERREICH, and new banknotes were also issued with this feature. Later, still under the name *Oesterreichisch-ungarische* Bank, banknotes were printed using the German-language clichés on both sides yet still displayed the DEUTSCHÖSTERREICH inscription. From 1920 onward, a new stamp appeared on banknotes: ***"Ausgegeben nach dem 4. Oktober 1920".*** Next, in 1922 a new series of Krone banknotes was introduced with a completely new design to complete the second step. This series contained 1 Krone, 2, 10, 20, 100, 1000, 5000, 50 000, 100 000 and 500 000 Kronen, later 10 000 Kronen (1,000,000 Kronen was planned but not issued). Finally, in 1925, as the third step was to issue a new series of Austrian Schilling banknotes.

But the worst of the inflationary and economic disaster was about to begin. Various national groups began breaking away from the Empire, with declarations of independence by Czechoslovakia and Hungary, and the Balkan territories of Slovenia, Croatia, and Bosnia being absorbed into a new Serb-dominated Yugoslavia. The Romanians annexed Transylvania; the region of Galicia became part of a newly independent Poland; and the Italians laid claim to the southern Tyrol.

Because of the Communist Contagion, wealth simply went into hiding. As the economy imploded, tax revenue also declined. The Austrian government had no choice but to pay for its expenditures through the printing press. Between March and December 1919, the supply of new Austrian crowns increased from 831.6 million to 12.1 billion. By December 1920 it increased to 30.6 billion; by December 1921, 174.1 billion; by December 1922, 4 trillion; and by the end of 1923, 7.1 trillion. Between 1919 and 1923, Austria's money supply had increased by 14,250 percent.

Austrian Republic 1918 25 Korona
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Prices rose dramatically during this period. The cost-of-living index, which had risen to 1,640 by November 1918, had gone up to 4,922 by January 1920; by January 1921 it had increased to 9,956; in January 1922 it stood at 83,000; and by January 1923 it had shot up to 1,183,600.

The foreign–exchange value of the Austrian crown also reflected the catastrophic depreciation. In January 1919 one dollar could buy 16.1 crowns on the Vienna foreign–exchange market; by May 1923, a dollar traded for 70,800 crowns.

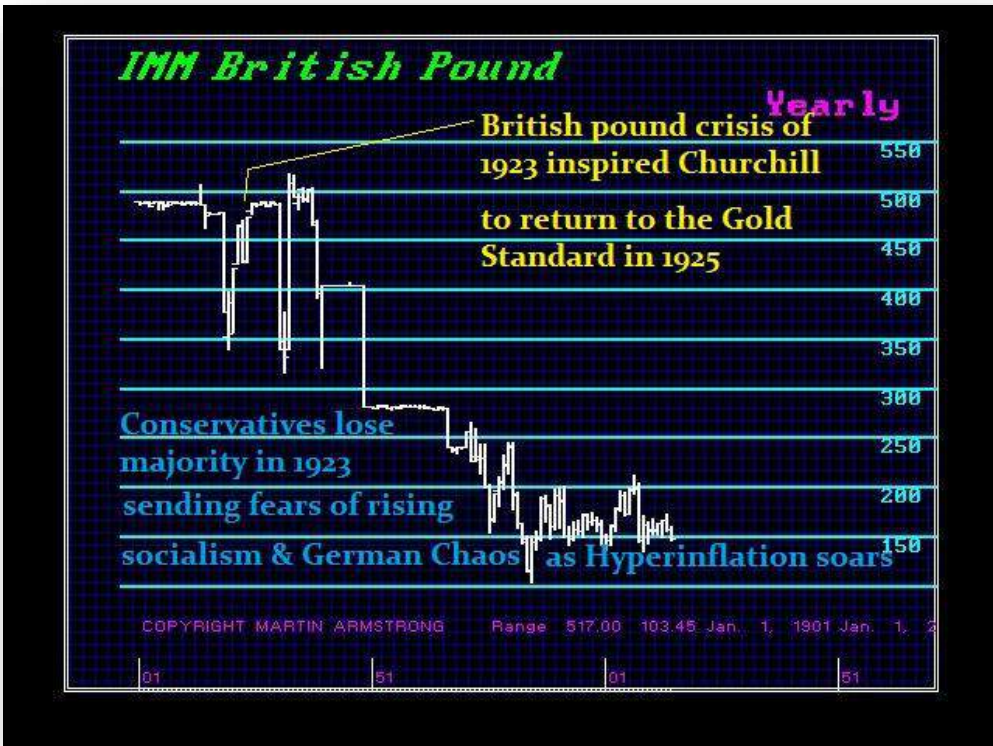
During this period, the printing presses worked night and day churning out the currency. This experience would deeply influence the economic theories of Austrian economist Ludwig von Mises.

At last, during late 1922 into early 1923 the Great Austrian Inflation was brought to a halt. The Austrian government appealed for help to the League of Nations, which arranged a loan to cover a part of the state's expenditures. But the strings attached to the loan required an end to food subsidies and a 70,000–man cut in the Austrian bureaucracy to reduce government spending.

Simultaneously, the Austrian National Bank was reorganized, with the bylaws partly written by Ludwig von Mises. A gold standard was reestablished in 1925; a new Austrian shilling was introduced in place of the depreciated crown. Restrictions were placed on the government's ability to resort to the printing press again.

Still, the return to a gold standard only imposed deflation and prevented the economy from truly recovering. Therefore, fiscal and regulatory mismanagement thanks to the rising demand for socialism prevented any hope of economic recovery. This set the stage for Austria to fall into the open arms of the rising Nazi totalitarianism in 1938 and the destruction of World War II.

British Crisis of 1923 & The German Hyperinflation



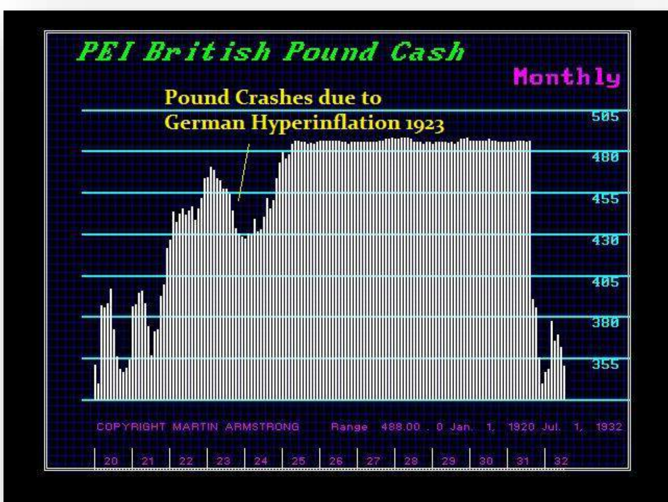
Britain has routinely been influenced by trends in Europe that are **not** directly caused by trends in Britain. In reality, there have always been internal contagions within Europe that have spread to other countries on the continent. Historically, Britain has been influenced by trends in Europe as well as at times Europe has been influence by contagions arising in Britain.

I have warned that fundamental logic really means nothing at the end of the day, for markets are driven by anticipation. Most traders are familiar with buy the rumor and sell the news, which reflects that reality. Nevertheless, we need only to open the history book to see that Germany's hyperinflation seriously impacted Britain, and in fact, was the leading logic behind Churchill returning to the gold standard and subjecting Britain to austerity in 1925.

Stanley Baldwin
(1867-1947)
British Prime Minister 1923-24; 1924-29; 1935-37

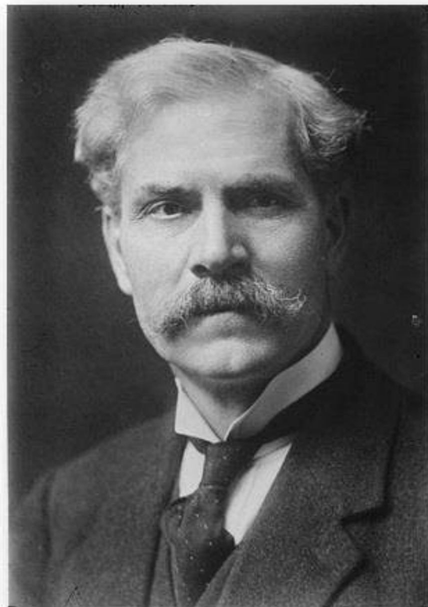
Germany's hyperinflation in 1923 sent shockwaves throughout Europe, as there was a strong rise in socialism. Stanley Baldwin (1867–1947) became Prime Minister under the Conservatives on May 23, 1923. He made the fatal mistake of calling for a general election on the tariff issue. The rising trend of socialism in Britain following the rise of Marxism with the Russian Revolution in 1917, and then the German Communist Revolution in 1918, sent fear running through capitols in Europe.

Baldwin misread this trend and largely dismissed it. He called for a general election, assuming he would end the issue of rising socialism. The British pound began to collapse, falling from $4.70 initially down to $4.54 by August. The combination of events such as Germany's hyperinflation, the pound being off the gold standard since WWI, and the Labour Party's rising socialist agenda combined forces to send the pound crashing down to about $4.27 by year-end, nearly a 10% decline.



The collapse of the British pound during 1923 precisely follows the collapse of the German currency between September 1923 and December that year on a timing perspective.

The general election was held on December 6. The conservatives won, but they lost their majority. This was devastating for the pound, as people feared that Britain could go the way of Germany if the Labour Party took control.



James Ramsay MacDonald
(1866 – 1937)
First British Labour Party Prime Minister (1929 – 1935)
Held Labour Leadership in 1924

Capital, both international and domestic, simply fled and it hopped on every available ship to the United States. The pound crashed on ANTICIPATION of Labour rising and the possibility of Britain going in the direction of Germany. That did not happen in 1923, but the fear of that possibility sent capital fleeing Britain. Hence – buy the rumor and sell the news.

Ramsey MacDonald (1866–1937) formed a minority Labour Government at that time, and he later became the first Labour Party Prime Minister in 1929. It would be MacDonald who was behind the British suspension of the gold standard defaulting on British debt during 1931. He viewed the suspension of debt payments as a blow against the capitalists.

MacDonald was one of the founders of the Labour Party constructed on Marxism. The Labour Party finally lost power only 51.6 years later when Thatcher began dismantling state–owned enterprises. Even Tony Blair did not return to the extreme left politics of the old Labour Party.

Things were looking better after the hyperinflation in Germany subsided as 1924 appeared on the horizon. The pound began to recover, but it was not until another general election was called on October 29th, 1924, that the Conservatives defeated the Labour Party and won back their majority.

Aftermath of the Hyperinflation

The hyperinflation crisis led many prominent economists and politicians to seek a means to stabilize German currency. As expressed in the previous gold-mark, the paper-marks of the Weimar Republic moved into a complete collapse which is reflected in its mirror image when expressed in gold-marks which when the German Empire was established in 1871, the exchange rate was 4.19 marks to the US$.

In August 1923, an economist, Karl Helfferich, proposed a plan to issue a new currency, the "Roggenmark" ("rye mark"), to be backed by mortgage bonds indexed to the market price of rye grain – agriculture. The plan was rejected because of the greatly fluctuating price of rye in paper marks.

Agriculture Minister Hans Luther proposed a plan that substituted gold for rye and led to the issuance of the Rentenmark ("mortgage mark"), backed by bonds **indexed** to the market price of gold – but they were not backed by gold. These gold bonds were indexed at the rate of 2790 gold marks per kilogram of gold, the same as the pre-war gold marks.

Rentenmarks were **not** redeemable in gold but only indexed to the gold bonds. The plan was adopted in monetary reform decrees, on October 13–15, 1923. A new bank, the Rentenbank, was set up and controlled by new German Finance Minister Hans Luther.

After November 12, 1923, when Hjalmar Schacht (1877–1970) became currency commissioner, Germany's central bank (the Reichsbank) was not allowed to discount any further government Treasury bills. This meant that the corresponding issue of paper-marks also had to end. The solution was allowing the discounting of commercial trade bills thereby the amount of Rentenmarks could be expanded. However, this issue was strictly controlled to conform to current commercial and government transactions.

The Rentenbank refused credit to the government and to speculators who were not able to borrow Rentenmarks, because Rentenmarks were not truly legal tender. Therefore, they could not be used to pay taxes or fines to the government.

German 50 Rentenmark (1925 issue)

Then finally on November 16, 1923, the new Rentenmark was introduced to replace the worthless paper-marks issued by the Reichsbank. Twelve zeros were cut from prices, and the prices quoted in the new currency remained stable at last as confidence began to slowly return.

Weimar Republic - (1924-1925) Reintroduction of 50% Silver Coinage

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After the successful stabilization of the currency in the aftermath of the hyperinflation, the Weimar Republic introduced of the Rentenmark which replaced the Reichsmark in September 1924. Silver returned to the coinage, albeit with a fineness of .500. This was a huge step over the pre-reform coinage which was effectively just aluminum.

Weimar Republic - Reform of 1925 Reichs Mark
50% Silver Content

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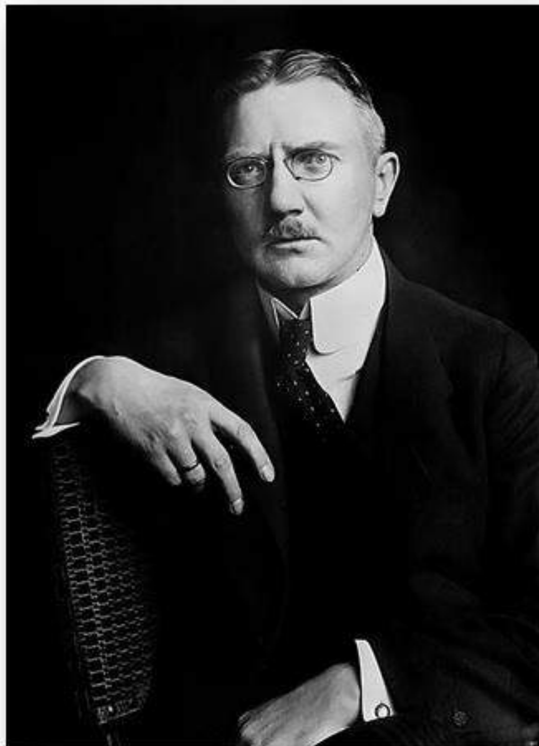
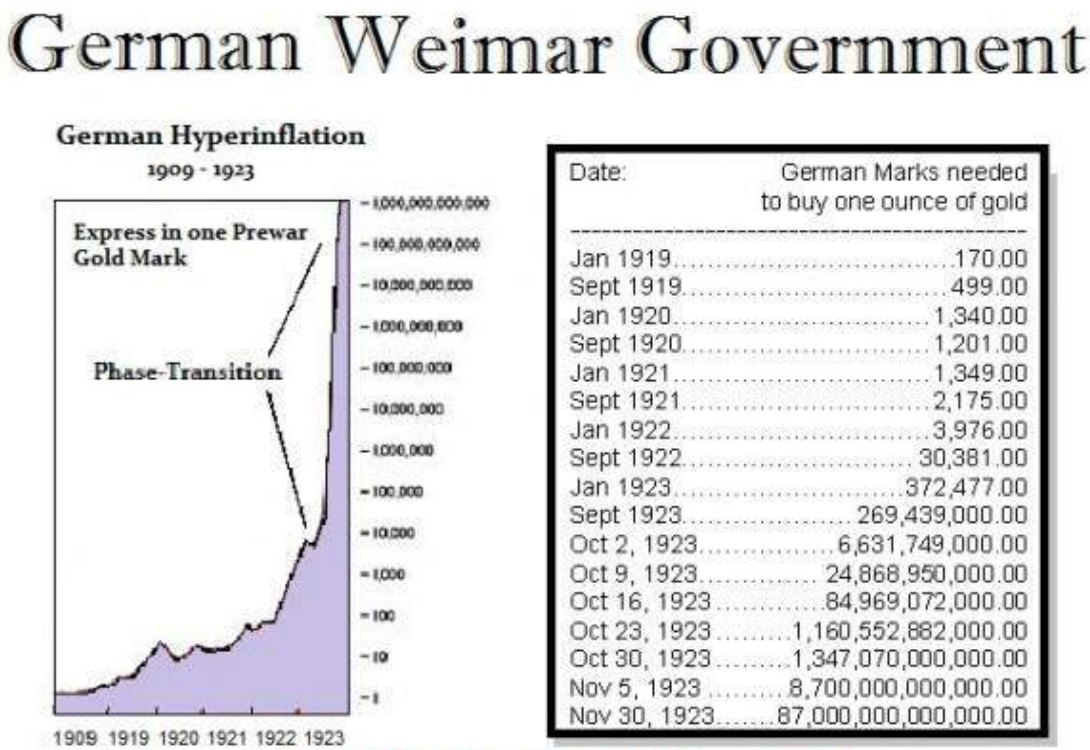
Then in 1925, the coinage was expanded to include four silver denominations contain a purity of 50% – 1 to 5 reichsmarks.



Hjalmar Schacht
(1877–1970)
President of the Reichsbank

When the president of the Reichsbank, Rudolf Havenstein, died on November 20th, 1923, Schacht was appointed to replace him. By November 30, 1923, there were 500,000,000 Rentenmarks in circulation, which increased to 1,000,000,000 by January 1st, 1924 and to 1,800,000,000 Rentenmarks by July 1924. Meanwhile, the old paper-marks continued in circulation. The total paper-marks increased to 1.2 sextillion (1,200,000,000,000,000,000,000) in July 1924 and continued to fall in value to a third of their conversion value in Rentenmarks.

By August 30th, 1924, a new monetary law permitted the exchange of a 1-trillion paper-mark notes to a new Reichsmark, worth the same as one Rentenmark. By 1924 one dollar was equivalent to 4.2 Rentenmark.



Date:	German Marks needed to buy one ounce of gold
Jan 1919	170.00
Sept 1919	499.00
Jan 1920	1,340.00
Sept 1920	1,201.00
Jan 1921	1,349.00
Sept 1921	2,175.00
Jan 1922	3,976.00
Sept 1922	30,381.00
Jan 1923	372,477.00
Sept 1923	269,439,000.00
Oct 2, 1923	6,631,749,000.00
Oct 9, 1923	24,868,950,000.00
Oct 16, 1923	84,969,072,000.00
Oct 23, 1923	1,160,552,882,000.00
Oct 30, 1923	1,347,070,000,000.00
Nov 5, 1923	8,700,000,000,000.00
Nov 30, 1923	87,000,000,000,000.00

Revaluation

The hyperinflation of the German mark under the Weimar Republic was massive. It certainly appears that the final straw that broke the back of the camel was the forced loans. Compelling that the wealthy turnover 10% of their wealth to the government investing in bonds devasted the economy for it is the wealthy who provide investment and therefore private sector employment. Consequently, efforts had to be made to try to compensate people for their losses.

Eventually, some debts were reinstated to compensate creditors who were wiped out by the catastrophic collapse in the value of debts denominated in the Weimar Republic currency. A decree of 1925 reinstated some mortgages at 25% of face value in terms of the new currency. Essentially, this worked out to be 25 billion times their value in the old paper-marks provided they had been held for at least five years. Similarly, some government bonds were reinstated at 2.5% of face value, to be paid after reparations were paid.

Charles G. Dawes
(1865–1951)

Against this backdrop, the German Hyperinflation prompted what became known as the **Dawes Plan.** This was a proposal set forth by the Dawes Committee, chaired by Charles G. Dawes (1865–1951) which took place as an initial plan in 1924 to resolve the World War I reparations and the hyperinflation. German reparation payments were seriously harming the entire European economy – not just Germany (see British crisis of 1923). Forcing Germany to pay reparations had strained diplomacy following World War I and the validity of the **Treaty of Versailles** in all practical terms.

Moreover, the catastrophic collapse in the value of the Germany marks under the Weimar Republic wiped out the creditors. This was devastating from the perspective of capital formation. It became impossible for people to lend money and thus the German economy simply imploded. There was no private investment for it simply became too risky. No one will lend money when the value if repaid is worth a fraction of what it would have purchased at the time it was originally lent.

The **Dawes Plan** provided for an end to the Allied occupation, and a staggered payment plan for Germany's payment of war reparations. Because the Plan resolved a serious international crisis, Dawes shared the Nobel Peace Prize in 1925 for his work. Nevertheless, the **Dawes Plan** was an interim measure and proved unworkable.

In an agreement of August 1924, the main points of The Dawes Plan were:

- The Ruhr area was to be evacuated by foreign troops
- Reparation payments would begin at one billion marks the first year, increasing annually to two and a half billion marks after five years
- The Reichsbank would be re-organized under Allied supervision
- The sources for the reparation money would include transportation, excise, and customs taxes

Germany would be loaned about $200 million, primarily through Wall Street bond issues in the United States. The bond issues were overseen by consortium of American investment banks, led by J.P. Morgan & Co. under the supervision of the US State Department. Germany benefitted enormously from the influx of foreign capital. The Dawes Plan went into effect in September 1924. Dawes and Sir Austen Chamberlain shared the Nobel Peace Prize.

The Replacement Loan 1925 consisting of a bond (left) and a connected Drawing Certificate (right)

The owners of previous forced loan bond purchases were compensated for their loss with new certificates of the **"Replacement Loan"** of 1925. The conversion rate was between 2½ and 15%. The total value of this new loan was 1.7 bn. Reichsmark.

The new Replacement bonds were non-interest bearing until the termination of all German war reparations payments. The bonds however were directly connected to a drawing certificate with the same nominal value. These drawing certificates participated in a yearly drawing of the redemption of five times their nominal value. This reinstated a similar approach to the first lottery bonds of 1919.

The economy of Germany began to rebound during the mid-1920s, and the country continued with the payment of reparations—now funded by the large-scale influx of American capital. However, the **Dawes Plan** was considered by the Germans as a temporary measure and they expected a revised solution in the future. In 1928, German Foreign Minister Gustav Stresemann called for a final plan to be established, and the **Young Plan** was enacted in 1929.

The **Dawes Plan** resulted in French troops leaving the Ruhr Valley. It provided a large capital influx to German industry, which continued to rebuild and expand. The capital now available to German industry functionally transferred the burdens of Germany's war reparations from German government and industry to American bond investors. The **Dawes Plan** was also the beginning of the ties between German industry and American investment banks.

The Ruhr occupation resulted in a victory for the German steel industry and the German re-armament program. By reducing the supplies of coal to France, which was dependent on German coal, German industrialists managed to hobble France's steel industry, while getting their own rebuilt. By 1926, the German steel industry was dominant in Europe and this dominance only increased in the years leading to WWII.

The 1929 **Young Plan**

At the Hague Conference on Reparations, the Committee met in the first half of 1929 and submitted initial report on June 7th, 1929. In addition to Young, the United States was also represented by J. P. Morgan, Jr. and his partner Thomas W. Lamont. The report was objected to by the United Kingdom. The plan was eventually resolved in the Hague on August 31st, 1929 just a few days below the peak in the

Dow Jones Industrial index (U.S. stock market) on September 3rd, 1929. The plan was formally adopted at a second Hague Conference, in January 1930.

At the Hague Conference on Reparations a struggle broke out between Great Britain and France over three questions: the distribution of the so-called unconditional part of the reparation payments—that is, the part not subject to postponement; deliveries in kind (Great Britain demanded their reduction in the interest of increasing its own exports, especially coal); and the percentage distribution of the total sum of the reparation payments among the creditor nations. As a result of secret negotiations among the main participants at the conference, a protocol approving the **Young Plan** in principle was signed on Aug. 31, 1929. The final confirmation of the Young Plan, as well as the adoption of a resolution on the application of sanctions in case Germany refused to pay reparations, took place at the second session of the conference (Jan. 3–20, 1930), at which Austria, Bulgaria, and Hungary were represented, in addition to the states that had participated in the first session.

One of the main decisions of the conference was an agreement on the withdrawal ahead of time of all occupation troops from the Rhineland (five years earlier than the time established by the Treaty of Versailles of 1919 and not later than June 30, 1930).


Bank for International Settlements

The **Young Plan** also called for an international bank of settlements to be established to handle the reparations transfers. The resulting **Bank for International Settlements** was duly established at the Hague Conference in January. Hague Conference on Reparations was held at The Hague from Aug. 6 to Aug. 31, 1929, and from Jan. 3 to Jan. 20, 1930. The first session of the Hague Conference on Reparations (Aug. 6–31, 1929) was attended by representatives of Belgium, Czecho-Slovakia, France, Germany, Great Britain, Greece, Italy, Japan, Poland, Portugal, Rumania, and Yugoslavia. The USA did not officially participate in the conference;

however, having proposed the Young Plan, it exerted pressure on the participants in the conference for adoption of the plan.

Willis C. Hawley (left) and Reed Smoot (right)
Hawley Republican Congressman from Oregon
Chairman of the House Ways and Means Committee
Smoot Republican Senator from Utah
Chairman of the Senate Finance Committee
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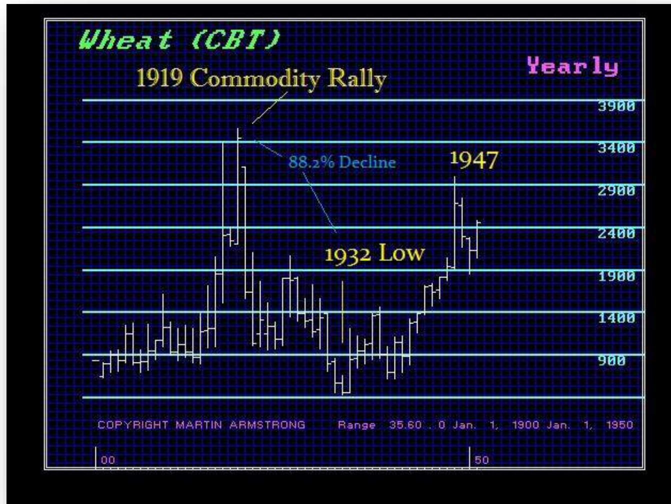
Between agreement and adoption of the plan came the Wall Street Crash of 1929, of which the main consequences were twofold. The American banking system had to recall money from Europe and cancel the credits that made the **Young Plan** possible. Moreover, the downfall of imports and exports affected the rest of the world. By 1933, almost two–thirds of world trade had vanished.

Politicians never understood the Great Depression no less the collapse in sovereign debts throughout Europe. This simply resulted in pushing the dollar to record highs which in turn reduced American exports. A new trade policy was set with the **Smoot–Hawley Tariff Act** which began based upon agriculture – not manufacture. **Smoot–Hawley** wasn't signed into law until June 17th, 1930, when stocks had already taken a nose dive from 1929 September high.

Senator Reed Smoot, was a Republican from Utah and chairman of the Senate Finance Committee, championed a tariff increase in 1929, which became the

Smoot–Hawley Tariff Bill. In his memoirs, Smoot made explained: ***"The world is paying for its ruthless destruction of life and property in the World War and for its failure to adjust purchasing power to productive capacity during the industrial revolution of the decade following the war."*** This was a partially correct statement, but he overlooked the dramatic change in the economic foundation set in motion by the innovation of electricity and the combustion engine.



Agriculture had employed 40% of the civil workforce in 1900. These two inventions in technology reduced the need for labor and allowed for the sharp rise in production. They blamed foreign imports in an effort to maintain artificial prices. However, we can see that wheat prices collapse into 1932 and only began to rise thanks to the **Dust Bowl** in combination with the devaluation of the dollar in 1934.

This era of Protectionism, which was really driven by currency values, latter resulted influencing the rise in nationalism. Political trends and solutions were turning toward adopting economic policies that were clearly nationalistic.

Unemployment soared to 33.7% in 1931 in Germany, and 40% in 1932. Under such circumstances, U.S. President Herbert Hoover issued a public statement that proposed a one–year moratorium on the reparation payments. He managed to assemble support for the moratorium from 15 nations by July 1931. But the adoption of the moratorium did little to slow economic decline in Europe.

Herbert Hoover
(1874 - 1964)
(President 1929 - 1933)

> During this new stage of the depression, the refugee gold and the foreign government reserve deposits were constantly driven by fear hither and yon over the world. We were to see currencies demoralized and governments embarrassed as fear drove the gold from one country to another. In fact, there was a mass of gold and short-term credit which behaved like a loose cannon on the deck of the world in a tempest-tossed era.

THE MEMOIRS OF Herbert Hoover - The Great Depression 1929-1941, id/p 67

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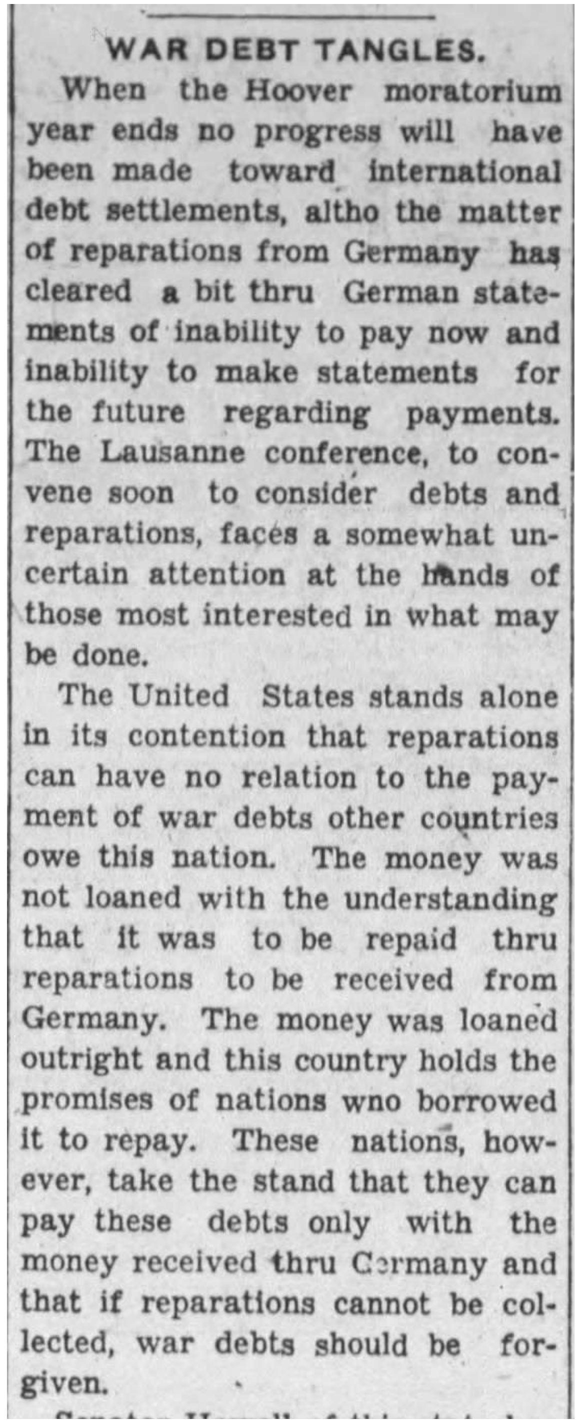
Germany was gripped by a major banking crisis that emerged as a **CONTAGION** that began in Austria. In 1931, the Sovereign Debt Crisis and banking system collapse began in Austria with the failure of Credit Anstalt (Creditanstalt), which was partly owned by the Rothschilds. The bank was forced to absorb another bank and a secret loan was created in London off the books to hide the insolvency to do the merger for political purposes. When that failed to be enough, the whole scam was exposed when Creditanstalt had to declare bankruptcy on May 11th, 1931. This set off a **CONTAGION** that spread as people wondered if the Rothschilds went broke and what government would fail as a result. Smart money realized it had been a shotgun wedding and the government's manipulating behind the curtain to hide the truth meant that government itself could not be trusted. President Hoover in his memoirs explain that capital **"behaved like a loose cannon on the deck of the world in a tempest-tossed era."**



WAR DEBT TANGLES.

When the Hoover moratorium year ends no progress will have been made toward international debt settlements, altho the matter of reparations from Germany has cleared a bit thru German statements of inability to pay now and inability to make statements for the future regarding payments. The Lausanne conference, to convene soon to consider debts and reparations, faces a somewhat uncertain attention at the hands of those most interested in what may be done.

The United States stands alone in its contention that reparations can have no relation to the payment of war debts other countries owe this nation. The money was not loaned with the understanding that it was to be repaid thru reparations to be received from Germany. The money was loaned outright and this country holds the promises of nations wno borrowed it to repay. These nations, however, take the stand that they can pay these debts only with the money received thru Germany and that if reparations cannot be collected, war debts should be forgiven.

A final effort was made at the **Lausanne Conference of 1932**. Here, representatives from Great Britain, France, Italy, Belgium, Germany and Japan gathered to come to an agreement. By that time, it was clear that the deepening depression had made it impossible for Germany to resume its reparations payments.

The powers attending the **Lausanne Conference of 1932** were forced to agree not to press Germany for immediate payments. They also sought to reduce the indebtedness by nearly 90% and require Germany to prepare for the issuance of bonds. This provision was close to cancellation, reducing the German obligation from the original $32.3 billion to $713 million. However, it was also informally agreed among the delegates that these provisions would be ineffective unless the US government agreed to the cancellation of war debts owed by the Allied governments.

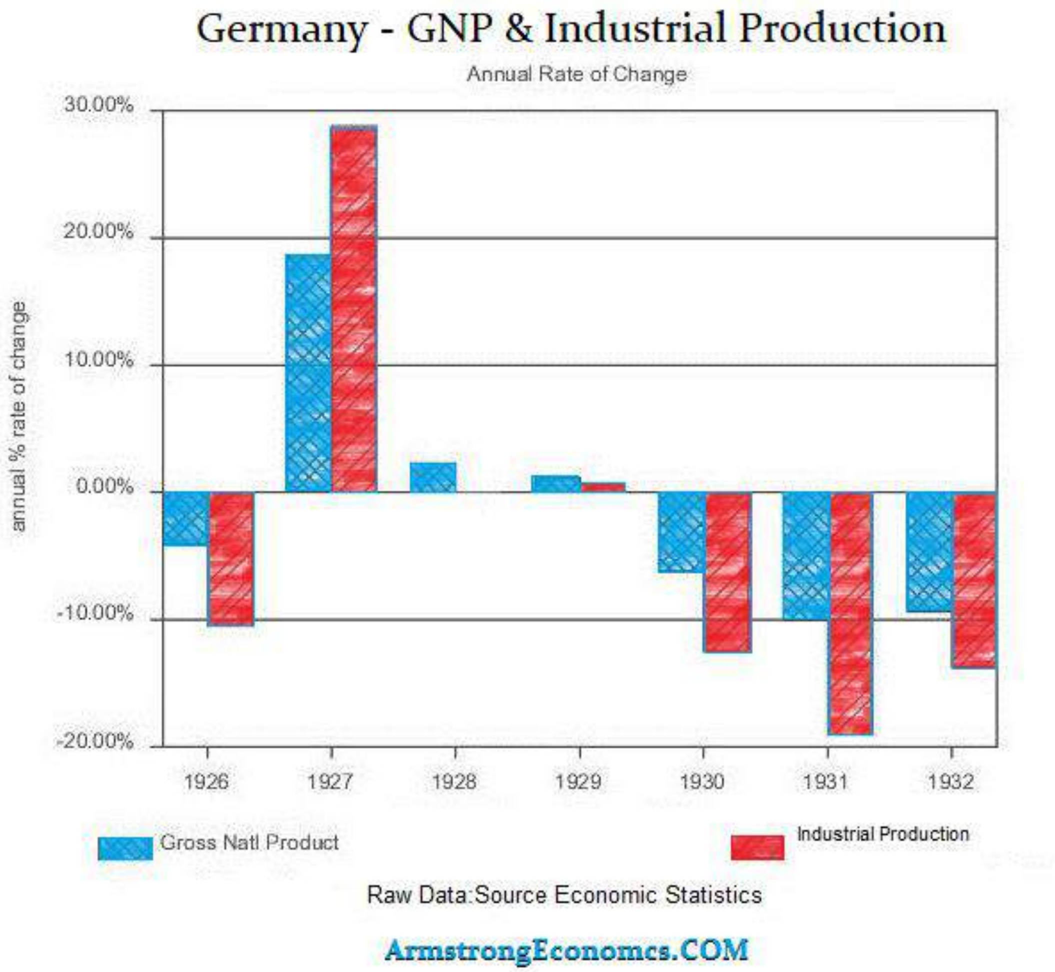
Hoover made the obligatory public statement about the lack of any connection between reparations and war debts, however in December 1932, the U.S. Congress rejected the Allied war debt reduction plan, which technically meant that the war reparations and debt reverted to the debt reduction previously granted Germany by the 1929 **Young Plan**.

Nevertheless, the system had collapsed, and Germany did not resume payments. Once the National Socialist government consolidated power, the debt was repudiated, and Germany made no further payments. By 1933, Germany had made World War I reparations of only one eighth of the sum required under the **Treaty of Versailles** and owing to the repudiated American loans the United States in effect paid "reparations" to Germany. The plan ultimately failed, not because of the U.S. Congress' refusal to go along, but because it became irrelevant upon Hitler's rise to power.

The new Rentenmark issued, which was an interim currency backed by the Deutsche Rentenbank, was not backed by gold, but by industrial and agricultural real estate assets owned by the bank. While there was a return to silver coinage in 1924, the small change, such as the 50 pfennigs, was struck in Aluminum–Bronze.

During a hyperinflation, the only real currency to hold on to some value was the coinage. The price of raw materials rises and as such, the coins become worth more as scrap metal than they did as coins from a legal tender perspective. This end result unfolded only **AFTER** the hyperinflation – not during.

The stories that people saved their copper coins and were able to spend them with a higher value than paper are really just stories. The coinage of the Weimar Republic was aluminum, not even copper.



Once the currency was stable, capital formation again began to take shape. It took until 1927 for the economy to truly begin to grow. Indeed, the German recovery was truly remarkable. Industrial production exploded reaching about 28% that year alone.

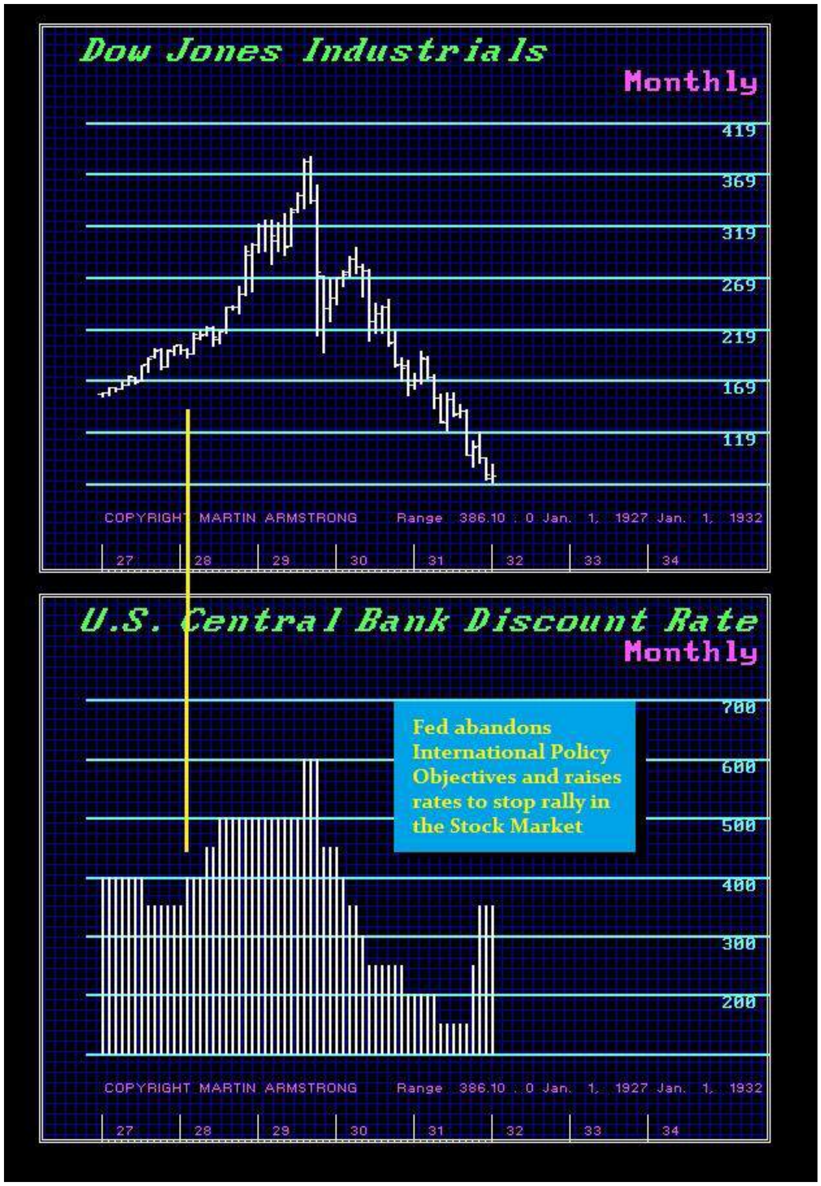
In Britain, during April 1926, owners of coal mines locked out the miners because they had rejected the owners' demands for longer hours and reduced pay. The coal industry was now in decline facing of falling prices caused by decline demand as industries began to shift to the more efficient oil substitute. This led to a general strike by the coal miners who did not wish to look at the shifting trends. Their strike failed despite the fact that there was a nine-day nationwide walkout of over one million railroad workers, transport workers, printers, dockers, ironworkers and steelworkers all supporting the 1.5 million coal miners.

Ernest Bevin
(1881–1951)
British Trade Union Leader & Labour Politician

The rising socialists that were taking over unions simply believed they could force their demands. This was part of the Communist contagion. They never bothered to look at the fact that demanding higher wages meant they the standard of living for the consumer would be reduced. In 1922 Ernest Bevin (1881–1951) was one of the founding leaders of the **Transport and General Workers Union (TGWU)**, which soon became Britain's largest trade union.

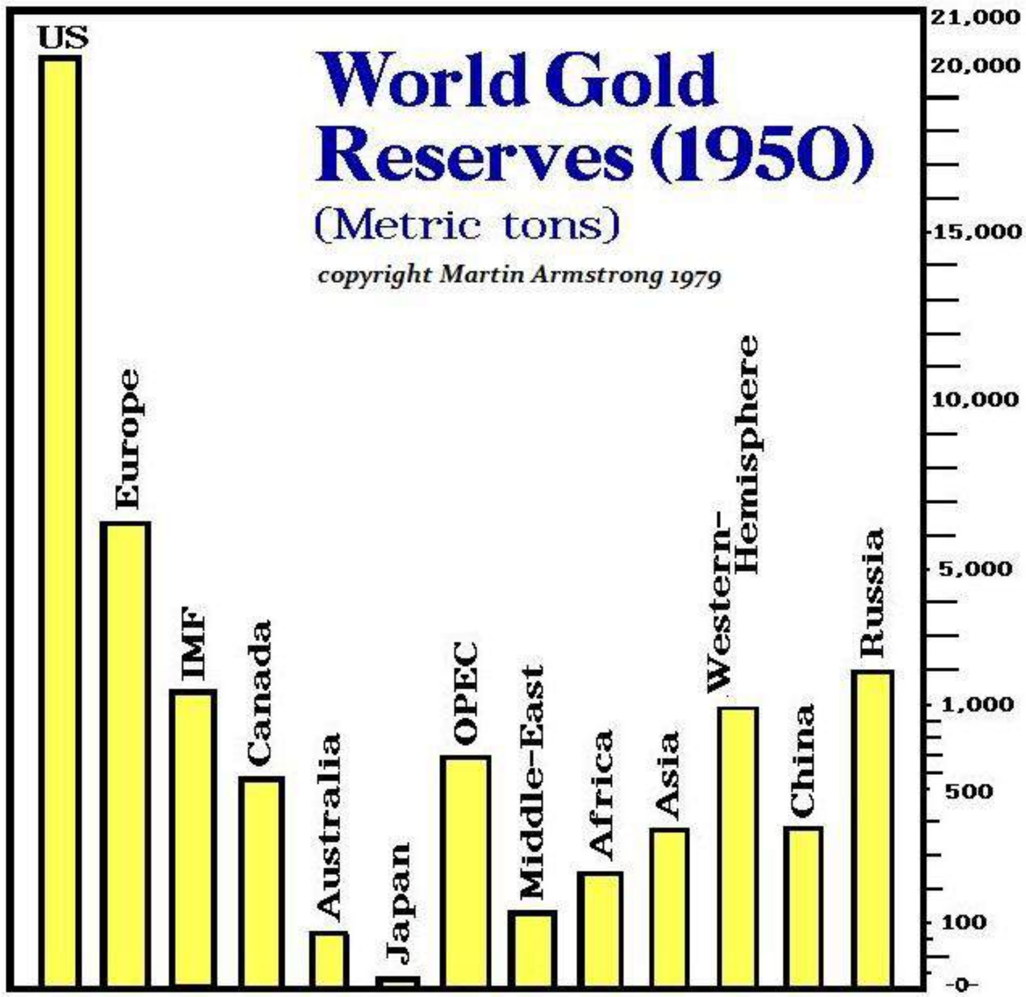
The government had provided a nine-month subsidy in 1925 to help the miners but that was not enough to turn around a sick industry. Oil was replacing coal, and this was simply the beginning of a major long-term trend.

The unions hoped the government would intervene to reorganize and rationalize the industry and raise the subsidy. The Conservative government had stockpiled supplies and essential services continued with middle class volunteers. All three major parties opposed the strike which was clearly socialist inspired. Still, the general strike was largely non-violent, but the miners' lockout continued and there was violence in Scotland.



It was the only general strike in British history, but it accelerated the movement of working-class voters to the Labour Party. The **Trade Disputes and Trade Unions Act** 1927 made general strikes illegal and ended the automatic payment of union members to the Labour Party. That act was largely repealed in 1946.

Still, these events contributed to the capital flight from Europe. This prompted a secret meeting with the head of the New York Federal Reserve in an attempt to get the US to lower its interest rate in hopes that capital would return to Europe. We see the same situation today with the IMF and the ECB lobbying the Federal Reserve not to raise interest rates. As the capital inflows intensified, the Fed abandoned this international cooperation and raised interest rates.



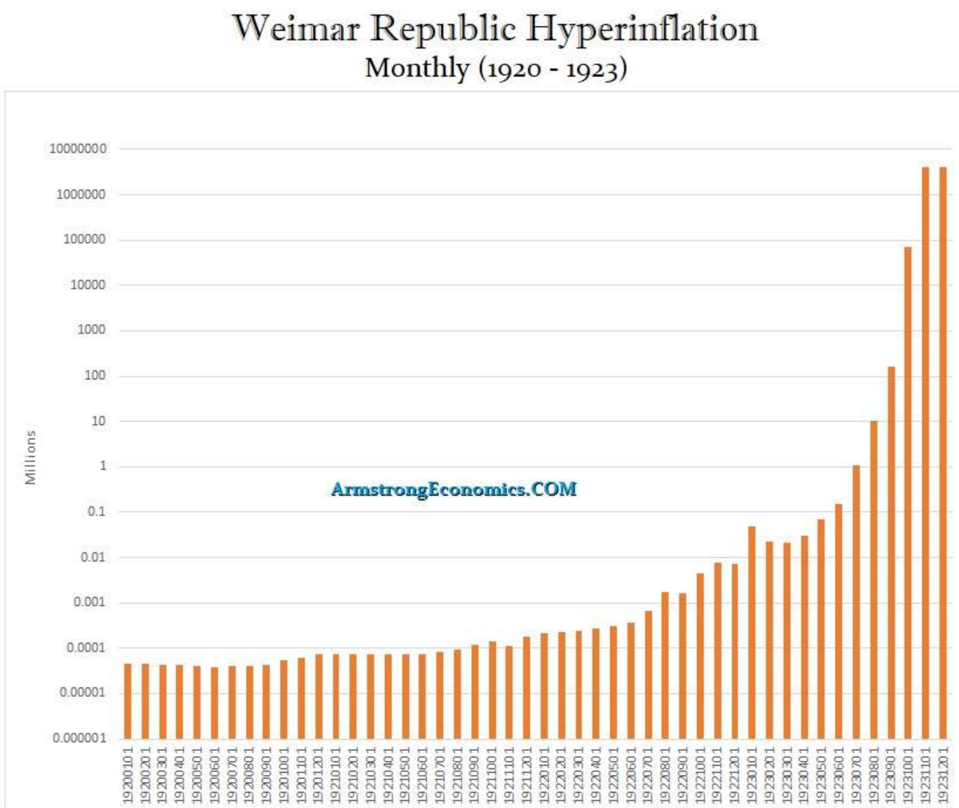
The rise of the United States was enabled by the chaos in Europe. The USA was on the verge of bankruptcy in 1896 when JP Morgan had to arrange a $100 million gold loan to bailout the country. After World War I, the USA was already beginning to take on the mantle of the Financial Capital of the World. London emerged as the trading capital for currency. Nonetheless, the USA was on the rise.

By the end of World War II, the United States became not just the Financial Capital of the World, it was also the home of the largest gold reserve. The United States ended up with nearly 76% of the official world gold reserves and as such, the US dollar became the nature reserve currency as established at Bretton Woods in 1944.

The true impact of the hyperinflation of the 1920s was the wrongful interpretation of its cause. As always, the problem in research is always the attempt to reduce everything to a single cause and effect. This process is what created our economic theories that to this day plague our attempts to manage the economy on the part of central banks.

The most widely studied hyperinflation has been that of Germany during this period of 1921–1923 after World War I. The ratio of the German price index in November 1923 to the price index in August 1922—just fifteen months earlier—was 1.02×10^{10}. This astonishing number amounts to a monthly inflation rate of 322%. On average, prices quadrupled each month during the sixteen months of hyperinflation.

It was too easy to attribute the cause of hyperinflation to merely an increase in the supply of money. In light of 10 years of Quantitative Easing on the part of the European Central Bank has proven that analysis is simply wrong.



However, we can easily see from the data we have put together, that the collapse in the monetary system became extremely rapid only during 1923. The events that took place during 1921 clearly set this in motion draining the German population of hope, faith, and trust in the future. The Allies punished the German people for the abuses of their political leaders. But with all governments even in the USA, only three presidents even captured more than 60% of the popular vote. Most have captured the office with just a few percent greater than their opposition. What the Allies did was merely open the door to Adolf Hitler. However, it was that punishment which eroded the German confidence in the future.

The forced loans were the final straw. The data clearly shows that the hyperinflation took off from that moment. Once any government seeks to confiscate the assets of the people, they inevitably destroy the economy. They cause people to hoard their wealth and that in turn furthers an economic contraction and deflation.

1925 German Replacement Bonds

The mere fact that Germany was compelled to address the forced loans by creating the 1925 **Replacement Bonds** confirms the problem. German Reich bonds issued prior to 1924 in old Reich currency under the **Bond Redemption Law** of July 16, 1925 (Reich Gazette vol. I, p. 137) stipulated whether and, if so, in what amount these securities could be exchanged for the German Reich loan redemption debt of 1925. Generally speaking, the securities were exchanged at a ratio of 40 (gold) marks to 1 Reich mark. However, securities from the inflationary years of 1922/1923 were exchanged at much lower percentages of the face values.

Attacking the "rich" has always led to the contraction in economic activity. Long lines appeared during the hyperinflation in both Germany and Austria due to the lack of economic production. As wealth contracts, production declines.

Because people begin to hoard their wealth rather than invest, others seek to target the rich and blame them for recoiling like any animal when threatened.

German Bonds from the 1927
ArmstrongEconomics.COM

While the Federal Reserve attempted to redirect the capital flows in 1927, Germany began to issue bonds rather extensively. Nevertheless, when the Federal Reserve System began raising interest rates in 1928, those capital inflows to Germany lessened. Germany then could not use funds gained from capital inflows to pay its reparations, but instead had to run a trade surplus to gain the needed funds. The price level in Germany had to fall to make its exports more attractive to the rest of the world. Institutional investment in the USA was turning away from Europe. Net portfolio lending by the United States declined from more than $1 billion in 1927 to less than $700 million into 1928 as domestic investments were more attractive. Then as the US share market rallied into 1929, American institutions began to redeem European debt and the flows then turned negative.

As a result, in 1928 U.S. financial markets began attracting gold from Europe as Europeans were looking at the US bull market. Foreign central banks had to raise their domestic interest rates to offset gold losses. The Federal Reserve Bulletin (November 1930, 655) talked about "Money rates abroad, which had been kept up largely to protect the reserves of foreign countries against the attraction of speculative and high-money conditions in the United States." George Harrison, governor of the Federal Reserve Bank of New York, informed Secretary of the

Treasury Andrew Mellon that "our high money rates. . . continue to act as a pressure upon all the European bank reserves." At the same time, France, with its undervalued franc, also absorbed gold from the rest of the world. In 1928 and the first half of 1929, France absorbed 3% of global gold reserves.

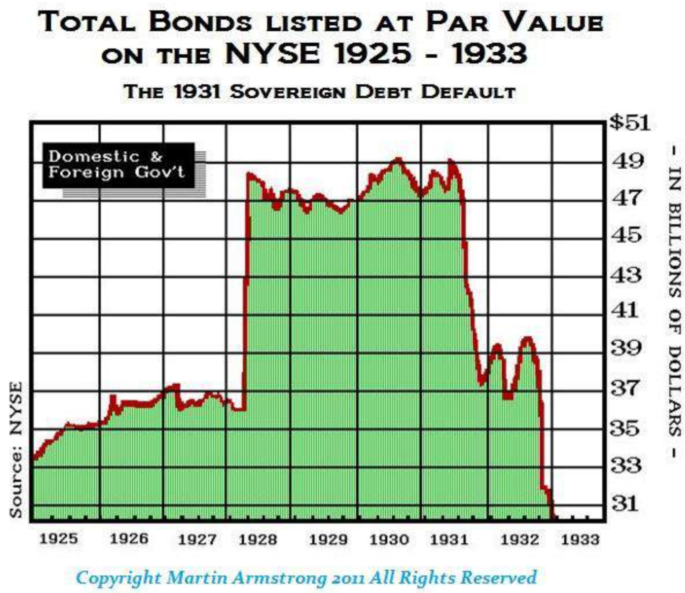
The **Treaty of Versailles** was all about punishment as was the **Treaty of St. Germain.** In both cases, this was really about settling old scores and in doing so, they punished the populations for the sins of their political leaders. This punitive action created the devastation in hope and confidence that would allow extremists to come to power. In light of the Communist Contagion spreading from the Russian Revolution of 1917, a new philosophy was changing the minds of many people who were tied of the old–world order.

As the capital flows turned toward capital hoarding in the face of an economic decline, the level of confidence in the common people continued to be assaulted. Besides the Communist Contagion, there was also the shift in technology that was also destroying jobs thank to the invention of the combustion engine. Agriculture, which had even employed 40% of the civil work force in 1900, was collapsing creating simultaneously new waves of unemployment.

The 1930s was becoming a perfect economic storm. Rising unemployment as the combustion engine replaced manual labor much as companies today like Amazon are replacing local stores. Add to this, the punitive actions against Germany and Austria further suppressed any sustainable economic growth. The core crisis that created the Great Depression was a combination of events that was then further complicated by weather creating extreme cold and the droughts.

Credit Anstalt - 1931 Austria

In 1931, the sovereign debt crisis and banking system collapse began in Austria with the failure of Credit Anstalt (Creditanstalt), which was partly owned by the Rothschilds. The bank was forced to absorb another bank and a secret loan was created in London off the books to hide the insolvency to do the merger for political purposes. When that failed to be enough, the whole scam was exposed when Creditanstalt had to declare bankruptcy on May 11th, 1931. This set off a **CONTAGION** that spread as people wondered if the Rothschilds went broke and what government would fail as a result. Smart money realized it had been a shotgun wedding and the government's manipulating behind the curtain to hide the truth meant that government itself could not be trusted.



In that case, foreign governments issued bonds in dollars in small denominations and the New York bankers sold them to the general public. The crisis emerged because this was a Sovereign Debt Crisis in 1931. Hence, there could be no bailout domestically within the United States to protect foreign bonds sold to domestic mom and pops.

As the economic depression deepened in the United States during the early 30s, which also was when the **Dust Bowl** unfolded, farmers had less and less money to spend in town and could not pay their loans. Banks began to fail at alarming rates in the Mid-West as farmers could not repay, and in the East, the default on foreign government bonds wiped out savings and caused depositors to withdraw funds. During the 20s, there was an average of 70 banks failing each year nationally. During the first 10 months of 1930, 744 banks failed. By 1934, 9,000 banks had failed in all. It's estimated that 4,000 banks failed during the year of 1933 alone. By 1933, depositors saw $140 billion disappear through bank failures.

This is what made the Great Depression so great. Banks saw bad loans soar and mom and pops who bought foreign bonds were wiped out. The combination of these events led to the massive collapse in the capitalization of the global economy. Even in the United States, more than 200 cities had to issue their own money for there was a shortage of money and banks.

The Rise of Adolf Hitler

Adolf Hitler (1889-1945)

With the Sovereign Debt Crisis hitting in 1931, the shift in technology which was also destroying jobs, the rising threat of the Communist Contagion, and the punitive actions of both **Treaty of Versailles** and the **Treaty of St. Germain,** the people of German and Austria were pushed to the limit. Left with little hope for a future and being punished for the sins of their former political leaders, the situation was ripe for Adolf Hitler and the National Socialist party to gain power. The German economy was in dire straits and external debt levels due to WWI preparations were unprecedented.

The punitive actions of particularly the French against Germany and Austria to settle old score actually united the German people in one very clear respect. The **Treaty of Versailles** not merely was punitive, it was intended to also humiliate the German people. The German economy was decimated in the aftermath of WWI, and the punitive economic conditions became the common bond that united all Germans. They may have had nothing else in common save this one element. Still, it was not enough to impact the day-to-day lives of all Germans yet kept their solutions divided. Some argued for communism, others socialism, and still others for revenge. This is the perfect environment that breeds the souls of tyrants.

The economic crisis of 1929 destroyed the stability of German financial markets, which had been built up over the past 5 years. Additionally, the German economy was also caught in the midst of the 1929 Global Great Depression after the ruinous collapse of the German Mark in 1923 during the period of hyperinflation. The hyperinflation destroyed not just the national currency, but private sector savings of the people as a whole.

The German share market topped in 1928 in advance of the US market which peaked about one year later on September 3rd, 1929. As the US economy began to collapse, private sector American firms began recalling their loans from Germany. With the global economy declining rapidly, the ability of Germany to export production rapidly declined. This began to cause widespread layoffs in the Germany economy driving unemployment significantly higher. Must of the rumors of the day were blaming the Jewish Bankers.

The Jewish firm of Goldman Sachs nearly went bankrupt. The Goldman Sachs Trading Corporation floated the Shenandoah & Blue Ridge investment trusts. The disaster was monumental to say the least. Goldman Sachs Trading Company, whose shares had stood at $326 at their peak, fell during the Great Depression to $1.75. Goldman Sachs was awash with lawsuits and it became the target of jokes in Vaudeville. This would fuel the anti-Jewish feeling in New York for decades to come as well as in Europe.

Adolf Hitler Pays Respect to Paul von Hindenburg
former field marshal & elected President of the Weimar Republic

Paul von Hindenburg (1847–1934) was elected President of the Weimar Republic in 1925 and served until August 1934. Even Hitler had to pay his respects to Hindenburg. In October 1929 the Wall Street Crash on the US stock exchange brought about a global economic depression. In Europe, Germany was worst affected because American banks called in all of their foreign loans at very short notice. These loans, agreed under the **Dawes Plan** in 1924, had been the basis for Weimar's economic recovery from the disaster of hyperinflation. The loans funded German industry and helped to pay reparations. Without these loans German industry collapsed.

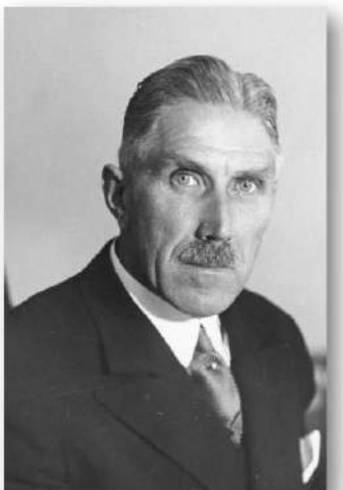
The collapse of Wall Street set in motion its own contagion. As Americans recalled loans, the most obvious consequence of this contagion was to export the economic collapse to Germany which resulted in a dramatic rise in unemployment.

Over the winter of 1929–30 the number of unemployed Germans rose from 1.4 million to over 2 million. By the time Hitler became Chancellor in January 1933 one in three Germans were unemployed, with the figure hitting 6.1 million. Industrial production had also more than halved over the same period.

This sharp rise in unemployment was even furthered by the 1931 Sovereign Debt Crisis. This combination merely added to the conditions that would make it the perfect opportunity for the rise of Adolf Hitler who was rising in popularity in 1932. It was that rise in popularity that compelled Hindenburg to also respect Hitler.

1932 Government by Emergency Decree

Millions of people were out of work, a number of large banks had collapsed, the market for German exports had dried up overnight, and a US–led lending freeze (withdrawal of credits under the Young Plan) had thrust German industry and finance into a severe slump. By 1932, German industrial production was nearly half of what it had been a year earlier. Unemployment soared from 1.5 million in 1929 to more than 6 million by the end of 1932.



Franz von Papen
(1879-1969)

Intrigues among President Hindenburg's inner circle of advisors and failure to govern against the background of the worsening economic depression toppled the government on May 30th, 1932. Two days later, Hindenburg appointed Franz von Papen (1879–1969) Chancellor. In addition to two national elections for the Reichstag in July and November 1932, Hitler ran for President against the incumbent, Field Marshall Paul von Hindenburg, in April 1932. Although he lost, he obtained 36.8% of the vote. Ironically, on February 25th, Adolf Hitler obtained his German citizenship by naturalization, so he could run for election in the 1932.

Franz von Papen secured Hitler's promise to tolerate his government by lifting a recent ban on the SA and SS (Brownshirts). Interestingly, von Papen took advantage and used the street violence on July 20th, 1932 to overthrow the democratically elected Prussian State Government by emergency decree. He replaced it with an unelected administration. This tactic would be something that Hitler would use eight months later to gain control.

The year 1932 was the year of Hitler's dramatic rise to popularity in Germany. The sentiment was shifting around the world. The year 1932 saw Herbert Hoover lose to the socialistic dreams of Franklin D. Roosevelt. In early 1929 Mao and Zhu De led their armies into southern Jiangxi and by February 1930, Mao formed the Jiangxi Soviet. In late 1930 Mao initiated a series of purges to remove Jiangxi and Red Army leaders who were hostile to his own leadership. Mao spent 1931 consolidating his control and in November 1931, Jiangxi formally became the Chinese Soviet Republic.

General Kurt von Schleicher
(1882 – 1934)

Politics was changing around the globe as the economic storm clouds gathered on all fronts. Whatever government was in power, the trend became to expel them from office. The German people's frustration with dismal economic conditions and the punitive actions of the French only created festering wounds with the harsh peace terms of the **Treaty of Versailles**. Hitler was a very charismatic speaker. He understood how to tap into the rising popular discontent with the post-war Weimar Republic that was creating growing support for his Nazi party.

In an election held in July 1932, the Nazis won 230 governmental seats; together with the Communists, the next largest party, they made up over half of the Reichstag. Hindenburg was clearly intimidated by Hitler's growing popularity. He even understood the frustration of many that was manifesting into violence among what was called the Brownshirts.

Hindenburg initially refused to make Hitler chancellor. Instead, he appointed General Kurt von Schleicher (1882–1934), who attempted to divide the Nazi faction in which there too was dissent led by Gregor Strasser. At the next round of elections in November, the Nazis lost ground—but the Communists gained seats.

Schleicher's efforts to divide the Nazi Party actually that made right-wing forces in Germany even more determined to get Hitler into power. In a series of complicated negotiations, ex-Chancellor Franz von Papen, backed by prominent German businessmen and the conservative German National People's Party (DNVP), went to Hindenburg imploring him to appoint Hitler as Chancellor. The argument was that von Papen would become vice-chancellor and other non-Nazis members would be put in key government positions. They argued that this would temper and control Hitler's more violent tendencies.

Hitler's emergence as Chancellor on January 30, 1933, marked a crucial turning point for Germany and, ultimately, for the world. His plan, embraced by much of the German population, was to do away with politics and make Germany a powerful, unified one-party state. He began immediately, ordering a rapid expansion of the state police, the Gestapo, and putting Hermann Goering in charge of a new security force, composed entirely of Nazis and dedicated to stamping out whatever opposition to his party might arise. From that moment on, Nazi Germany was on its course with destiny.

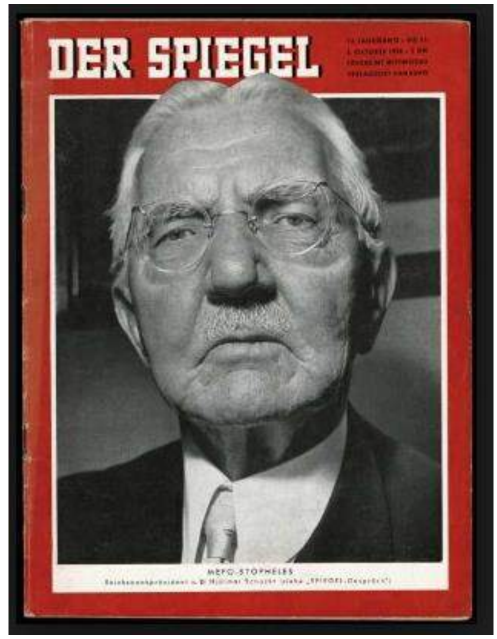
Nationalism 1933-1945

Adolf Hitler - 1933

Adolf Hitler after being appointed Chancellor of Germany on January 30, 1933 by President Hindenburg, upon the death of Hindenburg on August 2nd, 1934 Hitler became the dictator of Germany. He merged the offices of the Presidency and Chancellery. A national referendum was held on August 19th, 1934 when Hitler was appointed sole Führer und Reichskanzler (Leader and Chancellor) of Nazi Germany.

Indeed, between January 1933 and July 1935 the number of people employed in Germany increased from 11.7 million to 16.9 million. Moreover, the national currency had stabilized. There was no hyperinflation post–1923.

Hitler, who had been sworn in as chancellor under President Paul von Hindenburg in January 1933, appointed German economist and banker, Hjalmar Schacht (1877–1970), as President of the Reichsbank and Minister of Economics. Schacht, in turn, launched a groundbreaking fiscal stimulus program that rebuilt the nation's worn infrastructure and put millions of people back to work.



Unfortunately, Hjalmar Schacht has been simply regarded as a Nazi and thus ignored in the annals of economic history. It was Schacht who created the German Economic Miracle – not Hitler. He raised Germany from the economic abyss of the Great Depression and postwar punitive action of the Allies. He was initially a supporter of Hitler and the Nazi Party. Hitler appointed him as President of the Reichsbank and Minister of Economics.

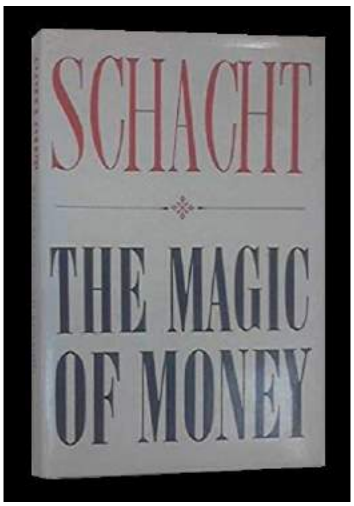
Nonetheless, Schacht eventually developed serious concerns about German re-armament policy and feared there would be another war. He clashed with Hitler and was thus dismissed from his duties just before the beginning of the war. Still, the vindictiveness against Germany saw Schacht put on trial at Nuremberg where he was acquitted and cleared of all blame for rearmament and inflation. Nevertheless, Schacht was later tried again and sentenced by a German denazification court to eight years in a work camp. Because of that wrongful conviction, his economic policies have been just ignored.

Schacht's goal was to strengthen the currency, and he realized that maintaining a gold standard only benefited bond holders – not the people. For this reason, he rejected any return to a gold standard. He also understood capital flight and thus he imposed capital controls. These measures served to reinforce Germany's economic independence and produced what many called the German Economic Miracle.

Employing Schacht's economic theories, he created an independent monetary policy of sovereign credit simultaneously with a full-employment public-works program. the Third Reich was able to turn a bankrupt Germany, stripped of overseas colonies it could no longer exploit, and converted the situation into the strongest economy in Europe within four years. This was all accomplished before armament spending began to which he objected.

Schacht understood that the people had to have confidence and just printing money as the Weimar Republic would bring back bad memories. Instead, he contrived a unique unconventional monetary solution by thinking out of the box. For payments, state contractors and suppliers received bills of exchange that were issued by a company known as MEFO.

The MEFO stood for Metallforschungsgesellschaft (Metal Research Company), a private empty-shell company with paid-up capital of 1 million marks. This was co-owned by Siemens, Gutehoffnungshutte, Rheisenstahl and Krupp, in whose names the bills were issued and thus were private. This did not expand the fiscal budget and thus would be inflation-neutral. Yet, these MEFO-bills were also state guaranteed. They were allowed to circulate in the economy and could be discounted by their holders at the Reichsbank in exchange for cash.



Schacht believed that the duty of the central bank was to make available to the economy as much money as necessary to facilitate output production. The issuance of bills of exchange was instrumental to this end – as each bill stood against the sale of newly produced goods, and each issue of money was based on the exchange of the new goods, central bank money issuance against bills could not be inflationary. Indeed, the employees of MEFO checked that every MEFO-bill issued was tied to a quantity of newly produced goods, and only bills issued against the sales of these goods were granted. This way, the circulation of money and the circulation of goods remained in equilibrium.

"The system worked in the following way: a company with a paid-up capital of one million Marks was formed. A quarter of the capital was subscribed by each of the four firms Siemens, A. G. Gutehoffunungshiitte, Rheinstahl and Krupps. Suppliers who fulfilled state orders drew up bills of exchange for their goods, and these bills were accepted by the company. This company was given the registered title of Metallforschungsgesellschaft (Metal ResearchCompany, 'MEFO' for short), and for this reason the bills drawn on it were called MEFO bills. The Reich guaranteed all obligations entered into by MEFO, and thus also guaranteed the MEFO bills in full. In essence all the Reichsbank' s formal requirements were met by this scheme. It was a question of financing the delivery of goods; MEFO bills were therefore commodity bills. They rested on a threefold obligation: that of drawer, acceptor and Reich. This provided the Reichsbank with every justification for discounting the bills, and, although it was put to every test by the Reichsbank' s directorate in collaboration with the country's best legal brains and economists, they agreed unanimously that it was valid. The Reichsbank declared itself ready to prolong the bills, which true to the form laid down were drawn on three months' credit, to a maximum of five years

if so required, and this point was new and unusual. Each bill could thus be extended by a further three months, nineteen times running. This was necessary, because the planned economic reconstruction could not be accomplished in three months, but would take a number of years. By and large such extensions by themselves were nothing new with the Reichsbank; it was quite common to prolong agricultural bills, but an extension over five years, together with a firm declaration that such extensions would be granted, that was most unusual.

One other aspect was even more unusual. The Reichsbank undertook to accept all MEFO bills at all times, irrespective of their size, number, and due date, and change them into money. The bills were discounted at a uniform rate of four per cent. By these means the MEFO bills were almost given the character of money, and interest-carrying money at that. Banks, savings banks, and firms could hold them in their safes exactly as if they were cash. Over and above this they proved to be the best of all interest-bearing liquid investments, in contrast to long-dated securities."

– **Hjalmar Schacht: The Magic of Money p 113**

1935 Issue - 100 Reichsmark

The Reichsbank undertook to accept on demand all MEFO bills, irrespective of their size, number and due date, and to exchange them for legal tender money. Therefore, these were in reality backed privately yet guaranteed by the government. There was no collapse in confidence with respect to their value.

Furthermore, Schacht also understood international capital flows. He realized that capital rushed around the world from one nation to another. In the process, if capital is being attracted, then the supply of money can increase causing inflation that is neither created by fiscal spending or by the monetization of a central bank. There was a source of capital that could disrupt a domestic economy that was outside the control of a central bank without capital controls.

As I have explained many times, if a building sells for $1 million between two domestic citizens, the money supply is not altered. However, if a foreigner brings money into the economy to purchase that same building, he does increase the domestic money supply as his currency is converted to the local currency. Hjalmar Schacht understood this external wildcard which can lead to inflation of deflation depending upon the flow of capital.

Understanding capital flows, Schacht instigated these refugee notes that were exchanged for German marks before you were allowed to migrate from Germany. Regular German Reichsmarks had to be exchanged for Konversionskasse notes before leaving Germany. Unfortunately, the notes were found to be practically worthless upon arrival to asylum countries. When I went to East Germany through Check-Point Charlie in Berlin, I was forced to exchange West German Marks at par for East German. In town, nobody wanted the Eastern marks. When I left, I had the same amount of East German marks I was compelled to exchange. They then just confiscated the East Germany marks, gave me a receipt and said I had to go to the central bank the next day to exchange them. These Konversionskasse notes were this similar to that insofar as they were worthless when you got out. The object was to prevent the domestic currency from leaving the country. There were two distinct issues of the Konversionskasse notes. Those with the red seals were given to the Jews.

In 1938, Schacht strongly urged terminating the MEFO program once full employment had been reached. This is when he clashed with Hitler on this subject, and on January 19th, 1939 the Hitler dismissed him from the Reichsbank.

With regard to furthering his power, Hitler came up with a plan to destroy the rival Communist Party in the process. Hitler used a very famous event that was the origin of the term **"False flag"** after being in office as Chancellor for just one month. The German False flag used by Hitler was known as the **Reichstag Fire**. Hitler had a problem. He won less than 35% of the vote. The Reichstag Fire was an arson attack on the German parliament in Berlin on February 27th, 1933, one month after Adolf Hitler was sworn in as Chancellor of Germany. Hitler's government claimed it was set by Communists because the 1918 German Revolution which installed the Weimar Republic and resulted in the hyperinflation was a Communist movement which even asked the Russian to take Germany.

One man was prosecuted named Marinus van der Lubbe, a Dutch council Communist, who was simply found near the building. A German court later decided that van der Lubbe had acted alone as was the case with Oswald in the Kennedy Assassination. After the Reichstag Fire, a Decree was passed that the Nazi Party used as evidence that Communists were plotting against the German government. This event was critical in the establishment of Nazi Germany. The very term Reichstag Fire in Germany has been ever since used to refer to False flag actions perpetrated by the government to promote their own interests to gain more power and infuriate the public for retribution that has **ALWAYS** resulted in the loss of civil rights necessary to catch the conspirators.

Following the **Reichstag fire**, the Nazis began to suspend civil liberties and eliminate political opposition. The Communists were excluded from the Reichstag. At the March 1933 elections, again no single party secured a majority. Hitler required the vote of the Centre Party and Conservatives in the Reichstag to obtain the powers he desired. He called on Reichstag members to vote for the **Enabling Act on 24 March 1933**. Hitler was granted plenary powers "temporarily" by the passage of the Act. The law gave him the freedom to act without parliamentary consent and even without constitutional limitations

On the 12th of March 1933, Hindenburg banned the German flag of the Weimar Republic and ordered the Imperial and Nazi flag to fly side by side. Three days later on the Ides of March 1933, Hitler proclaimed the Third Reich.

Beginning on April 1st, Nazi soldiers began hanging a poster on the window of Jewish-owned business, that says: **"German, protect yourself. Do not buy from Jews"**. Hitler by no means invented the hatred of Jews. Jews in Europe had been victims of discrimination and persecution since the Middle Ages, but in truth it was always economic based that was masqueraded to justify some religious reason. The entire Protestant Reformation was really being funded by merchants who wanted to be bankers but would be excommunicated by the Catholic Church for usury. The only bankers were the Jews and whenever debts could not be paid, it suddenly was justified by claiming some religious issue to hide the default on debts. Edward I (b1239; 1272–1307) of England borrowed from the Jews to fund his war with France. When he could not pay, he banished the Jews from England and confiscated all their real property.

Hitler was Austrian, not German by birth. Among the Austrian politicians who greatly influenced Hitler's thinking was the Viennese mayor Karl Lueger (1844–1910) who was very antisemitic. In ***Mein Kampf***, Hitler praised Lueger as 'the greatest German mayor of all times'. Lueger opposed Austro-Hungarian dualism and advocated a federal state. When the Christian Social Party won two-thirds of the seats in the Viennese municipal council in 1895, he was elected mayor, but he was regarded as a social revolutionary. Clearly, Hitler was deeply influenced by Lueger while he lived in Vienna from 1907 to 1913, which was a city with a large Jewish community.

During the First World War (1914–1918), Hitler was a soldier in the German army. At the end of the war many German soldiers could not accept their defeat. Some say that the German army command blamed a conspiracy between the Jews and the Communists to betray Germany and thus 'stab in the back' as this postcard illustrates. The Rothschilds closed the Frankfurt branch in 1901. The Vienna branch was shut down in 1938 after the Nazis invaded Austria. Louis Nathaniel de Rothschild (1882–1955) was arrested in Austria. He was released only after paying the Nazi ransom of $21 million – the highest ransom perhaps ever paid. Nevertheless, the myth that the Jews were funding the Allies against Germany was a popular allegation. This is actually a common human trait just as the South blamed the blacks for losing the American Civil War in 1864. Someone else always must be blamed to save face.

In the end, Hitler's attack on the Jews cannot be viewed purely as just anti-sematic. There was also a profit to be had. Jewish assets were confiscated the same as Edward I had carried out. Hitler executed the Jews whereas Edward I had banished them. The Spanish crown did the same. The Jews converted or were banished, and the property was confiscated by the state. The confiscation of Jewish assets was a major funding source for the Third Reich.

Hitler also passed on April 7th, 1933, the Law for the **Restoration of the Professional Civil Service** which forced all "non-Aryans" to retire from the legal profession and civil service. Then on the 21st of April, Hitler outlawed the kosher ritual shechita.

The month, on May 10th, 1933, student groups at universities across Germany organized a series of book burnings. Everything they determined was associated with an "un-German spirit" was tossed into the flamed. Any books by Jewish authors such as Brecht, Einstein, Freud, Mann and Remarque, just to mention a few, were all thrown into the fames. In Berlin, some 40,000 people gathered to hear a speech by the propaganda minister, Joseph Goebbels, in which he pronounced that "Jewish intellectualism is dead" and endorsed the students' "right to clean up the debris of the past."

That same month, the Nazi Party introduced legislation to legalize eugenic sterilization. By mid July 1933, any attempt to form a political party was outlawed. In August, the Nazi Party began issuing lists of people, whose German Citizenship, Passports and other privileges were to be withdrawn. Then on October 16th, 1933, Hitler announced its intention to officially leave the League of Nations.

Previously at the Lausanne conference of 1932, Britain, Germany and France agreed to settle war debts among themselves with an informal understanding provided an agreement was reached with the US regarding the debts of France and Britain. The British and French both defaulted on their war-debt payments to the United States in 1933. In January 1934 Congress passed the **Johnson Act** prohibiting any further government lending to nations in default on their debts to the United States. For all practical purposes, German Reparations was a dead issue. Hitler was not yet in power, but he was always against Versailles and the Young plan.

The German strategy to rearm its military was actually brilliant. They realized that no matter what they would propose, the French would always deny any concession. They decided to make idealistic offers of limited rearmament with the expectation that all such offers would be rejected by the French, and this would then justify allowing Germany to go on ultimately with the maximum rearmament. In October 1933, the Germans again walked out of the conference, stating that everyone else should either disarm to the Versailles level, or allow Germany to rearm beyond Versailles.

With both Britain and France defaulting on their debts to America in 1933, Hitler saw no reason to do the same. Germany still owed the loans from American and other creditors when Hitler came to power. Hitler now defaulted on these loans in 1935 after several threats to do so with Hjalmar Schacht (1877–1970), who had been President of the Reichsbank until 1930 and then Finance Minister in 1934 to 1937, encouraging the default. They thought Multilateral world trade was dead and resorted to autarky (and eventually robbery of Jews and occupied countries as a means of finance). By September 1935, the 7th Nazi Party Congress was held in Nuremberg, and it was called the **"Rally of Freedom"** (Reichsparteitag der Freiheit) in reference to the reintroduction of compulsory military service and German **"liberation"** from the **Treaty of Versailles**.

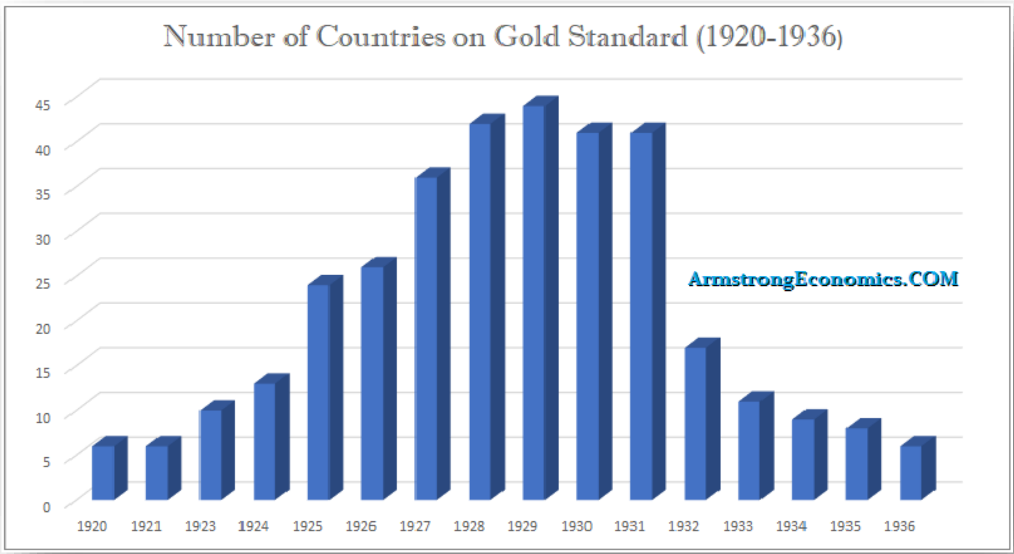
The default on the Weimar Republic bonds by Hitler did not line his pockets with gold. To the contrary, it merely stopped the bleeding of the German economy led by France. It was clear that when Hitler came to power in 1933, there would be no debt Reparation Payments. The 1935 defaults prevent capital outflows. Hitler actually declared:

> *"We were not foolish enough to try to make a currency [backed by] gold of which we had none, but for every mark that was issued we required the equivalent of a mark's worth of work done or goods produced. . . .we laugh at the time our national financiers held the view that the value of a currency is regulated by the gold and securities lying in the vaults of a state bank."*

– Adolf Hitler, quoted in "Hitler's Monetary System," www.rense.com, citing C. C. Veith, *Citadels of Chaos* (Meador, 1949)

Nonetheless, there were extensive issues of silver coinage under the Nazi regime that were 90% pure silver. There were no gold coins ever produced.

The Gold Standard & the Contagion of Deflation



The gold standard became the key factor behind the Great Depression creating austerity and intense worldwide deflation associated economic contraction. The gold standard is deflationary, and the idea was supported when countries had to borrow money. Under a gold standard, a lender would expect to get the same value back upon repayment of the loan. Conversely, the idea was to benefit the lender and it was not based upon economic growth.

In a closed economy under the gold standard, a country's money supply is determined by its stock of gold. To increase its money supply, the government must mine more gold. Thus, the gold standard would cause a severe deflation in the world economy detached from the actual economic growth or potential of the people to produce. If there were only 10 gold coins in the country and there were 10 people, the value of those coins would rise if the population grew to 20 without increasing the supply of gold. In this manner, the gold standard is actually deflationary, and it would not matter if it were platinum or seashell based provided the object being used had a fixed supply. Following World War I, the number of nations on the gold standard increased until that peaked in 1929 in time to a Sovereign defaults to come in 1931.

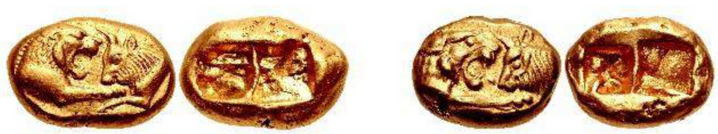
LEGAL RESERVE REQUIREMENTS

COUNTRY	BACKING FOR	BACKING %	GOLD & FX %
Belgium...	Notes & Demand Liabilities	30%	40%(*)
France......	Notes & Demand Liabilities	35%	-
Germany....	Notes	30%	40%
Switzerland...	Notes	40%	-
United Kingdom	Notes in excess of £280 million	100	-
United States	Deposits	35%	-
	Notes	40%	-

(*)Belgium shifted from a gold exchange to a gold standard in August 1930
Source: Federal Reserve Bulletin, August 1930, p502

Moreover, when you say some country is on the gold standard, what most people fail to grasp is that hardly means there really is a standard. As always, the definition varies from country to country. The percentage of actual gold backing varies and what they are actually backing varies as well.

The First Debasement of Coinage due to War Expenditures



LYDIA Kroisos AV Stater (18mm, 10.75 g)
Circa 564/53-550/39 BC Heavy standard
Sardes mint Pre-Debasement

LYDIA Kroisos AV Stater (16mm, 8.08 g)
Circa 550/39-520 BC Reduced Standard
Sardes mint - Debasement

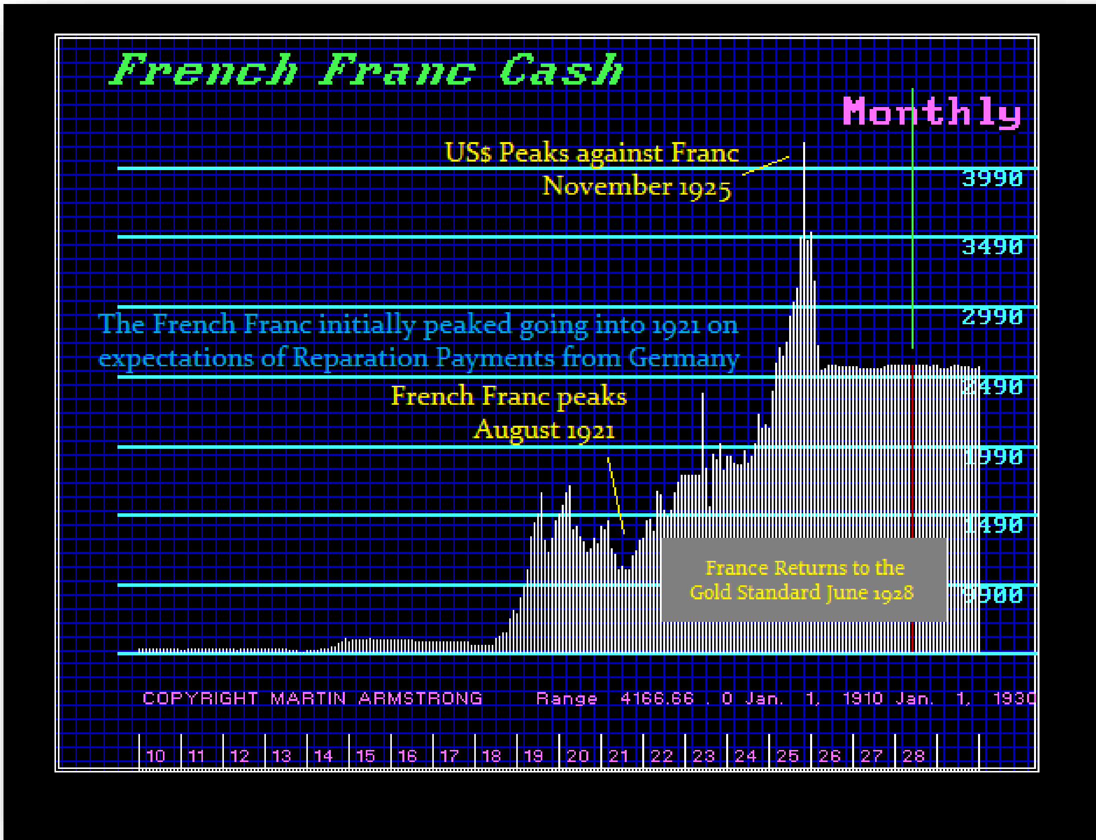
ArmstrongEconomics.Com

The gold standard has no precise date of origin. Merely because ancient empires used gold in their coinage, even they would vary the quality of fineness as well as the weight depending upon the immediate business cycle. Here are gold coins from Lydia which was the city that invented coinage. The weight of the coins was reduced as the expenditures for war increased. Here we have evidence of inflation still taking place due to war from the 6th century BC.

The gold standard gradually emerged around 1865–1880 when most of the industrial nations of Europe adopted the gold standard. (Great Britain adopted the gold standard in 1821, Australia in 1852, Canada in 1853, France in 1878, Germany in 1871, the US in 1879). The Latin Monetary Union (LMU) was a 19th–century system that unified several European currencies into a single currency much like the Euro today. It was established in 1865 and disbanded in 1927. Many countries minted coins according to the LMU standard even though they did not formally accede to the LMU treaty.

The LMU adopted the specifications of the French gold franc, which had been introduced by Napoleon I in 1803. It failed because it was also not exclusive, and nations would also print money while pretend to be on a gold standard.

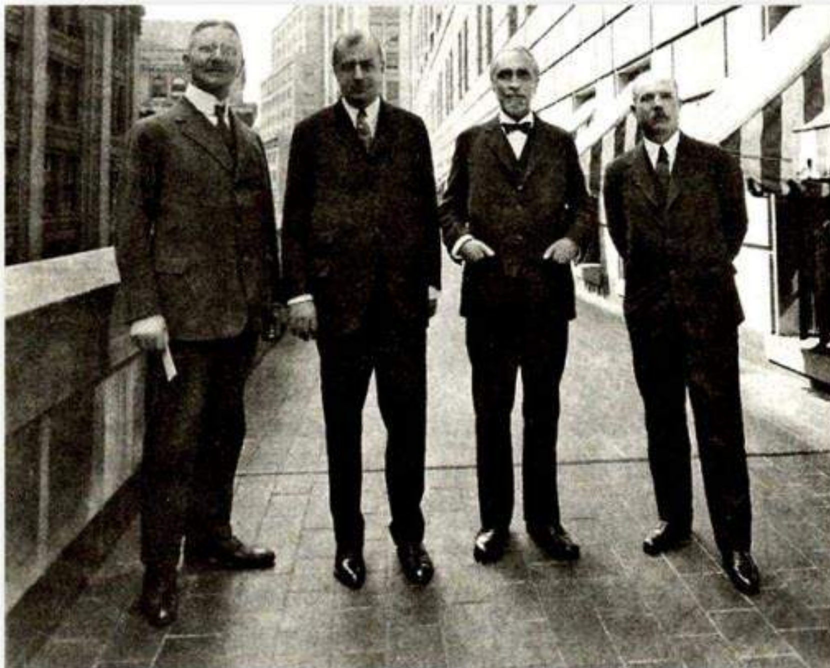
The gold standard lasted until 1914, before the outbreak of World War I. There was no formal treaty or agreement and no treaty was actually signed. Each nation defended its currency in terms of gold. Its treasury or central bank was required by law to buy and sell gold without limit at the stated price. The public had complete confidence in the convertibility of its currency into gold and that was the key – a check against the corruption of government.



While the tightening of U.S. monetary policy during 1928 is often blamed for having initiated the downturn, we can see that the stock market doubled going into 1929. The higher interest rates did not create the economic downturn in the USA, they did in fact attract refugee gold from Europe.

France saw the franc peak during August 1921 on expectations that they would make a fortune through German Reparation Payments. From that point onward, when it became obvious Germany could not pay such vast sums, the French franc plummeted and finally bottomed in November 1925. Britain returned to the Gold Standard on June 1st, 1925. Many other countries followed Britain in returning to the gold standard. As expected, this was viewed to restore a period of relative stability but that meant also deflation – austerity.

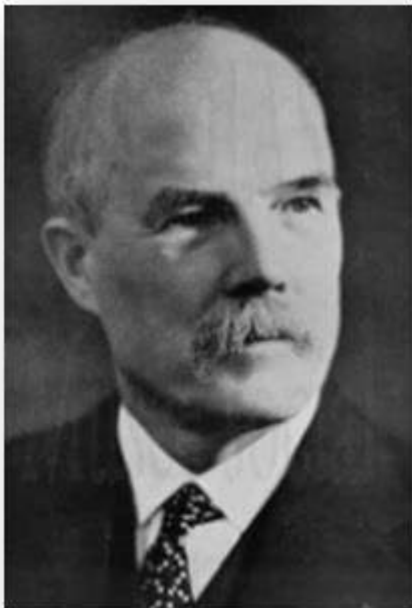
In France, there was a struggle between the Bank of France and the government over the timing and level of franc stabilization between 1926 and 1928. During this period the Bank of France, under its new Governor of the Banque de France, Georges Robineau, had abandoned its commitment to pre-war parity unlike that of the British. It was not until de facto stabilization of the franc was finally achieved in December 1928 at a rate of 122.50 francs/£.



Secret Meetings of the Central Bankers Germany - USA - Britain - France

On July 1, 1927, Montagu Norman of Britain was accompanied by Hjalmar Schacht, head of the German Reichsbank. They were joined by Charles Rist, governor of the Banque de France. All three went into conference with Benjamin Strong to discuss the weak reserve position of the Bank of England and the capital flight from Europe to America. It was hoped that lowering US interest rates would deflect the capital inflows from Europe.

The war created much distrust among nations, and this filtered over between central banks as well throughout the 1920s. To some extent, this also created a problem of trying to maintain the gold standard post WWI with the failure of central bank cooperation. In fact, during the first half of the 1920s, central bank cooperation was really limited to London and New York, falling to the personalities and reasoning of the Bank of England governor, Montague Norman, and his American counterpart Benjamin Strong. There was distrust of France who was driving the demand for Reparations from Germany that appeared vindictive if not approaching the Carpet–Bag era of post American Civil War. This is why the 1927



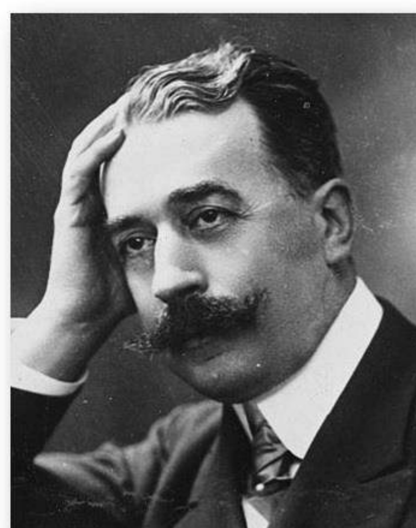
Charles Rist
(1874-1955)
Sub-governor Banque de France (1926-1930)

meeting of central bankers in creating the first G4 was so important during this period.

Actually, as early as 1922 the leading French economists such as Charles Rist (1874– 1955), who was an advisor to the post–WWI socialist governments and served as a sub–governor in the Banque de France, and others, began to realize any attempt to return to the gold standard at the old prewar parity would come at far too high an economic cost. Nevertheless, Rist was a staunch believer in the gold standard and wrote in 1952 Défense de l'or, [English 1962 transl. The Triumph of Gold].

The politicians made it increasingly difficult for the Treasury to manage the floating French debt. As the market realized that France would not be able to restore the franc to prewar parity as Britain had adopted, the franc began its decline into 1925. Politicians were facing the paradox of maintaining a strong currency which produces deflation, or a depreciating currency to support the economy. Politicians were simply paying lip–service to the idea of an ultimate return to parity.

This became a universal rule on the eft and right because the strength of the nation was wrapped up in this old–world view of the currency value. Étienne Clémentel (1864–1936), the French Minister of Finance from June 9th, 1914 to June 13th, 1914., said in 1924, it was necessary to defend the franc as one had had to ***"defend the first line of the trenches"*** in the war. This was the attitude at that point in time.



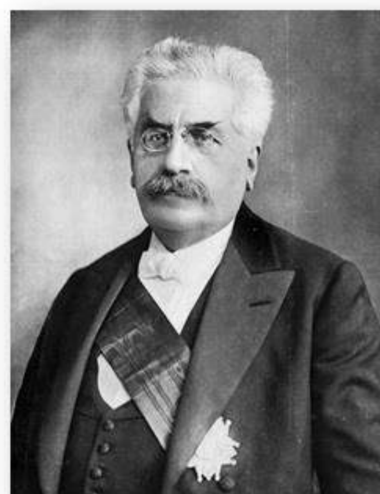
Étienne Clémentel
(1864 – 1936)
French Minister of Finance (June 9th - 13th, 1914)

The French election of May 1924 saw the Cartel of the Left (Cartel des Gauches) come to power. This was a governmental alliance between the Radical–Socialist Party and other smaller left–

republican parties. The Cartel des Gauches won general elections in 1924 and later again in 1932. The first Cartel was led by Radical-Socialist Édouard Herriot (1872–1957) of the Third Republic who served three times as Prime Minister and for many years as President of the Chamber of Deputies.

The politics of French public finance produced similar distress and political fragmentation. The parliamentary crisis under the Cartel de Gauches emerged in primarily because of the incompatibility between socialists and moderates among the left coalition. What emerged was conflicting interests within the middle-class parties themselves. The new government was confronted with a budget deficit, but also a limit upon money in circulation that was enforced by a rigid monetary orthodoxy of austerity.

Just a few days after Finance Minister Étienne Clémentel took office, the new Directeur du Mouvement General de Fonds (the Treasury), Pierre de Mouj, urged the government in his report of June 27th, 1924 to press immediately for a higher ceiling and for another renegotiation of the 1920 Francois-Marsal convention that obligated the state to repay the Bank of France two billion francs per year. He pointed out that issuing short-term paper to lend that to the Treasury from the Bank of France was still creating money. The short-term paper could not be rolled, and the public was not keen on buying long-term debt. Therefore, Pierre de Moüy, chose to resist the public demand of a return to gold (with the revaluation and the deflation it implied). He tried to stabilize the franc progressively, but without any clear target. This made France wait until the Poincaré stabilization in 1926 for any stabilization of the Franc and its sharp decline which accelerated in 1924 moving into 1925.

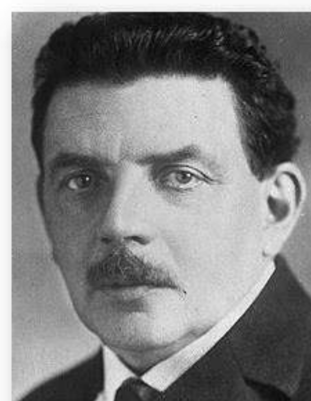


Alexandre Millerand
(1859-1943)
President of France (1920-1924)

The Bank of France, on the other hand, insisted on orthodoxy – austerity. Clémentel accepted that position and said: ***"The danger of inflation under whatever insidious form it might be presented is a death threat to be avoided at any price."*** Clémentel and everyone else simply accepted this judgment and adopted the rules of the old-world game of finance rather than challenge the bankers which would only risk a defeat in parliament. They attempted the progressive approach to try to stabilize the franc within a floating exchange rate system.

Between the political fragmentation among the left and the fiscal policy of orthodoxy, the Cartel de Gauches was politically and economically doomed. The left and the right were merely clashing with each other much as we see today between Democrats and Republicans in the United States. Such political confrontations ensure inaction. Alexandre Millerand (1859–1943) was the President of France from September 23rd, 1920 to he was forced to resign on June 11th, 1924. Millerand was accused of favoring conservatives in spite of the traditional neutrality of French Presidents and the composition of the legislature. He had previous escaped an assassination attempt by a French anarchist. Millerand had enough. He resigned in the face of growing conflict between the elected legislature and the office of the President. He was replaced by Gaston Doumergue, who was the president of the Senate at the time.

While the left was celebrating their power, their attempts to subjugate the country to their will only stimulated organization on the right building a period of great political confrontation which even supported the rise of French fascists. Political confrontations and street violence rose to denounce the leftist threat to liberty. Their quest to remove Millerand, only left the presidency of the Senate to be taken by moderates transforming the Senate itself into a conservative opponent furthering the anger of Socialists and militant Radicals.



Édouard Marie Herriot
(1872–1957)
Prime Minister June 15th, 1924 – April 17th, 1925)

When the left-wing Cartel des Gauches government came to power in 1924, it was presented with a report written by Pierre de Moüy dated July 27th, 1924, who was then the director of the Treasury, advocating the abandonment of deflation. But left-wing governments who inherit a calamitous financial situation are often particularly timid as a result of a desperate need to display their financial rectitude. So, the Cartel des Gauches blinked failing to seize the opportunity which sealed its fate because the Bank of France then had a powerful weapon against the left.

Since March 1924 the Bank of France had been doctoring the published figures on the level money in circulation in order to hide the truth fearing a collapse in

Raymond Poincaré
(1860–1934)
(President of France 1913-1920)
(Prime Minister Prime Minister 1926-1929)

confidence as plague Germany. Creating fake economic number was the policy of Governor of the Banque de France, Georges Robineau, and the regents of the bank were not informed at the time. Later, on June 26, 1926, then French Minister of Finance Joseph Caillaux had Robineau removed from office and replaced by Émile Moreau (1868–1950).

Georges Robineau had refused to allow France's gold reserves to be used to help stop the devaluation of the franc. He was extremely hawkish with respect to monetary stabilization to the point of faking the number to proect the currency. Many outsides of the Bank did not realize until 1930 that the faux bilans had started before the arrival to power of the Cartel des Gauches. Prime Minister Édouard Marie Herriot (1872–1957) (in office June 15th, 1924 – April 17th, 1925) was not informed of this trust issue until October 1924. Although the practice of faux bilans had originally been devised in order to help the government out of its financial crisis. Once the bank decided to publish the true figures in April 1925, the Herriot government fell, and the dollar rose against the franc in a panic that did not peak until November 1925.

Raymond Poincaré (1860–1934) who was the President of France 1913 to February 1920, returned as the head of a coalition government of national unity and became Prime Minister July 23rd, 1926 until July 29th, 1929. Poincaré's government rapidly reversed the decline of the franc. It took a number of financial reform measures, but in truth, it was a matter of restoring public confidence and it was his reputation that carried the day. The franc stabilized without being fixed to the gold standard demonstrating it was a matter of confidence more than anything else. The concern began to turn to the question of the franc rising too much which would unleash deflation.

By the end of the year the danger was that the franc would appreciate too far, jeopardizing the economy. Once the franc was firmly anchored again, this method of blackmail would no longer work. The French stopped issuing gold coins in 1915. They resumed in 1929. However, about the same amount of gold which was 20 francs in 1915 was now denominated at 100 francs. The French did not attempt to reestablish prewar parity as was the case with the British. Consequently, France returned to gold but at a parity which undervalued the franc. Fearing inflation, France sterilized its gold inflows to prevent a rise in prices declining to monetize the gold.

After re–reading the memoirs of Governor of the Banque de France Emile Moreau who served between 1926 and 1930, Milton Friedman said that he ***"would have assessed responsibility for the international character of the Great Depression somewhat differently"*** than he did originally in his Monetary History with Anna Schwartz, by laying some of the blame on France as well.


OAKLAND, CALIFORNIA, SUNDAY, JUNE 24, 1928

FRANCE RETURNS TO GOLD STANDARD IN VOTE TO BE TAKEN BY DEPUTIES TODAY

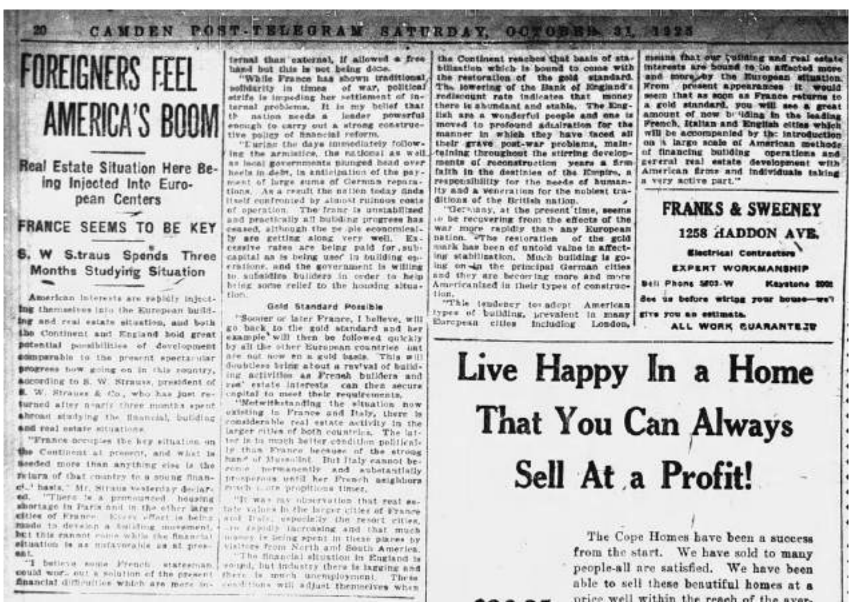
Passage of Stabilization Measure Forecast By Attitude of French Chamber

Both the Federal Reserve and the Bank of France were determined to prevent inflation and were not expanding the money supply but were hoarding gold inflows thereby engaging in sterilization preventing them from providing the required increase in the quantity of money. France's contribution to this process was driven by the fear of hyperinflation that Germany had experienced. The hoarding of gold by France was much greater than economists ever knew including Freidman. Friedman commented that if he was rewriting his work today, he would have to "paint a slightly different picture, one which made the great contraction and worldwide depression a consequence of the joint actions of both France and the U.S."

There was much speculation on real estate in France after the war because it was assumed that they would return to the Gold Standard and thus the value of property would rise to the new value of the French Franc.

The American real estate boom in Florida peaked in 1927. Here we see that real estate speculation was also ramped rushing into Europe, particularly France, in hopes that a return to the Gold Standard would create a windfall profit for American speculators.

As you can easily see, international capital flows were critical even back during the 1920s. This idea that globalization is something new is really unfounded.



20 CAMDEN POST-TELEGRAM SATURDAY, OCTOBER 31, 1925

FOREIGNERS FEEL AMERICA'S BOOM

Real Estate Situation Here Being Injected Into European Centers

FRANCE SEEMS TO BE KEY

S. W. Straus Spends Three Months Studying Situation

American interests are rapidly injecting themselves into the European building and real estate situation, and both the Continent and England hold great potential possibilities of development comparable to the present spectacular progress now going on in this country, according to S. W. Straus, president of S. W. Straus & Co., who has just returned after nearly three months spent abroad studying the financial, building and real estate situations.

"France occupies the key situation on the Continent at present, and what is needed more than anything else is the return of that country to a sound financial basis," Mr. Straus yesterday declared. "There is a pronounced housing shortage in Paris and in the other large cities of France. Every effort is being made to develop a building movement, but this cannot come while the financial situation is as unfavorable as at present.

"I believe some French statesman could work out a solution of the present financial difficulties which are more internal than external, if allowed a free hand but this is not being done.

"While France has shown traditional solidarity in times of war, political strife is impeding her settlement of internal problems. It is my belief that the nation needs a leader powerful enough to carry out a strong constructive policy of financial reform.

"During the days immediately following the armistice, the national as well as local governments plunged head over heels in debt, in anticipation of the payment of large sums of German reparations. As a result the nation today finds itself confronted by almost ruinous costs of operation. The franc is unstabilized and practically all building progress has ceased, although the people economically are getting along very well. Excessive rates are being paid for substitute capital as is being used in building operations, and the government is willing to subsidize builders in order to help bring some relief to the housing situation.

Gold Standard Possible

"Sooner or later France, I believe, will go back to the gold standard and her example will then be followed quickly by all the other European countries that are not now on a gold basis. This will doubtless bring about a revival of building activities as French builders and real estate interests can then secure capital to meet their requirements.

"Notwithstanding the situation now existing in France and Italy, there is considerable real estate activity in the larger cities of both countries. The latter is in much better condition politically than France because of the strong hand of Mussolini. But Italy cannot become permanently and substantially prosperous until her French neighbors reach more propitious times.

"It was my observation that real estate values in the larger cities of France and Italy, especially the resort cities, are rapidly increasing and that much money is being spent in these places by visitors from North and South America.

"The financial situation in England is sound, but industry there is lagging and there is much unemployment. These conditions will adjust themselves when the Continent reaches that basis of stabilization which is bound to come with the restoration of the gold standard. The lowering of the Bank of England's rediscount rate indicates that money there is abundant and stable. The English are a wonderful people and one is moved to profound admiration for the manner in which they have faced all their grave post-war problems, maintaining throughout the stirring developments of reconstruction years a firm faith in the destinies of the Empire, a responsibility for the needs of humanity and a veneration for the noblest traditions of the British nation.

"Germany, at the present time, seems to be recovering from the effects of the war more rapidly than any European nation. The restoration of the gold mark has been of untold value in affecting stabilization. Much building is going on in the principal German cities and they are becoming more and more Americanized in their types of construction.

"This tendency to adopt American types of building, prevalent in many European cities including London, means that our building and real estate interests are bound to be affected more and more by the European situation. From present appearances it would seem that as soon as France returns to a gold standard, you will see a great amount of new building in the leading French, Italian and English cities which will be accompanied by the introduction on a large scale of American methods of financing building operations and general real estate development with American firms and individuals taking a very active part."

ASBURY PARK EVENING PRESS, 20 TUESDAY, DECEMBER 21, 1926.

FRENCH WEALTH NOW CUT IN HALF

Seydoux Claims War Losses, Reparations, Inflation Have Wrought Havoc.

FINAL PROSPERITY IS CERTAIN, HIS OPINION

By EDWARD PRICE BELL

"Let no one suppose that France's postwar problems will do to France what Germany tried to do to her—namely, overwhelm her," said Jacques Seydoux, underdirector at the ministry of foreign affairs, Paris, continuing the conversation partially reported in a previous article. "History pretty well establishes the postulate, I think, that France is unconquerable."

"Observers generally remark upon what strikes them as great prosperity in France."

"Yes. Usually, only one reason is assigned for our apparent prosperity, but there are two—inflation, which is momentary, and the quality of the French worker, which is permanent. Inflation, for a time, augments exports, thus stimulating business from the land up. But inflation is costly, and ultimately its full price must be paid. French sobriety, thrift and efficiency, however, are unfailing factors of stability and prosperity in France."

"Will stabilization, when it comes, cause a serious crisis?"

"It will cause a crisis. How serious the crisis will be one cannot foresee. But I expect no sensational, no grave, no prolonged sequel of maladjustment. French agriculture and industry have been modernized entirely since the war. Our economic position, therefore, is strong. Basically, we should be affected but slightly by the forthcoming return to the gold standard. Of course, exports will be reduced — temporarily, at all events — and this contraction will have its natural radiant effects, of which one will be unemployment. But we have in France 3,000,000 foreign workers, drawn to us by our economic needs. As these needs—needs of the farm, the factory, the mine—diminish, our immigrant workers will tend to go home, and so we shall escape the extensive unemployment suffered by countries like Austria, Germany and England."

Against Hasty Deflation.

"You will not stabilize precipitately?"

"Under Poincare, we shall do nothing precipitately. If the Scotch proverb, 'Haste makes waste, waste makes want,' is true generally it is true particularly in a case of attempted escape from the almost countless evils, actual and imminent, of inflation. When the franc, for example, is going down, capital is vanishing, and holders of French ready money or its equivalent are distressed and alarmed. When the franc, on the other hand, is going up—especially if it goes up too rapidly—holders of French securities dependent upon industrial prosperity are likely to cry out or rush to sell; they fear the partial or total loss of their dividends. Hence, once your money has soared away from the gold standard you must use caution in bringing it back to that basis, lest you plunge your industry and finance into chaos.

"France, please note, did not inflate wantonly. It no more could avoid inflation than it could avoid invasion. Our most productive provinces were laid waste; they presented, when the invader was forced out, a spectacle of desolation unparalleled in the history of the world. This blow was what sent the franc reeling, so to speak. We are compelled to rebuild at our own expense. Just as America claims for debts contracted by foreign countries, so France claimed for damages caused by the enemy; but when the Dawes payments started (in September, 1924) France had received reparation payments to the extent of only about 140,000,000 marks (some $35,000,000), or the veriest bagatelle. Inflation, in these circumstances, was salvation, for our roads, bridges, farms and mines, had to be restored, and our factories, cities and villages rebuilded, in order that our dispossessed and shelterless people might labor and live. We would urge the world never to forget these agonizing chapters in the war and postwar history of France."

"How much of the work of reconstruction had been done when the Dawes payments started?"

When Case Was Reversed.

"Eighty percent. Six years had elapsed since the armistice, and we had received only $35,000,000. Contrast that with what France did some two generations before. Three years after we were invaded on that occasion we had discharged completely the debt of $1,000,000,000 militarily imposed upon us by Germany, and this imposition represented merely military expenses, since Germany had not been invaded and had suffered no damage on her own soil."

"How much do you reckon that the wealth of France has been reduced by the war?"

"Berenger showed accurately in Washington that a typical French fortune consisting of the best French securities had shrunk more than 82 percent. Tradespeople, manufacturers and those who had invested their wealth in foreign securities appear at present to have escaped this loss. It is only appearance. Whenever the currency is brought back to the gold basis it will be seen that the whole country has sustained a diminution in wealth. To measure this diminution is difficult, but we know that it will be not less than 50 percent of our pre-war wealth. One full generation, with peace and a good government, will be necessary to restore French wealth to its former level. Our hope is rooted in the fact that our population, on various occasions has been similarly, tho not so terribly, stricken and invariably has remade its fortunes thru its efficient work and its rigid thrift."

"Your expatriated money will come back?"

"It will come back as soon as we stabilize on gold. The flight of capital is the greatest danger besetting a country in financial trouble. Our currency resting steadily upon gold, we shall see happening here the same thing which happened in Germany after stabilization there; our exiled capital will return of its own motion and the Bank of France will be overloaded with foreign currency as the Reichs bank in Berlin is overloaded today."

"Your financial situation is in the way of permanent improvement?"

To Disarm Slowly.

"It is. Only political oscillation could check this improvement. Given political stability at home and peace abroad—assured, as we are, that the Poincare government will push resolutely along the track it has traced so far—all will go well with the franc and, in the end, with French prosperity."

"Shall you seek a foreign loan?"

"No one can tell now. The Poincare government has increased taxes and balanced the budget, prepared the writing off of the floating debt and effected large administrative economies. Only when all these measures begin to give calculable results can we tell whether foreign credit will or will not be necessary. Financial reconstruction, after the hurricane of the World war, cannot be accomplished in a day. We shall work back to the gold standard thru ~~much thought and step~~ by step. Great issues are involved for us, moral no less than material. Patience at home and forbearance abroad are all we require."

Touching raw materials and tariffs, M. Seydoux pleads for the utmost practical freedom, declaring that an effort by any nation to deny other nations access to an indispensable raw material "obviously would cause an outbreak of war," and that serious fiscal interferences with the commercial exchanges of the nations always must be expected to engender bitterness.

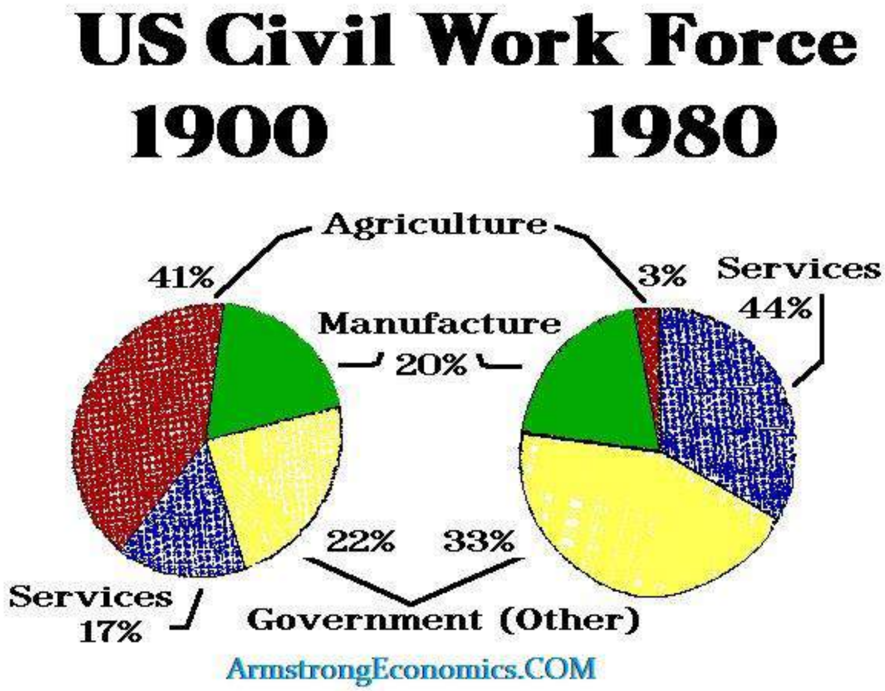
Disarmament M. Seydoux can see only as progressing slowly, tho, he hopes, surely. It depends, in his view, upon the growth of international confidence — upon the waning of international fears—and he profoundly is convinced that the United States, while integrally safeguarding its independence, could quicken such confidence and aid in allaying such fear by identifying itself formally and whole-heartedly with the League of Nations. Economically M. Seydoux favors a single European group working in agreement with America. His general economic philosophy and faith fall completely within the axiom that the interests of the world are one.

whose defense was branded in closing argument as "imaginative fiction or the grossest perjury," and whose prosecution was decried as a "travesty on justice," entered its final phase in federal court here today.

The taking of testimony ended late yesterday and arguments to the jury were in progress when court adjourned. Each side had 45 minutes in which to complete the summing up of its case today. It was expected that Judge A. F. St. Sure would give the case to the jury before night.

Intimations that perjury had entered the testimony were renewed yesterday in Assistant United States Attorney Eugene Bennett's address to the jury.

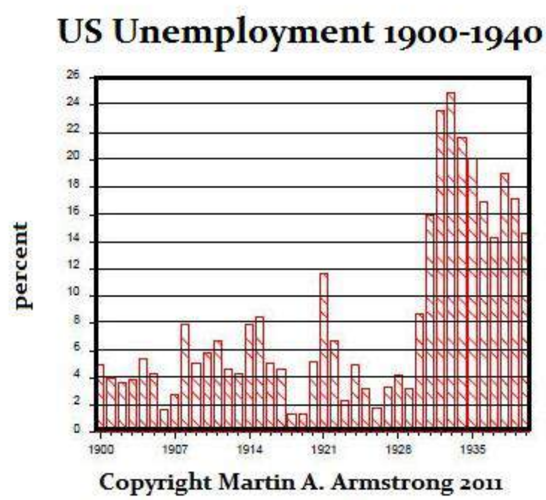
"Somebody must have lied," he declared, calling attention to numerous contradictory assertions made from the witness stand

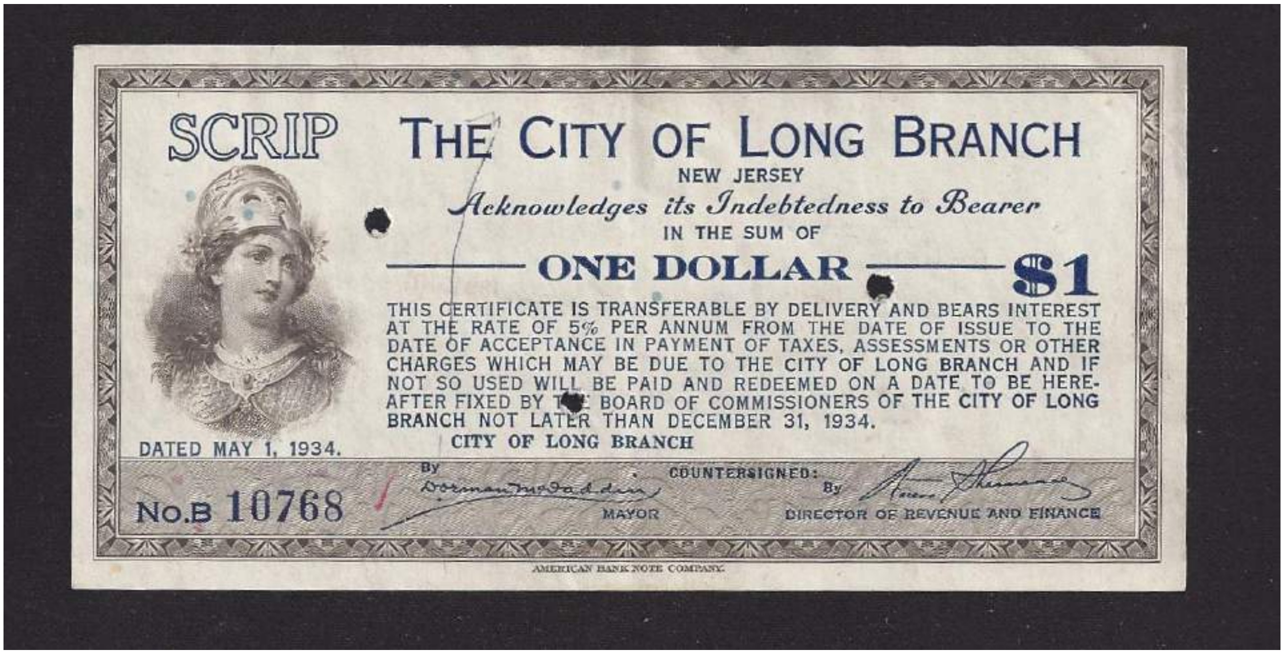


Indeed, France increased its share of world gold reserves from 7% to 27% between 1927 and 1932 and failed to monetize most of this accumulation. As illustrated previously, the same amount of gold coins now became 100 francs compared to 20 francs. This created an artificial shortage of gold reserves and put other countries under very significant deflationary pressure. This is an interesting theory, but one I feel is far too narrow.

Obviously, the United States and France shared the blame for creating global deflation by hoarding gold and sterilizing the gold flows. This effectively withdrew gold from the rest of the world increasing the deflationary wave between 1929 and 1932.

However, there were other factors involved not the least of which was also the process of technological evolution within the economy from an agriculturally based to an industrial base. This shift alone was profound in creating unemployment in the USA of 25% when the agricultural center had employed 40% of the civil workforce.





Some have argued that the Great Depression would not have been so dramatic if the USA and France were not hoarding gold and feared creating inflation. I do not buy the argument that this would have been eliminated but for this hoarding or the fact that it would have also been lessened in the steep decline.

There were over 200 cities in the United States which issued their own money known as Depression Scrip because of the shortage of money. But this also fails to address that as banks began to fail, people themselves also began to hoard their money. Spending declined not because the money supply shrunk, but because the confidence in the future among the people collapsed. They too hoarded their money which was far greater than that of the central banks. In Minneapolis. The scrip program put over 7,000 people to work and issued over half a million dollars of currency.[1]

In Detroit, the payment of over $2 million in back wages to city employees in scrip brought about an upturn in sales at local department stores. Stores that would accept it could use it to pay their local taxes to the city. Therefore, the scrip was in fact local legal tender. The equivalent of Depression Scrip in America also appeared in Canada. Of course, there was the extensive issue of German Notgeld. There did not appear to be any extensive depression scrip in use within France.

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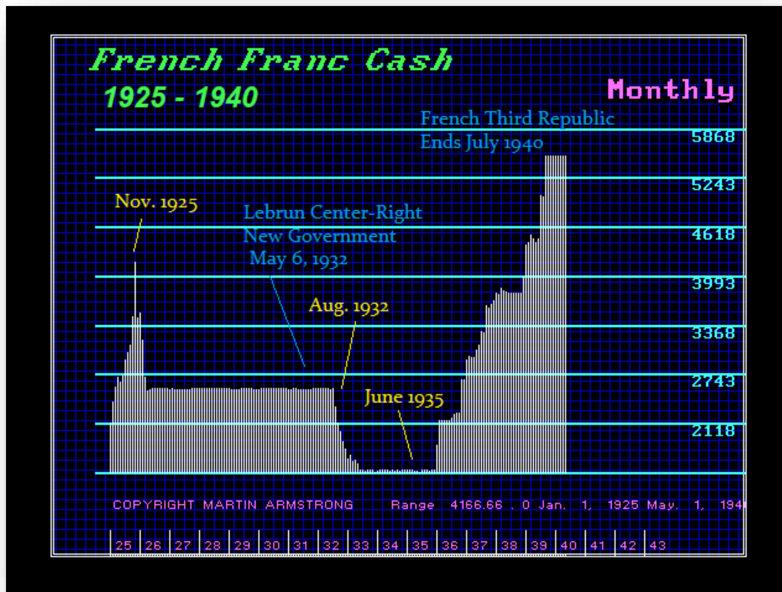
1 "The Organized Unemployed, Inc. Minneapolis, Minnesota" typescript leaflet, n.d., George Tselos collection, box 1, Minnesota Historical Society (MHS)

In May 1931 a run on Austria's largest commercial bank caused it to fail. Because the bank was partially own by the Rothschilds, they believe that they if the Rothschilds were bankrupt, the financial world was coming to an end. This led to a contagion and they began selling banks the owned outside of Austria. The bank run spread to Germany, where the central bank also collapsed. International financial assistance was too late and in July 1931 Germany adopted its exchange controls, followed by Austria in October.

The Austrian and German experiences, as well as British budgetary and political difficulties, were among the factors that destroyed confidence in sterling, which occurred in mid-July 1931. Runs ensued and the Bank of England lost much of its reserves.



Indeed, as mention previously, President Herbert Hoover (1874-1964) remarked about this contagion in his memoirs how he explained that capital "behaved like a loose cannon on the deck of the world in a tempest-tossed era." We can see that even France, with its excess gold reserves, held on the longest. Nevertheless, even France was compelled to abandon the Gold Standard.

One by one, the Great Depression forced countries off the gold standard. In September 19th, 1931, speculative attacks on the pound forced Britain to abandon the gold standard. Loans from American and French Central Banks of £50,000,000 were insufficient and exhausted in a matter of weeks, due to large gold outflows across the Atlantic as capital fled to America. The British could not employ monetary policy increasing the money supply to stimulate the economy as long as a gold standard was maintained. Australia and New Zealand had already left the standard and Canada quickly followed suit. The "Gold Cure" turned into a Gold Pague.

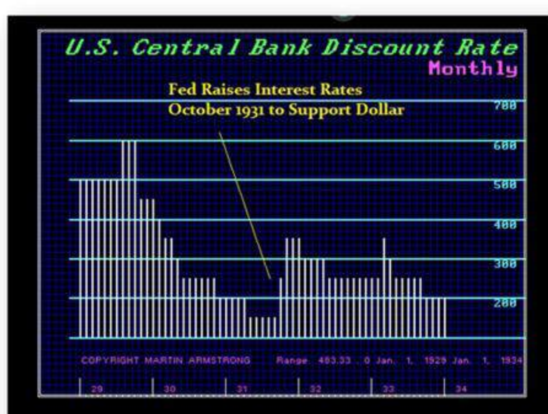
The Quantity Theory of Money & Its Failure

Milton Friedman
(1912–2006)

John Maynard Keynes
(1883-1946)

Both Milton Friedman and John Maynard Keynes developed their ideas based upon the interpretation of the German Hyperinflation being the result of an increase in the supply of money. Nevertheless, their theories were predicated upon a system that was striking different from today. The government only took part of Keynes' suggestion to increase spending to the point of creating a deficit to stimulate demand. He also never advocated perpetual spending indefinitely. Keynes also advocated lowering taxes to stimulate. Few Presidents have ever done that: JFK, Reagan, and now Trump is attempting it.

Milton argued that the Fed was following austerity refusing to monetize the gold which reached twice the required backing and raised rates to support the dollar during the 1931. Milton Friedman and Schwarz wrote:



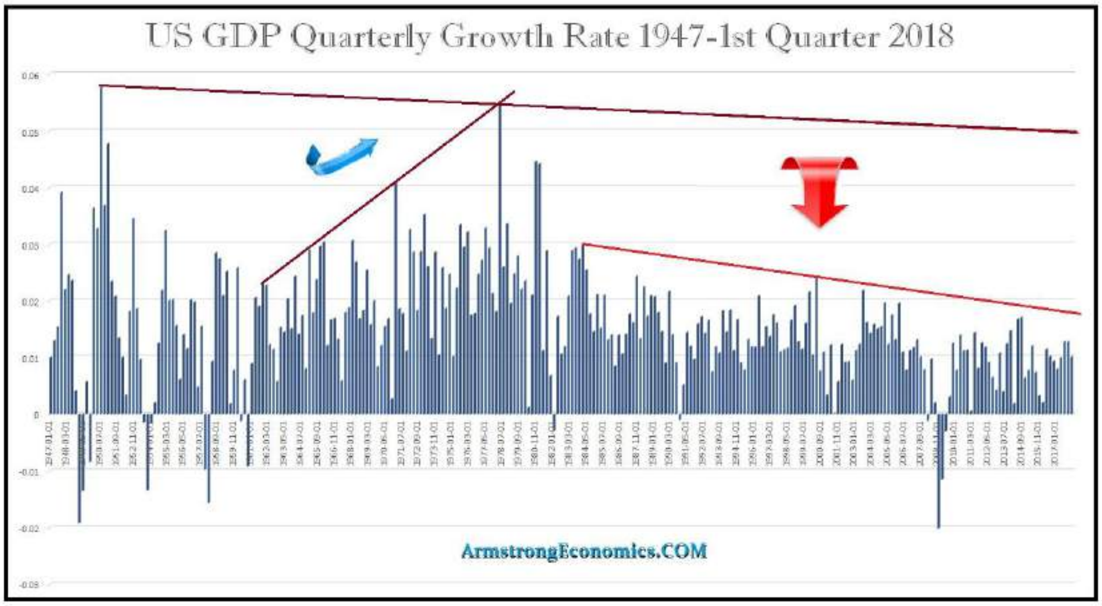
"The Federal Reserve System reacted vigorously and promptly to the external drain. . . . On October 9 [1931], the Reserve Bank of New York raised its rediscount rate to 2-1/2 per cent, and on October 16, to 3-1/2 per cent–the sharpest rise within so brief a period in the whole history of the System, before or since (p. 317)."

Milton's premise was that the Fed was doing what Germany is doing today – austerity. They were trying to support the currency to retain confidence in the bond market rather than stimulating the economy. The gold flows to the USA were excessive and the gold backing of the dollar reached double the requirement. The Fed saw this as refugee gold and declined to increase the money supply believing that austerity was the best policy to maintain confidence in government debt. As mentioned, the Bank of France engaged in the very same policy.

In theory, Milton makes sense that one should expect higher inflation if the money supply were expanded instead of contracted. Nevertheless, there are a lot of assumptions in that statement that simply do not hold up with time.

Money is only a medium of exchange. It is **NOT** a store of wealth. There is no perfect store of wealth because the business cycle exists and at time assets rise in value meaning the purchasing power of money declines (**INFLATION**) and when asset values decline as in a recession or depression, the purchasing power of the currency rises (**DEFLATION**). The terms in an of themselves are designed to shift the blame away from government in the first place. By I**NFLATION** meaning assets rise, the culprit is also blamed as private sector greed. When assets decline, they call it **DEFLATION** in the value of assets when in fact it is the rise in the purchasing power of money..

Therefore, while interesting, this argument that the Great Depression was caused in part by the Federal Reserve and Bank of France refusing to expand the money supply in fear of creating inflation is one slice of the pie, there is just a lot more going on here. This theory has been behind the entire philosophy of Quantitative Easing (QE). Expanding the money supply was supposed to create inflation yet it too has failed to do so post–2007.



Indeed, taking the QTM as the foundation behind everything in economics has been disproven when we just look closer at 10 years of QE by the ECB which has failed to create inflation or stimulate the economy. Additionally, the money supply has expanded dramatically since the 1970s, yet economic growth has been steadily contracting. Each high is lower than the previous since the 1950s.

These economic theories have completely failed to grasp the full scope of the economy and how it functions leaving us with a strange paradox. If we cannot restore economic growth and stimulate the economy with QE, then where does this leave us?

Now we have MMT (**Modern Monetary Theory**) rising which assumes that we can just expand the money supply without end which will not cause inflation because QE proves there will be no inflation after 10 years. They are ignoring the clash between fiscal policy carried out by government enforcing taxes (**DEFLATIONARY**) and monetary policy in the hand of the central banks expanding money supply (**INFLATIONARY**).

Interest Rates & their Failure as a Monetary Tool

John Maynard Keynes criticized the **Quantity Theory of Money** (QTM) in The General Theory of Employment, Interest and Money. Keynes had originally been a proponent of the theory, but he presented an alternative in the General Theory. Keynes argued that the price level was not strictly determined by the money supply. Changes in the money supply could have effects on real variables like output.

It was Keynes who viewed the Great Depression as a contraction in **DEMAND**. His solution was to manipulate interest rates in order to **"stimulate"** demand. Again, this has proven false as well since the European Central Bank (ECB) even went negative. People simply bought safes and moved their money out of banks. They will not spend until they believe in the future. You cannot **"stimulate"** demand even at 0.1% interest rates if then do not believe that will even make 0.2%.

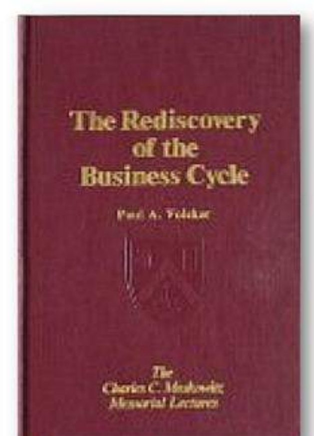
Supply side theory is aimed at increasing the supply of goods and services available to consumers by keeping corporate taxes down which will create jobs and businesses will spend on research and development creating new innovations. Apple's I–series products are examples of creating new demand by producing an innovative supply of new goods and services. Some argue that this presents a greater danger because tax cuts will reduce government revenue creating higher deficits which will weigh heavily on the future economy.

Conversely, **Demand-Side Economics** is all about increasing demand in the consumer. This has been referred to as Keynesian economics. The idea here is that

the quickest way to spur demand is to increase the relative wealth of the people who want to make purchases. This theory is mostly espoused by liberal Democrats who want to redistribute wealth by taking extra income taxes from corporations and the rich in order to redistribute it to the middle class and poor. This is really socialism under the name of **Demand-Side Economics**.

The economic view regarding **Demand-Side Economics** theory maintains that the economy can increase in two primary ways. First, it will create jobs and raise minimum wages. Tax rebates and tax cuts are two other ways to increase discretionary funds to drive consumer spending. Of course, government hates cutting taxes. They do regard that there is a danger of too much consumer demand produces inflation.

What Keynes ignored was the mere fact that at times there can be a **shortage** of say wheat due to weather which will result in prices rising irrespective of a change in the supply of money. The 1970s produced **STAGFLATION** because the costs were forcibly raised by OPEC oil embargo whereby prices rose but there was no economic growth. Keynes never quite took this potential into consideration we can call **Cost-Push Inflation** rather than pure demand.



Rediscovery of the Business Cycle
by Paul A. Volcker 1978

In 1978, former Chairman of the Federal Reserve Paul Volcker made it clear that Keynesianism failed in light of **STAGFLATION** and the economic recession of 1974-1976. His lecture was republished in a publication: the Charles C. Moskowitz Memorial Lectures. Volcker said:

> *"The Rediscovery of the Business Cycle – is a sign of the times. Not much more than a decade ago, in what now seems a more innocent age, the 'New Economics' had become orthodoxy. Its basic tenet, repeated in similar*

words in speech after speech, in article after article, was described by one of its leaders as 'the conviction that business cycles were not inevitable, that government policy could and should keep the economy close to a path of steady real growth at a constant target rate of unemployment.'

"Of course, some minor fluctuations in economic activity were not ruled out. But the impression was conveyed that they were more the consequence of misguided political judgments, of practical men beguiled by the mythology of the old orthodoxy of balanced budgets, and of occasional errors in forecasting than of deficiency in our basic knowledge of how the economy worked, or in the adequacy of the tools of policy. The avant-garde of the profession began to look elsewhere – to problems of welfare economics and income distribution – for new challenges.

"Of course, the handling of the economic consequences of the Vietnam War was an obvious blot on the record – but that, after all, reflected more political than economic judgments. By the early 1970s, the persistence of inflationary pressures, even in the face of mild recession, began to flash some danger signals; the responses of the economy to the twisting of the dials of monetary and fiscal policy no longer seemed quite so predictable. But it was not until the events of 1974 and 1975, when a recession sprung on an unsuspecting world with an intensity unmatched in the post-World War II period, that the lessons of the 'New Economics' were seriously challenged."

Time Magazine - March 1982

The mere fact that prices could rise in the middle of a recession (**Cost-Push Inflation**) was something outside the economic theories. It has still not been incorporated into any of the tools employed by central banks in their attempt to manage the economy using **Demand-Side Economics**.

Obviously, the price of something can also rise simply because of popular demand as is the case when some new toy becomes the craze for Christmas. Neither of these types of demand/cost driven price rises will ever be impacted by manipulating interest rates.

Ludwig von Mises
(1881 – 1973)

Ludwig von Mises agreed that there was a core of truth in the **Quantity Theory of Money,** but he criticized it's focus on the supply of money without adequately explaining the demand for money. He said the theory ***"fails to explain the mechanism of variations in the value of money"***. Of course, von Mises lived through the hyperinflations in Germany and Austria. He became too focused on the QTM, yet he understood there was something else lurking behind OTM by itself.

Mises maintained that all economic phenomena must to be traced back to individual decision-making, otherwise, the analysis would lead to wrong conclusions. Mises believed that decisions had to be traced back to the individual rather than from the community view, he still fell into the same trap as so many – the attempt to reduce the effect to one cause.

The Austrian theory of money is really constructed on the ideas of Ludwig von Mises's work **Theory of Money and Credit**, published in 1912. Mises took the **Marginal Utility Theory**, which examines the increase in satisfaction consumers gain from consuming an extra unit of a good or service. Utility is an idea that people get a certain level of satisfaction/happiness/utility from consuming goods and service. This has been the academic explanation of consumer demand which set the basis for the market price. Mises took the position that no longer did the theory of money need to be separated from the general economic theory of individual action and utility, of supply, demand, and price. Consequently, he concluded that monetary theory should not be confined in isolation in a context of "velocities of circulation," "price levels," and "equations of exchange."

Defining Money

Mises did not develop a proper definition of what constitutes the money supply. In current mainstream economics, there are at least four competing definitions, ranging from M1 to M4. However, the broad definition of the money supply has excluded assets that are not redeemable on demand at par in legal tender money. Therefore, anything that has a time liability, such as savings certificates, certificates of deposit (CDs) whether negotiable or nonnegotiable, and government bonds are normally excluded. Only debt instruments redeemable at par, are money substitutes under this definition. Therefore, the very definition of what constitutes the total supply of money to this day seriously impacts everything that surrounds the core economy.

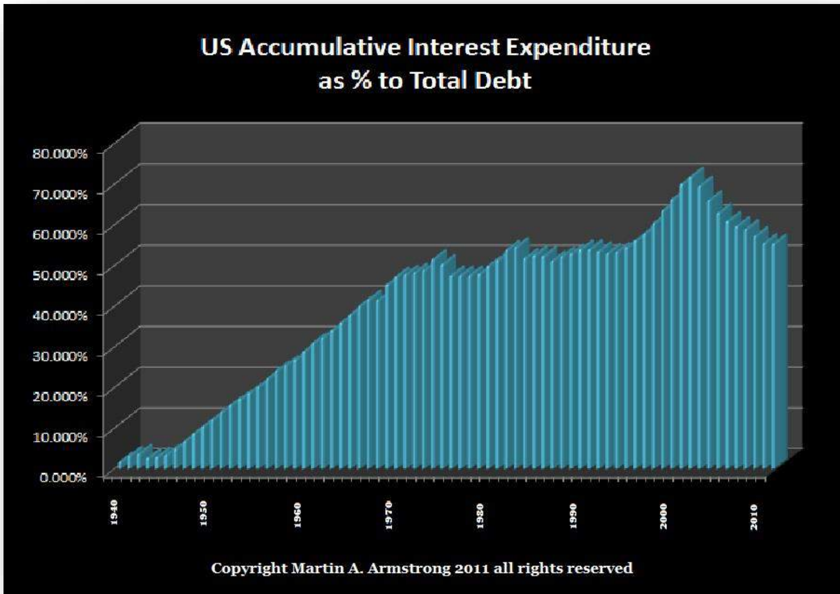
Commercial bank reserves are excluded from the outstanding supply of money definition on the theory that they are not available for use in the economy. This leads to the argument that those types of demand deposits that in turn function as reserves for the deposits of these other financial institutions must be excluded as well.

These definitions only confuse the entire analysis. If you wish to trade futures, you can put your money in the account and direct that it be kept in T-Bills – paper dated 90 days or less. There is a time element, however, it is acceptable collateral for instant trading because it is **LIQUID** and can be sold at any moment. When it was illegal to borrow against government bonds, such a savings bonds during the 1960s, then there was a critical distinction between debt and money. **Zero-coupon debt** is not acceptable for collateral.

ACCEPTABLE COLLATERAL FOR 31 CFR PART 225
(Acceptance of Bonds Secured by Government Obligations in Lieu of Bonds with Sureties)
Effective: March 26, 2018

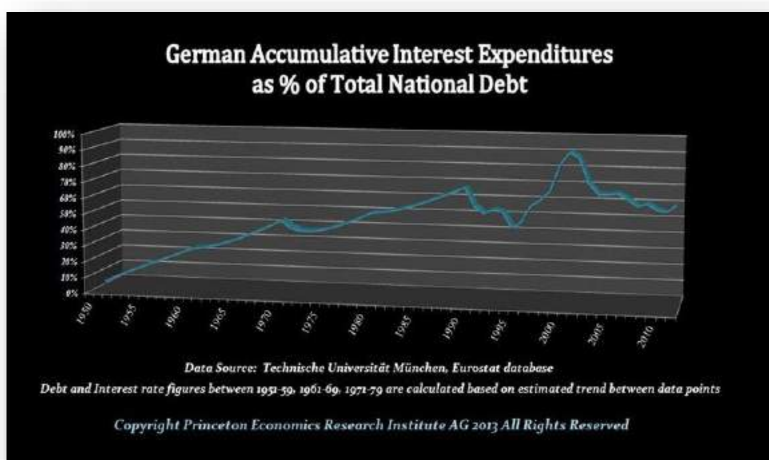
Acceptable collateral is currently limited to only public debt obligations of the United States Government whose principal and interest are unconditionally guaranteed by the United States Government (excluding stripped components).

The following classes of transferable securities are acceptable as collateral to secure obligations in lieu of a surety bond or to secure deposits of bankrupt estates under the jurisdiction of the U.S. Executive Office of Trustees or a bankruptcy court or judge. Zero-coupon obligations included in these classes, such as stripped principal and interest components, are currently not acceptable.



The evolution of the definition of what constitutes money is also what plagues our current situation and our future. Because debt was not considered part of the money supply, then it was believed that if governments borrowed rather than just created money, this would **NOT** be inflationary since the supply did not increase.

When we look at the national debts of all major Western powers, we are confronted with a shocking realization. This distinction that debt is not money is not merely wrong, it is propelling us into a complete economic meltdown. At times, up to 70% of the entire national debt is composed of accumulated interest expenditure. Since the government does **NOT** ever pay down its debt but constantly issues new debt to retire the old debt, the level of interest it takes to keep the Ponzi scheme rolling crowds out all other spending. In the USA, interest expenditures are destined to exceed military expenditure.



Banks and the Creation of Money

Then there is the external factor which creates money outside the ability of government to control. The majority of money is created as book-entries by banks. I deposit $100 in my account and the bank lends you $100. We now both have bank statements that clearly show we both have $100 in cash. In this manner, lending creates money. Obviously, the money supply can be increased domestically simply through lending.

On June 10th, 2018, Switzerland's electorate voted on a referendum calling for the country's commercial banks to be banned from creating money. The referendum proposed that commercial banks in Switzerland should no longer be allowed to create money out of thin air by lending and that in future only the Swiss central bank should have the power to create money. The very idea of introducing a "vollgeld" or "real money" system convinced voters to reject the proposals. The outcome would have created such an economic disaster. Switzerland would have committed suicide and entered a complete Dark Age unto itself. What about mortgages? The housing market would collapse under such an idea of preventing bank lending.

Capital Flows & the Creation of Money

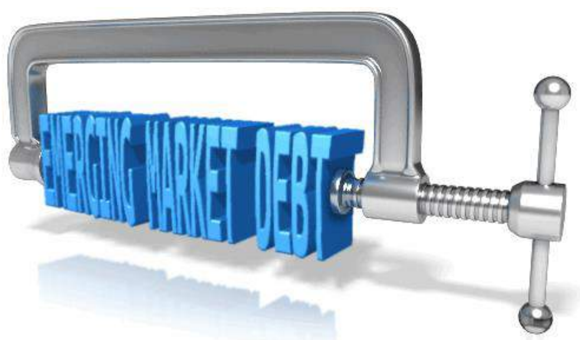
Money is also created by simple capital flows. If I owned a skyscraper in New York and sold it to another American, the transaction is neutral domestically with respect to the money supply. Even if both of us have mortgages, obviously there would be no real increase in the money supply except perhaps my profit. If I owned the building outright, then you are obtaining a mortgage would increase the money supply for I would then be monetizing that asset.

However, let us now introduce a foreign buyer. I sell the building to a Chinese investor. They bring cash into the USA (yuan) and convert it to dollars to purchase the building. Now the domestic money supply has been increased for I have the cash to now spend domestically and they have the non-liquid asset that is not part of the actual money supply.

The same is true when a foreign government buys US government debt. The payment is increasing the domestic money supply. If a foreign investor buys the Dow Jones Industrial shares, they are bringing in their currency, such as Euro, and converting it at banks to book-entry dollars. There is no creation of dollar formally by the US Treasury. Therefore, countries such as Japan had capital controls. You cannot issue a bond in Japanese yen without the permission of the Japanese government. That is not the case under the U.S. dollar.

External Creation of Money

There is also the creation of money which is entirely external to the domestic economy. Foreign governments can issue debt in the currency of another nation in order to eliminate currency risk when a currency is free without controls as is the case with the US dollar. Even two private parties in a foreign country can create a private loan in terms of dollars without asking permission of the United States. As a result, lending external to the United States can also blindly increase the supply of dollars within the world economy.



Emerging markets have introduced another problem. In order for them to sell their debt to American institutions seeking higher yield, they issued their debt denominated into US dollars. The sovereign forex-denominated debt burdens vary relative to GDP.

The Treasury and Finance Ministry of Turkey announced that the country's net external debt stock totaled $286.2 billion going into the end of the 3rd quarter 2018. The country's net external debt stock to its gross domestic product (GDP) ratio was 34.4% at the end of the third quarter of 2018. However, Turkey's gross external debt stock amounted to $448.4 billion at the end of the 3rd quarter bringing the debt/GDP ratio of 53.8%, according to the official figures.

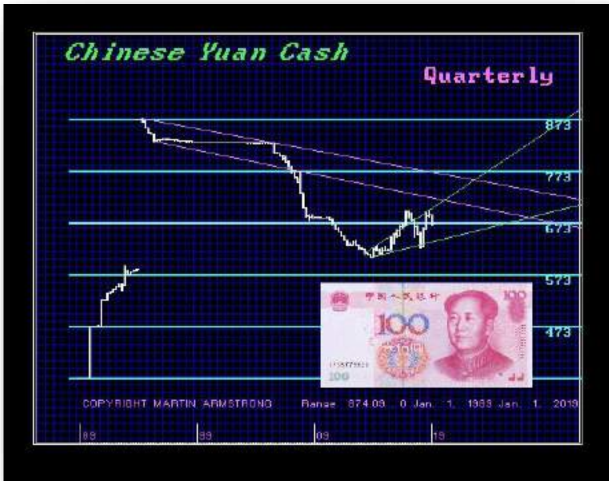
Interestingly, because of the fear of the Turkish lira, Turkish corporates have been often compelled to borrow in dollars. Therefore, the private sector's share in the country's gross external debt stock was 68.2% ($305.9 billion), while some $215.9 billion of this amount consisted of long-term debts – with a maturity of more than one year. The Turkish public sector's share of this debt was 30.6% in the country's total foreign debt which is about $21.4 billion that is short-term (under one year) with $115.7 billion in the long-term (over one year). The banking sector's (lenders and the central bank) external debt stock was $176.99 billion at the end of the 3rd quarter.

When we break this down further, 58.5% of the total gross external debt is denominated in U.S. dollars, with only 32.3% was denominated in euro. The amount denominate in Turkish lira among the external debt stock was a trifle 5.9%. This illustrates the crisis that will emerge with a change in the currency values.

The problem with issuing debt in a foreign currency is that there is never any professional risk analysis or management. The dollar debt rises exponentially in the cost to service that debt as the currency declines irrespective of interest rates. It was that very relationship which sent Germany into hyperinflation during the 1920s. If you look closely, Turkey's external debt has grown 10% just in the past year alone as its currency has declined and interest rates have risen.

Then we have the issue of rising interest rates which add to the crisis further undermining the economy. The interest must be paid in terms of the foreign currency. Also, keep in mind that they have also issued external debt in euros.

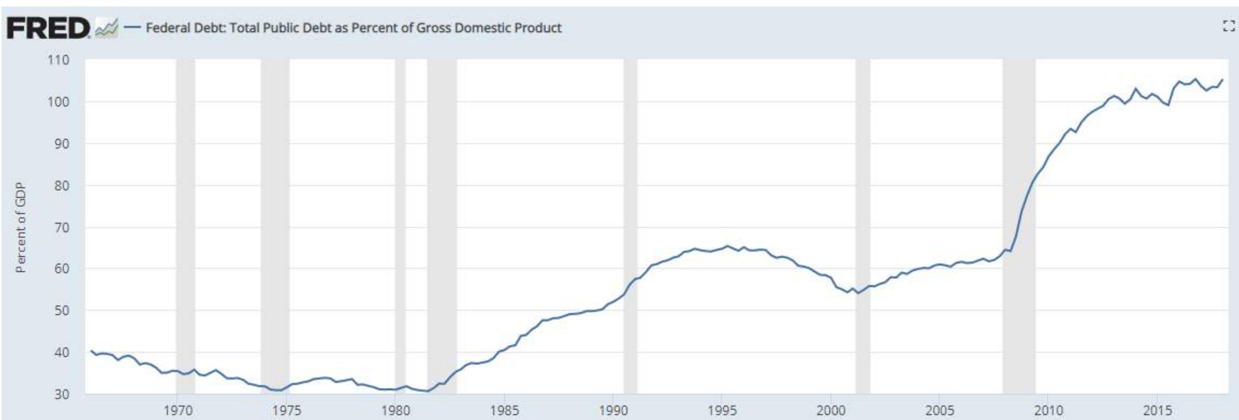
The third dimension of Emerging Market Crisis is private debt. Many private companies have also borrowed in dollars. This is true in Turkey, but also for China, which includes local municipalities and provinces.



China has previously underestimated its US$3 trillion-dollar debt and how this poses a major threat to creating a Chinese financial crisis. Property developers and other mainland companies and along with investors have borrowed dollar-denominated debt at low US interest rates mainly through Hong Kong. Once again, the risk of a rising dollar overwhelms any interest rates risk.

In many cases, this debt crisis differs significantly in a very critical manner looking at both Turkey on one side and China on the other – private debt is overlooked. Focusing only on government debt, we cannot ignore the private sector and municipality level of debt that does not impact the sovereign nation. Much of the private debt of corporations has also borrowed in dollars and euro exposing them to FX risk.

The Velocity of Money



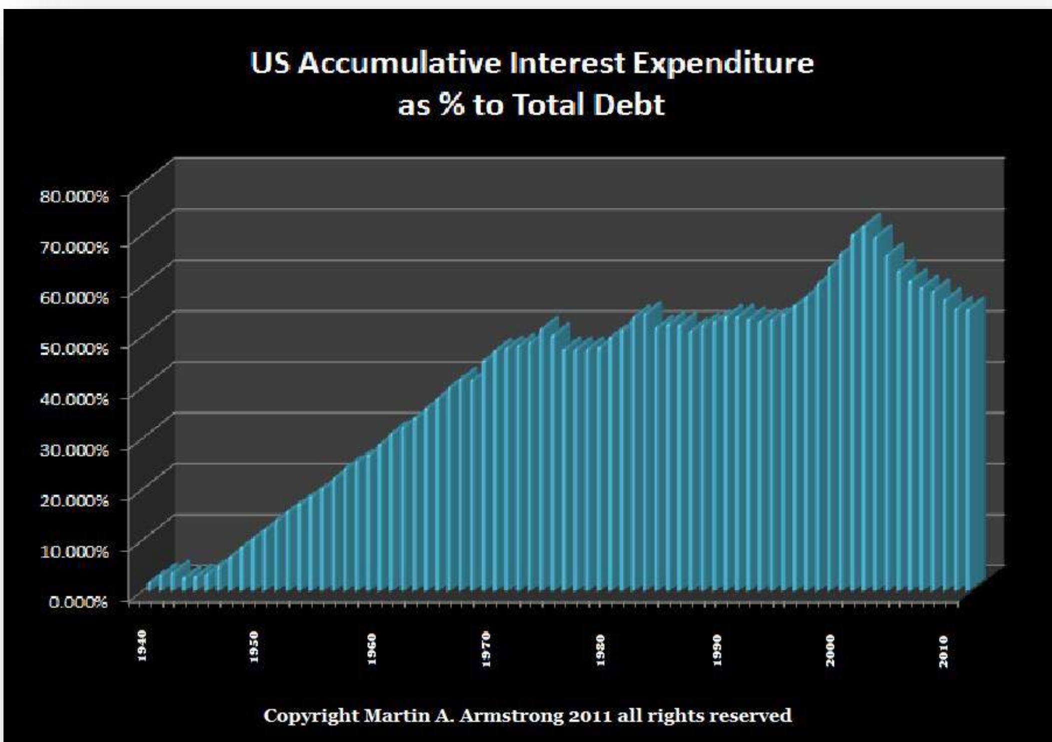
When we simply introduce the **Velocity of Money** to test the **Quantity Theory of Money,** we reveal another whole problem. The **Velocity of Money** is defined as the how many times the outstanding supply of money changes hands. Suddenly we see that you can increase the supply of money, yet the velocity declines meaning people are not spending the increase in money supply.

This interaction between the **Velocity of Money** and the **Quantity Theory of Money** has produced the reality that after 10 years of Quantitative Easing in Europe by the European Central Bank (ECB), inflation failed to materialize. In the United States, the **Velocity of Money** peaked during the 3rd Quarter 1997. The debt to GDP ratio stood at 62.48:1 back in 1997 and it is now 105.23:1 at the end of August 2018. One would expect the velocity to rise with the quantity of money but that did not unfold.

Consequently, after the Fed created $4 trillion of quantitative easing and Obama ran trillion-dollar deficits every year, the **Velocity of Money** declined yet the debt rose dramatically. This led to so many analysts screaming gold would take off and we were headed into hyperinflation. Again, nothing happened. Why?

There have been arguments that the QTM fails to work because the **Velocity of Money** is not stable and, in the short-run, prices are sticky. What they mean by that is that prices and wages tend not to decline in proportion the changes in the money supply. The argument remains that there is no direct relationship between money supply and price level that is constant. Wages are indeed far more "sticky" than prices meaning people are less likely to accept a cut in wages during a recession and thus companies simply lay off workers instead. Stores will offer sales to reduce inventory, but employees do not easily accept a decline in wages during a recession.

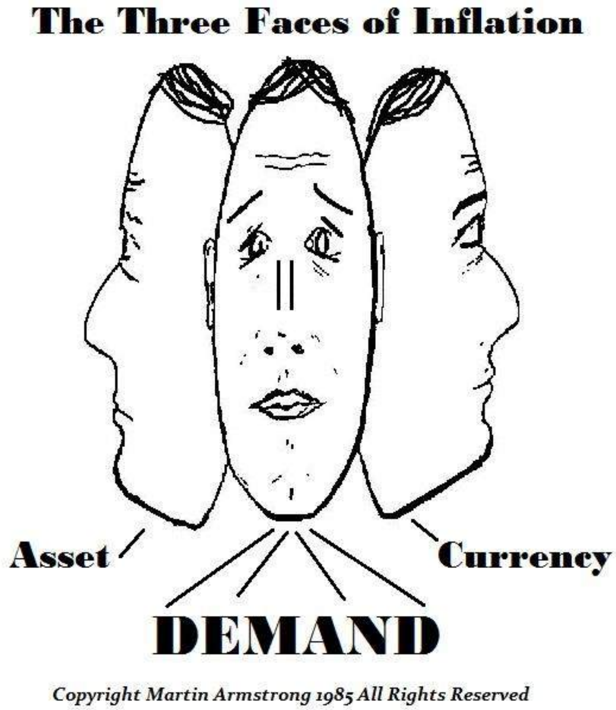
Alternative theories include the real bills doctrine and the more recent fiscal theory of the price level.



It is by no means a one-dimensional economy. This is global and we are all connected. The overlooked aspect here is the size of government has drastically changed from the time Keynes lived and Milton published his book. The size of government has grown to consume nearly 40% of GDP on average. It is no longer the incidental observer. It can no longer raise and lower interest rates to control demand when the government is the lion share of that demand and competes against the private sector. Volcker raised interest rates into 1981 to fight inflation and succeeded in costing the government vast amounts of interest thereafter. Raising rates to curb demand may stop the private sector, but it has no influence upon government. **You cannot stop a Ponzi Scheme once you begin**.

In Europe, increasing the money supply has had **ZERO** inflationary impact and has not stimulated the economy in the least. There is no one-to-one relationship. It is far more complex, and it becomes a balancing act. They have been sterilizing any impact of increasing the money supply by raising taxes. The monetary increase is only coming from buying government bonds. It is not supporting the private sector but instead, it has subsidized the government sector.

The Three Faces of Inflation

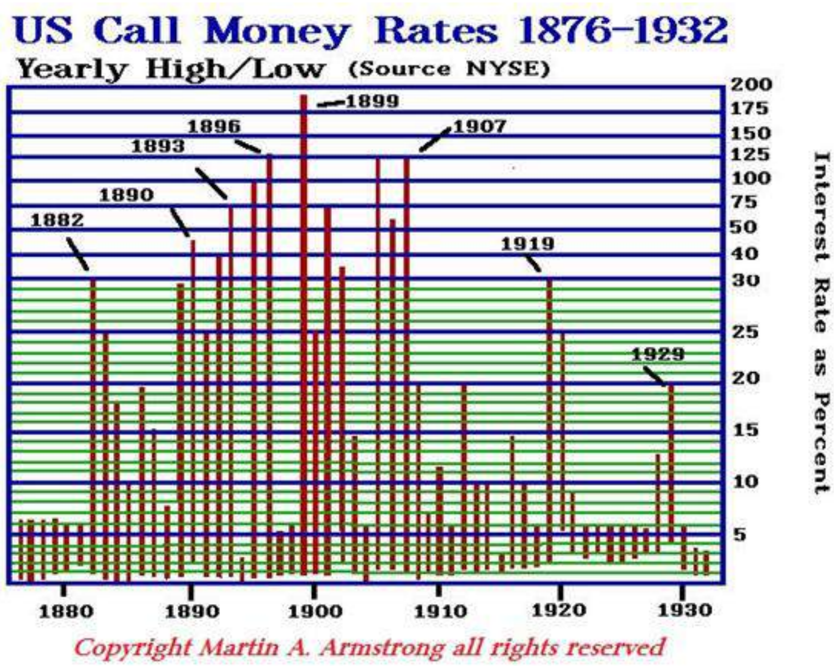


There are three major categories of inflation that unfold. First, there can be **Asset Inflation** that is not a general inflation experience through the entire economy. **Asset Inflation** can unfold from two main sources such as Cost-Push Inflation where there is a shortage in a particular asset such as the oil embargo of the 1970s or a weather event that create a shortage in something like wheat or corn. It can also be cause by a shift in sentiment so please no longer trust government and seek to move their assets out of government assets such as bonds and shift to any type of tangible assets which is short of hyperinflation. We can also see **Asset Inflation** just observing the Dow Jones Industrial Index which rose from 1,000 in 1985 to 26,000 by 2019 far in advance of prices or wages in basic living items.

Secondly, there is the **Currency Inflation**. The decline in a currency will result in a corresponding rise in prices of imported goods. This was what we saw with OPEC during the 1970s and the rise in the dollar from 1980 into 1985 all-time high correspondingly produce deflation. The extremes of will be the **Currency Inflation** hyperinflation scenario where people effectively abandon the local currency and begin to rely upon foreign currencies and commodities. As I have mentioned with buying a Ferrari in London in 1985 when the pound fell to par. The car in dollars now lost about $30,000. The Italians could not sell the cars for that, so they raised the price to about £50,000 and the pound rallied to nearly $2. Suddenly the car was now a $100,000 car. People misread the appreciation as the car was a great investment rather than it was merely a currency play.

Finally, there is the standard **Demand Inflation** which is what economists focus on. Since under Bretton Woods the world functioned on a fixed exchange rate, they never considered **Currency Inflation** as part of an economic model. This is taking place right now in butter in Europe as prices are up 300% because of shortages.

Only **Demand Inflation** was dealt with by Keynes and it was assumed that utilizing interest rates one could affect demand. Friedman believed that increasing the money supply would then relieve the deflation and stimulate the economy. Today, central banks employ both theories in setting their monetary policy without success.

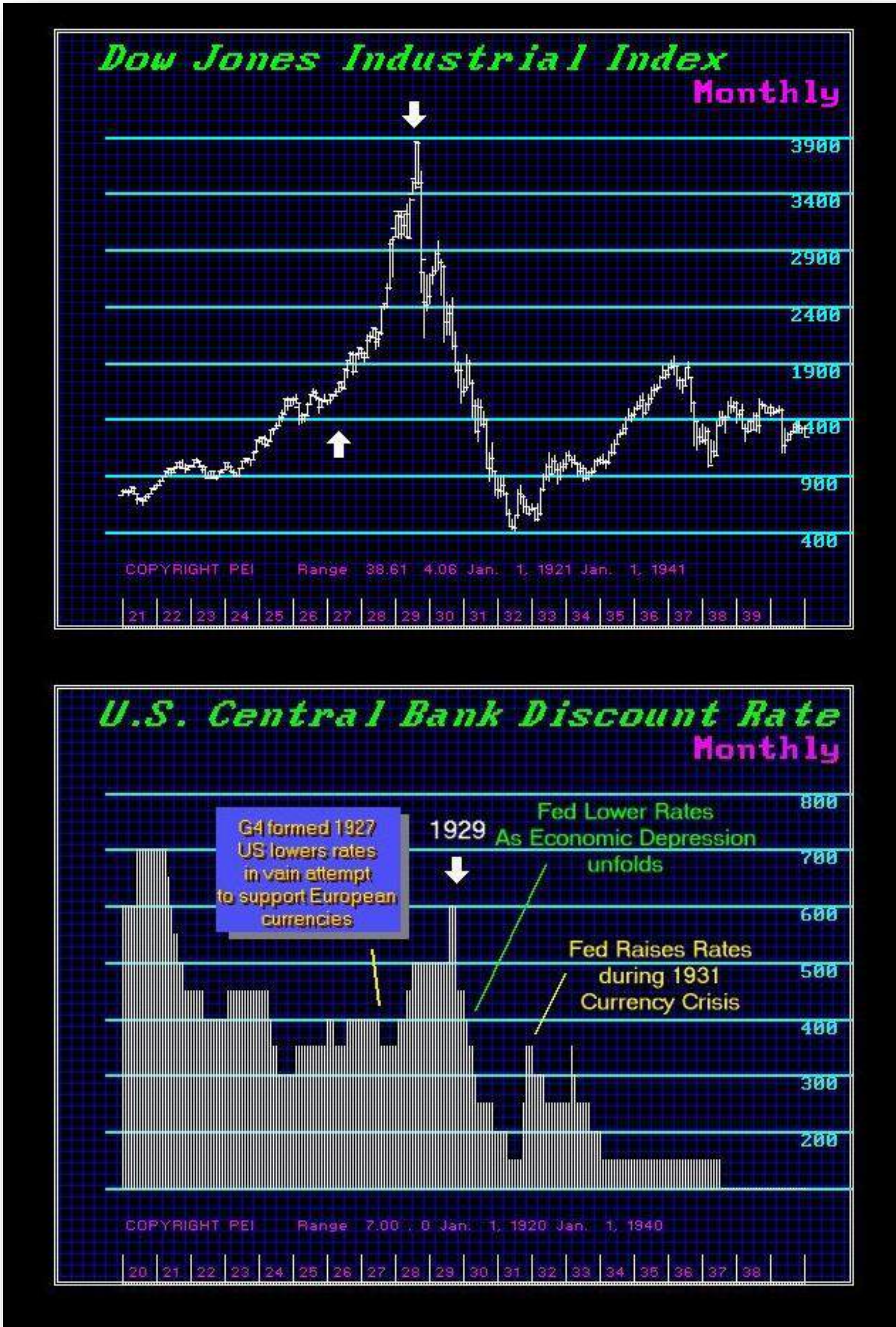


A close analysis of interest rates reveals that the economy has never peaked or bottomed with the same level of interest rates twice. The missing element in these theories is expectation. People will pay 20% rates of interest if they believe they will double their money in the same period of time. However, they will not pay 1% if they do not believe they will make even 2%.

Any close study of market behavior exposes the truth behind the fiction. The old saying among traders is ***buy the rumor and sell the news***. People will act on anticipation of something regardless if it ever materializes. It is like a herd of wild animals such as zebra. One may think he sees a lion in the bush, and he begins to run. The rest of the heard saw nothing but if one is running there must be a reason. This is the essence of a financial panic. People sell not because they even believe something, but because everyone else is selling. Far too often there has been a rumor that moves the market and it is later found to be untrue.

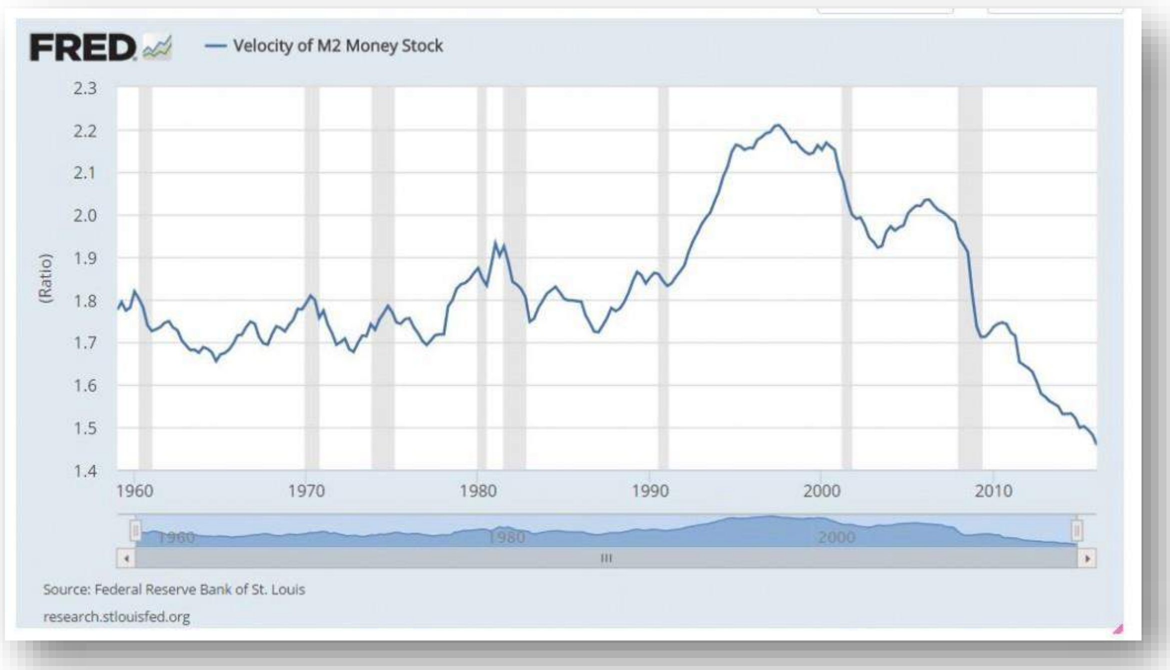
The human emotional aspect of the economy turns on anticipation and belief. A central bank can lower interest rates as they will always do and it will **NEVER** support a market because unless people **BELIEVE** there is an opportunity, they will never borrow at 1% if they do not see a potential to make a profit.

Consequently, there is no one-to-one relationship between raising interest rates and stopping inflation or asset inflation or conversely lowering interest rates to support a market in a freefall. The stock market has **NEVER** peaked with the same level of interest rates twice in history and we have watched the European Central Bank lower interest rates to negative to punish people for not spending without success. It boils down to the simple realization that people respond to the anticipation of further expectations not to theory. If you believed the stock market will double in one year, you will pay 20% interest. If you do not think the stock market will rally 5%, you will not pay 3%.


Dow Jones Industrial Index
Monthly
3900
3400
2900
2400
1900
1400
900
400
COPYRIGHT PEI Range 38.61 4.06 Jan. 1, 1921 Jan. 1, 1941
21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39
U.S. Central Bank Discount Rate
Monthly
G4 formed 1927
US lowers rates
in vain attempt
to support European
currencies
1929
Fed Lower Rates
As Economic Depression
unfolds
Fed Raises Rates
during 1931
Currency Crisis
800
700
600
500
400
300
200
COPYRIGHT PEI Range 7.00 . 0 Jan. 1, 1920 Jan. 1, 1940
20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38

The Bull Market in 1929 witnessed the Federal Reserve attempting to discourage demand and they raised interest rates from 3.5% to 6% without success. Yet the rally into 1919 saw interest rates peak at 7%. Likewise, the Fed dropped interest rates rapidly from 6% to 1.5% with no success in preventing the Great Depression.

Attempts to employ monetary theory to artificially control demand has had zero success. Nevertheless, central banks still use these tools knowing they fail to work only because they are expected to do something.

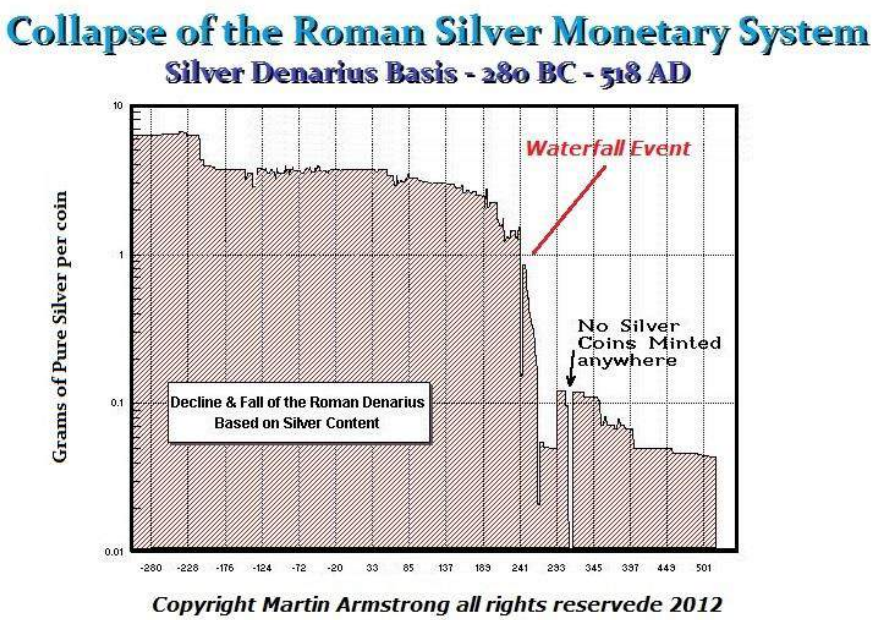


It comes down to a complex formula driven by **CONFIDENCE**. People are hoarding cash even though the quantity has increased in theory, so the velocity of money has been declining. The higher the tax rate, the lower the economic growth as people hoard money (save) and that produces the decline in the **velocity of money**.

Lowering interest rates **DOES NOTHING** to stimulate the economy when the banks do not lend anyway and would prefer to park money at the Fed in excess reserves which are sterilizing and the idea of quantitative easing.

If the QTM theory worked, then the central banks' stimulation QE should have worked. It failed. There is a lot more to this than a simple one–to–one relationship.

Even in ancient times, QTM did not hold up. There was no central bank in the Roman Empire and there was no public debt. The state funded itself by simply creating new coinage to cover expenses. Inflation was minimal during the Empire and even during the Republican period before 27BC except in times of war.

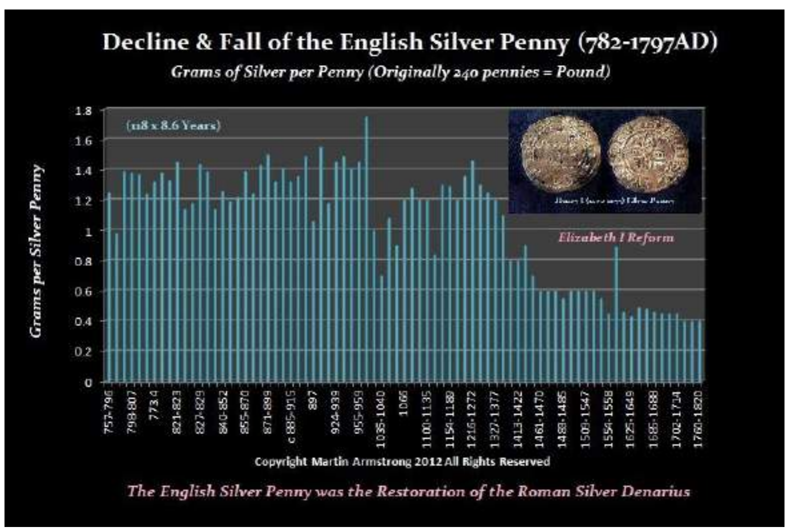


The narrow neo–classical economic theory maintains that hyperinflation is rooted in simply the increase in the money supply. This does not hold up historically. The entire monetary crisis in the Roman Empire took place between 260AD and 268AD where the silver content of the coinage collapsed to virtually zero. This took place ONLY when the Roman Emperor Valerian I (253–260AD) was captured by the Persians and turned into a royal slave.

A bas relief at Naghsh-e Rostam, Shiraz, Iran with Shapur I on horseback showing Roman Emperor Valerian held captive chained to the wall who he eventually had stuffed as a trophy

That single event shocked the Romans and they suddenly saw their empire as vulnerable. Other barbarian tribes began to invade. People contracted and began hoarding money.

Historically, the human response to an uncertain future is always the same – contract spending and save for a rainy day. When people have no concerns about the future they spend and the **Velocity of Money** increases. When they are faced with a debased currency, then they hoard the old and spend the new. Hence, Gresham's Law which he observed following the debasement of the English coinage under Henry VIII (1509–1547).



Gresham was an advisor to Henry's daughter, Elizabeth I. He represented England in the financial markets which were in Amsterdam at that point in time. As coinage was debased, people hoarded the older higher quality coins and thus his maxim: bad money drives out good. As debasement unfolds, the money supply shrinks and this in turn compels the state to produce even more money to try to keep the economy afloat and meet expenses. This has led to the erroneous assumption that hyperinflation is caused by the increase in the supply of money rather than it is the response to the hoarding of money

Conversely, if you contract the money supply you must come to understand that assets must decline for, they are merely expressed in the current purchasing power of money. An example of this was the Great Depression and how both the Federal Reserve and the Bank of France both refused to increase the money supply hoarding gold themselves.

In 1920, Britain legislated a return to the gold standard at the prewar parity to take effect at the end of a five–year period. That took place in 1925. Britain based its decision in part on the assumption that gold flows to the United States would raise price levels in Britain and limit the domestic deflation needed to reestablish the prewar parity which was their goal – strong British pound.

Indeed, the United States sterilized gold inflows as did the Bank of France to prevent a rise in domestic prices. In the 1920s, the Federal Reserve held almost twice the amount of gold required to back its note issue. Britain then had to deflate to return to gold at the prewar parity when the pound was $4.86.

Only when Britain was forced back off the Gold Standard and the deflation immediately ended, then it became clear that the way out of the Great Depression required the end of central bank hoarding of gold which would be the same human response of an individual during a period of financial crisis.

This deliberate deflation is what Milton Friedman saw that the Fed failed to monetize the refugee gold inflows fearing it would lead to inflation. So, what we had was the opposite roles back then. This predates income tax being applied to everyone so there was no hunt for taxes on the part of the political government. The scale was tipped because the Fed was imposing intentional deflation by sterilizing the gold inflows.

Conversely, after World War I, France had counted unrealistically on German reparations to balance its budget. When reparations did not materialize, France used inflation as a tax to finance expenditures. In 1926, France pulled back from the brink of hyperinflation. Unlike Britain, in France inflation had put the old parity hopelessly out of reach.

Clearly, inflation is by no means a single-dimension. Its causes vary and the most driving force behind it may be **DEMAND**, but demand is a human emotion which is inspired by everything from anticipation of the future to **Cost-Push Inflation** as well as the belief in a stable political government.

Modern Monetary Theory

The latest rage in economics goes by the name **Modern Monetary Theory** (MMT). because they have witnessed central banks increasing the money supply post-2007 and have been unable to create inflation. Economists then use this as evidence that the government can just create money at will and it does not lead to hyperinflation.

The approach of **MMT** is typically characterized as an evolution of Chartalism which is defined in macroeconomics as the theory of money which claims that money originated with a states' attempts to direct economic activity, rather than a solution to the problems with barter, and that the creation of fiat currency has value in exchange because of sovereign power to levy taxes on economic activity. In other words, fiat currency has value simply because it is deemed legal tender and will be accepted by the state in payment of fines and taxes.

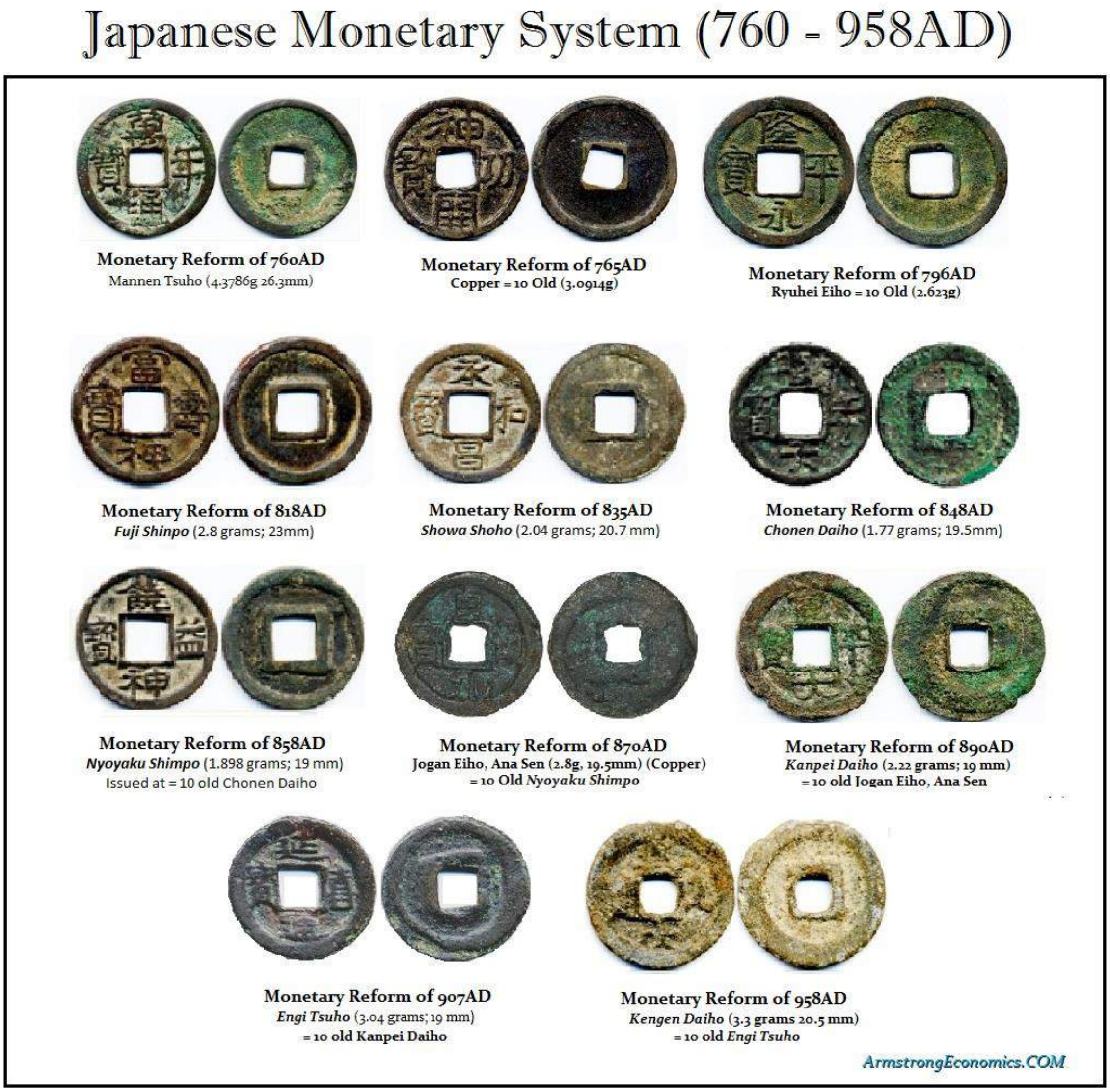
The argument centers on the fact that in sovereign financial systems, banks can create money for such **"horizontal"** transactions in lending, but this does not increase net financial assets since they are offset by liabilities. Therefore, they argue states that the balance sheet of the government does not include any domestic monetary instrument on its asset side.

In **MMT**, the proposition is that instead of horizontal creation of money through lending, the government actually creates **"vertical"** money which enters the economy through government spending. Therefore, since this money is legal tender, the government creates the **demand** for currency. In other words, you need the paper dollars to pay the government its pound of flesh.

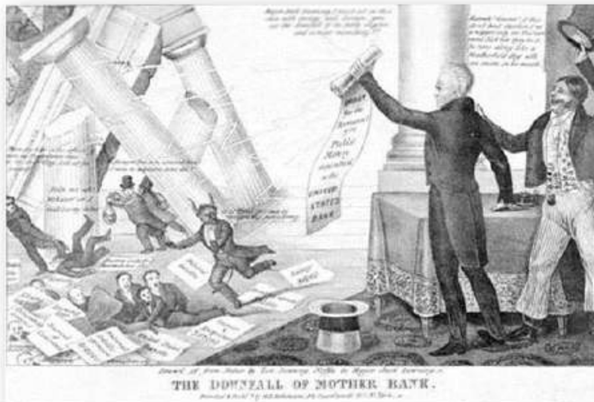
At the state and local level, we also have fines, fees, and licenses that all combine to also create **demand** for the currency. This is the fiat currency issued by the domestic federal government. Because the government can issue its own currency at will, under **MMT** it is argued that the level of taxation relative to government spending is, in reality, a policy tool that regulates inflation. As a result, under **MMT**, the logic produces the dreams of Bernie Sanders making everything free becomes possible because government can just create money out of thin air and raise taxes on the rich to regulate inflation reducing their net income and assets.

The reality is never addressed for it centers upon the degree of confidence the people have in government. As in the case of Rome, once the Emperor was captured, it should the very level of confidence that the people had in the government. They began to hoard the old coinage and the state had to increase its output to compensate for the economic contraction.

Even the hyperinflation in Germany was not the result of printing money. The printing money came as a response to the lack of ability to pay reparations, people hoarding their wealth, and the forced loans on the rich confiscating 10% of all of their assets.



The collapse in confidence in the Japanese monetary system was induced by each new emperor devaluing the outstanding money supply and issuing his own coins. Everything in circulation was devalued to 10% of the value of the new coins. This practice led people to lose confidence in the monetary system and it reached the point where they would no longer accept any coins produced by the emperor. They resorted to Chinese coins and bags of rice. Japan lost the ability to issue coins due to the collapse in confidence for 600 years. This demonstrates that MMT is bogus and this idea that as long as the money is legal tender, the government can control the economy and inflation. That does not stand the test of time.



Andrew Jackson's War on the Banks

Of course, MMT ignores the question of control and public confidence. We need central banks as a clearing mechanism and to maintain reserves of member banks. The problem is that central banks are not all created the same. Jackson's Bank War destroyed the Bank of the United States, which did not engage in quantitative easing and had no such power to create elastic money. They simply lent money to Jackson's opponents.

Andrew Jackson despised the Second Bank of the United States ostensibly not because it held too much power over the economy, but actually because his political enemies controlled it. Jackson set out to destroy the Bank for it had even provided loans to his political rivals. The Bank's President, Nicholas Biddle (1786–1844), routinely used lending practices for political gain, including using Bank funds to publish newspaper attacks on opponents as some money center trading NY banks engage in to this day. Biddle openly favored the National Republicans (later to become the Whig Party), many of whom benefited financially from Biddle's favor. Prominent National Republicans were Congressmen Daniel Webster (who was on the Bank's payroll as a legal counsel) and of course Jackson's arch enemy, Henry Clay, who was again his opponent in the 1832 presidential election but lost.

Nicholas Biddle
Second Bank of the United states
(1786 1844)

Second Bank of the United States chartered 1816 ceased to exist in 1836

Jackson withdrew federal assets from the Second Bank of the United States because of his bitter rivalry with political opponents. He then distributed federal funds to state banks setting in motion the entire wave of **wildcat banking**. State banks issued their own money and there was no longer a central clearing house or control. Jackson essentially killed central banking in the USA for political reasons rather than true principle among Jackson's supporters. Many of Jackson's supporters were the first to take banking charters among the various states and thus this was in their personal interest since they lined up with their hands out to receive federal deposits.

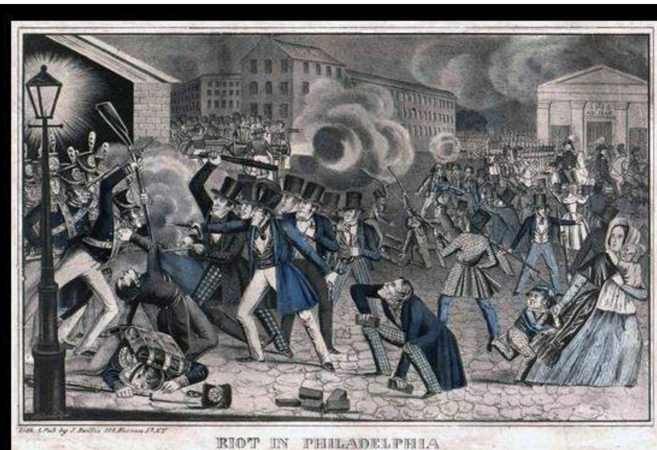
Jackson became aware of the excess in state banking that was unfolding as every bank began to issue its own paper money. To combat this new trend, Jackson persuaded Congress to pass the **Specie Circular Act of 1836**, which required land purchases to be made in gold or silver specie – not state bank paper. This had the effect of stopping the speculative bubble in land, but it also effectively devalued all paper currency in the country.

The **Specie Circular Act** ultimately led to a financial crisis when loans were called, and borrowers did not have enough specie to cover them. This sparked the **Panic of 1837**, which occurred almost immediately after Jackson left office. The result was a six–year depression.

With banks creating their own money, a secondary market emerged. Banks would print notes and sell them at a discount to brokers in New York. The brokers would put the notes into circulation of banks nobody heard of. The wholesale creation of money did not work well when the government began to refuse to accept these notes for taxes and the sale of land. Once the **Specie Circular Act** took place, the value of money collapsed, and nobody would accept it. The government refused to accept paper money in circulation within the United States and the collapse in the monetary system as a whole engulfed the entire country.

With every bank issuing their own money, the financial system became sheer chaos. States then issued debt to try to bailout their banks to defend political friends and sometimes fellow politicians. Many states then defaulted on their bonds, permanently setting in motion the first **Sovereign Debt Crisis** among the states.

The economic collapse then sparked the Nativism movement where riots became blood on the streets against immigrants. It was viewed that these immigrants were competing for jobs lowering wages and rising unemployment. Literally, gun battles erupted in Philadelphia in 1844 on the streets.



1844 Philadelphia Nativism Riots Against Irish Catholics

Jackson was succeeded by his supporter and Vice President, Martin Van Buren (1782 – 1862). He became the eighth President of the United States (1837–1841), but his inability as president to deal with the economic chaos of the **Panic of 1837** led to his defeat in 1840. This was the split of the Democratic–Republican Party of Jefferson, which at first was known as the Whig Party, which surged in popularity due to the economic depression. The Whig Party won the election in 1840. William Henry Harrison (1773–1841) was the ninth President of the United States (1841), an American military officer who was the last President born as a British subject. Harrison died in office on the 32nd day in office after complications from pneumonia.

John Tyler (1790–1862) was Harrison's Vice President who became president. After the **Panic of 1837**, Henry Clay and his Whig allies attempted to legislate a new charter, but Tyler opposed it. Clay sat down with Tyler and the two finally worked out a compromise creating the Third Bank of the United States. Rather than a single national bank against the many state banks that stood around the country, this Third Bank of the United States would serve as a link between the state and federal level, operating to moderate speculation but also supply good loans to growing areas. There was not precedent for it in the Constitution, but it could be enacted as a bill from Congress.

Reducing an Effect to a Single Cause

There was a 14th-century Franciscan friar by the name of William of Ockham who is credited with having formalized the principle that "simpler solutions are likely to be more correct than complex ones." Hence, we seem to always try to reduce everything to a single cause and effect. Some call it "keep it simple, stupid," and it has emerged with the label "**Ockham's razor**," which is supposed to be a tool that cuts through complexity to get from point A to point B. But is this really true?

Indeed, Ockham's Razor prevents true research. Always trying to reduce any analysis to a single cause and effect prevents us from actually seeing the complexity and interactions behind the global economy. We may respond the same in a crisis, but we do not always act for the same single reason. One country may be in a moderate recession while another is in a crisis. Capital will still flow to the nation in recession as the lessor evil provided there is still confidence in that nation.

Unfortunately, this principle of reducing complexity to simplicity leads to a crisis in analysis. The norm becomes the objective to reduce every effect to a single cause. This actually prevents our analysis of ever understanding the domestic no less global economy.

Reducing an Effect to a Single Cause

In funds management, the statement that proves there is complexity is a legal requirement: **Past performance is not a predictor of future success. All investing involves the risk of loss.** While there is a desire to make complexity simple and understandable, this is completely misguided. Clearly, simplicity rather than complexity is by no means the proper course of action for we then cannot see the interconnections of how everything truly functions.

The greatest mistake in the analysis is always trying to reduce any effect down to a single cause. The world is a complex mechanism. It is indeed like a rainforest. There are countless species, and each is interconnected. Exterminate species one and you will find that it was the food source for another. That species, in turn, was the food source for yet another and so on.

The world economy is equally complex. Therefore, I say we are **ALL CONNECTED**. Create a war in one region, we may not be involved with troops, but the capital flows shift. How can we forecast anything by ignoring all the interrelated influences?

There are those who advocate that the best way to achieve your long-term investment objectives is to keep in simple. Yet they are looking at history and banking everything on a continuation of inflation.

People wrongly believed that Ferraris were an investment all because the Italians raised the price in 185 when the British pound fell to near par against the dollar. The doubled the price in pounds and then the pound doubled so it created the appearance that they were a great investment when it was simply the currency.

I met clients in the early 1990s who have bought a number of cars believing they were an investment. They never understood it was simply inflation rather than actual curs.

Markets, on the one hand, appear deep and complex, rendering them impossible to understand fully when limited even by law to a purely domestic view. This has resulted in the advice of buy and hold as a strategy to fight against complexity with simplicity. Then there are investors who believe they need investment solutions that are nimble and flip positions based upon the talking heads on TV. They are brainwashed by their market myths. This has merely become grand sophistry trying to fight complexity with a simplicity that sounds logical by reducing all activity to a single cause and effect.

Rapid technological development in recent years across industries has helped to expose the fact that we live in a global economy and we are all interconnected. Fund managers, because of regulation, are blinded by this interconnected world for they are not allowed under US law to invest globally in a diversified portfolio of stocks, bonds, commodities, currency, real estate, and futures. This is why we have so many specified funds and people claiming to **"just keep it simple"** with a hold policy because it always comes back.

Asset allocation philosophies have emerged which invest in diverse market sectors knowing that they are polar opposites. They assume that the world is too complex beyond their comprehension so spread the wealth and hope for the best. These strategies have expanded as of late beyond the traditional stock/bond mix that was exclusively domestic-oriented. In modern times post-1985, alternative strategies emerged introducing hedge funds that also incorporated foreign exchange, commodities, options, private debt, venture capital, and even real estate.

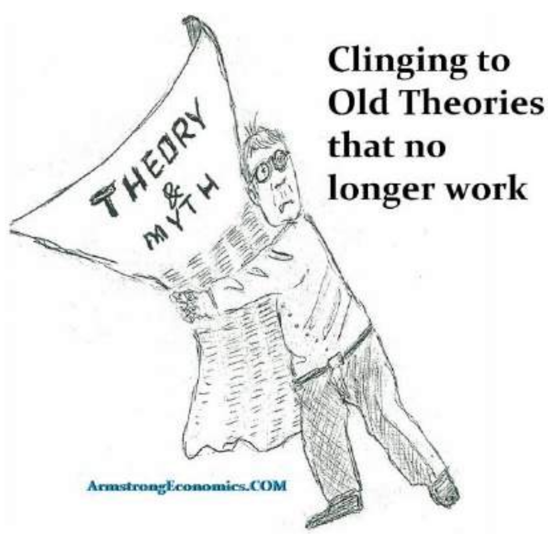
As hedge funds began to report their 2018 performance, an abyss quickly emerged between managers who outperformed the index and those who saw staggering losses with a third group landing somewhere in between. Overall, the industry saw its biggest annual loss since 2011, declining 4.1% on a fund-weighted basis, according to Hedge Fund Research Inc. Mostly, the smaller funds were able to flip portfolios quickly and that allowed them to trade around the big funds that can no longer maneuver. Most were unable to navigate the market turbulence in what became the worst year for the S&P 500 Index since the financial crisis. Most took **"views"** of what they thought would unfold and it cost them dearly. The funds that relied upon a personal opinion proved to be the worst for the vast majority kept viewing the stock market would crash any day, which never happened.

The illusion that simplicity provides the best long-term investment return is really predicated upon an assumption since the Great Depression that if you just held through all the 50–70% corrections you would be OK at the end of the day. The problem with this argument is that we are all human. I have never met someone who can actually do that. Then there is the problem of surviving the long-term. The city of Detroit suspended its debt payments in 1937 and resumed in 1963. If you owned such bonds for retirement, perhaps your heirs benefited, but you would have died broke and starving. It all depends where you are in the business cycle.

No matter what subject we look at, humans tend to try to reduce everything to a single cause. In medicine, for centuries people always assumed that every disease was introduced to the body from some external source. Doctors would apply leaches and bleed patients because it was presumed that there was some evil poison in the blood. If the patient died in the process, it was never that they took too much blood, it was because they did not bleed them soon enough.

Today, we have begun to see that many diseases are actually hard-wired genetically. That is why when you go to a doctor for the first time, the first question they ask is what has been your family history.

Our theories in economics are perhaps the worst of all. Where in medicine there has been an effort to advance because you actually look at results, when it comes to economics we are dealing with a Social Science. Therein lies the problem. Economics has been plagued by people who try to change the nature of society to conform what they would like to see happen. And they always try to reduce everything to a single cause and effect. If medicine took the same approach, we would still be going to see witch doctors.



The Crisis in Analysis

Junk Science is the real crisis we face as so many people think that Global Warming is caused by man and Co2. Of course, those who really believe this is the problem that will destroy the world perhaps should just commit suicide and take the dog with them to save the planet. After all, we exhale Co2 as do our pets.

Junk Science plagues us in every field be it economics to health. For 25 years we were told that eggs are bad. How many people ordered egg whites only. Then the Junk Science was revised, but after 25 years, nobody noticed. When scientists learned that high blood cholesterol was associated with heart disease, they immediately black-listed all foods with high cholesterol content. It took 25 years of study to figure out – oops, we were wrong!

You just didn't really hear the "oops we were wrong" but instead you heard of another great danger – saturated fat! It became evident that cholesterol in food by itself was not the culprit after all — the real great evil was now saturated fat. This is what had a much bigger effect on blood cholesterol when it was discovered that full-fat dairy products and fatty meats are loaded with saturated fat and that triggers the body to produce cholesterol.

This is the problem with analysis. They can conclude that everyone who has eaten a carrot eventually dies. That is an absolutely correct statement. They study one component and draw a correlation that clearly carrots are long-term lethal and thus produce the definitive study to get grants. The junk scientists did that with interest rates. Higher rates mean the stock market will decline. Oops. The Fed just raised rates and the Dow made a new high. Interesting! Hm? Is this a carrot paradox? Focusing on just one relationship (simplicity) blinds you to the complexity of the whole. Global Warming is the same as the carrot paradox.

In economics, we had the **Quantity of Money Theory** that has driven central banks into **Quantitative Easing** expecting this will stimulate the economy and people will spend rather than hoard their wealth. After 10 years of desperately trying to stimulate inflation, they have been beaten this theory to a pulp by deflation. As

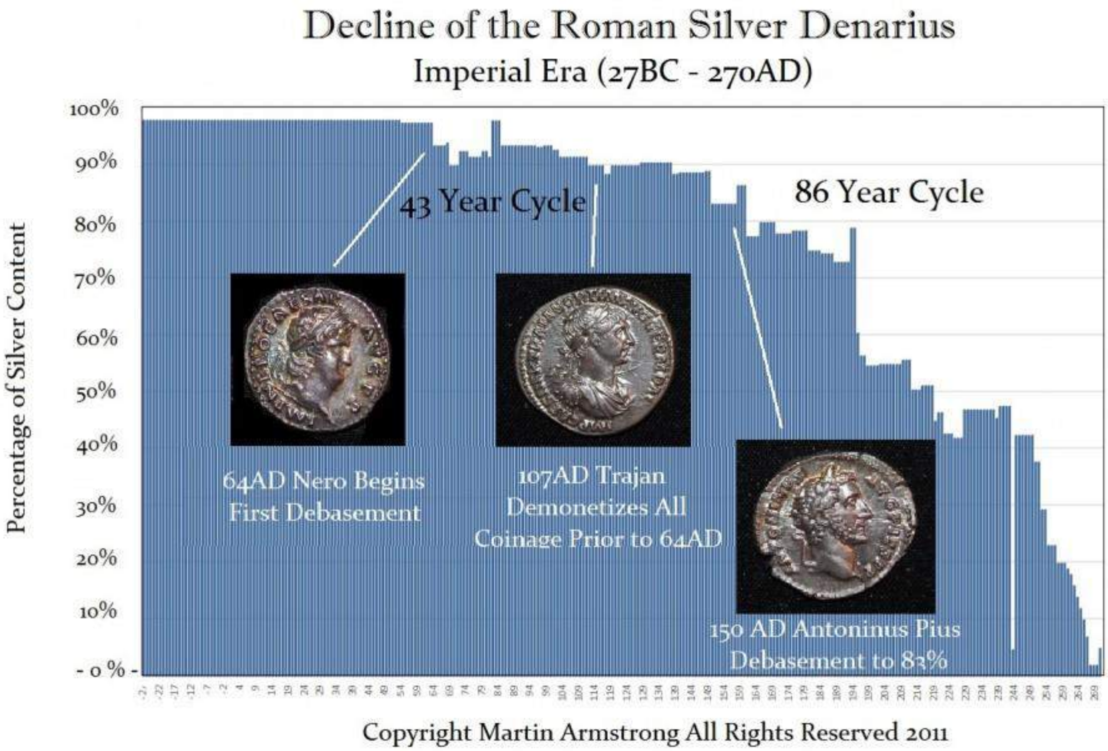
always, they make a false simple assumption at the outset which then leads to the false result because of complexity.

People seem to always approach everything in a linear fashion attempting to reduce a situation to a one-dimensional cause and effect. They fail to comprehend that the world is dynamic and complex, which defies this one-dimensional analysis. In economics, there is the contraction within the economy creating deflation from technology advances – the waves of innovation or creative destruction by Schumpeter. The work force is stagnant and unless they stay current with technology, they will quickly find themselves **UNEMPLOYABLE** with no useful skills in the face of advancement.

Think of this one-dimensional analysis and now try to explain LOVE. Can you reduce the feeling of "LOVE" to a single thing and definitively say I love this person because of just this one thing? How about the LOVE one has for family or children. Can you say you love your mother or children reducing it to a single thing?

Welcome to the would or dynamic interaction which defies a single cause and effect. Reducing everything to a simple explanation is the crisis in analysis that is destroying our ability to manage our economy or understand what we are facing. Our future will never appear bright until we come to the realization that we live in a world of complexity where we are all connected.

Conclusion



I have endeavored to reconstruct the monetary system of the world to ascertain above all else, how do empires die. The entire Quantity Theory of Money was really set in motion by Sir Thomas Gresham and his law that bad money drives out good. This was really based upon his observations of what took place when Henry VIII debased the coinage of England. Keep in mind that coinage was based on precious metals throughout Europe. Therefore, reducing the metal content of one which was not reflected in other nations created arbitrage and volatility. That is different from today where money is entirely valued upon confidence in the issuing state rather than some intrinsic value.

The chart offered here is of the debasement which took place in the Roman silver denarius. Note that the debasement begins with Nero (54–68AD). The reason for this was largely to cover the cost of government, which included the military but the Great Fire of Rome in 64BC. The final collapse takes place between 260–268AD when the Emperor Valerian I (253–260AD) was captured by the Persians.

Bloomberg

Economics

ECB Wins EU Top Court Fight Over Legality of QE Program

The entire threat to Europe is the policy of Austerity imposed upon the EU by Germany. This is in direct conflict with the Negative Interest Rate and Quantitative Easing policies of the ECB. The German court ruled that there are *"grave reasons to hold that the motions underlying the bond-buying program violate the ban on monetary financing of states and overstep the mandate of the European Central Bank and thus transgress the powers of the member states."*

Naturally, when this was taken up to the high court in Euroland, the decision had no choice but to uphold the ECB. If the court had ruled against the ECB, the massive selling of its balance sheet would have created a massive panic in Europe that would have spread to the world economy. Was the decision political? Of course. The ECB was barred from lending money to member states and Quantitative Easing has done precisely that.

The downside of this mess is that the ECB is now trapped. It cannot sell what it has already bought, and it cannot stop buying sovereign debt as it is issued for that too will result in a sharp rise in interest rates.

The only possible way out of this crisis is to monetize all debt within Europe.

APPENDIX

Understanding the Euro and the Chaos

PRINCETON ECONOMICS INTERNATIONAL

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UNDERSTANDING THE EURO

AND THE CHAOS IT IS UNLEASHING IN THE WORLD ECONOMY

By Martin A. Armstrong

There appears to be great confusion among not merely the public sector officials, but also among corporate and institutional Europe not to mention the rest of the world. Perhaps the most confusing aspect of the coming monetary changes in Europe is what will the single currency do? Will a single currency end currency speculation? Will a single currency lead to a single interest rate for Europe? Does a single currency mean Europe become one economy while retaining individual sovereignty? These were among a handful of questions that I encountered on my fall trip to visit our European clients. The most profound conclusion as I begin writing this piece while 60,000 feet in the air crossing back over the Atlantic, is just how many in Europe have absolutely no idea what a single currency is all about regardless if they oppose or support it.

To truly understand the implications of a single currency, we must begin with fact rather than mere opinion. In the postwar period, currency has become a badge of honor outside the United States. National pride has always been wrapped up in the European currencies as a standard form of measuring how far their nations have come since the devastation of World War II. This is also true in Asia. Because some sense of national pride is involved, politicians have often been judged by the value of their currency particularly against the dollar. If a nation's currency is suddenly devalued, politicians are attacked by their foes who paint this event as confirmation of their failure in government. Consequently, comments from Malaysia calling for currency trading to be banned is an example of a government enraged at being forced to allow its currency to devalue. The politicians see this as public and world confirmation of their own personal shortcomings in dealing with their economies.

We must understand that the old fixed exchange rate system of pre-1971 was also plagued by an age of "competitive devaluation" and cracks within the armor of the gold standard. Its ultimate demise was again wrongly blamed on speculation when in fact it was the political desire to spend at will while denying accountability and responsibility. Governments tried to hold the value of gold pegged at US$35 while allowing their money supplies to grow unchecked. The first sign of trouble came during the mid-1960s when private redemption of currency for gold was prohibited giving birth to a two-tier gold standard. Gold became a commodity that was traded on the London Metal Exchange. Governments agreed to uphold the old standard at $35 per ounce only between themselves allowing the private sector to trade separately on its own. The French, however, began an onslaught that would ultimately bring the entire house of cards down. The French began excessive redemptions of dollars for gold in an attempt to boost its gold supplies in hope of transforming France into the largest economy. Indeed, the French succeeded in forcing the entire gold standard to collapse because governments had printed far more paper currency than there was gold to go around. Instead of readjusting the value of gold to account for the huge growth in money supply between 1950 and 1970, politicians in all countries preferred to ignore the fact that the system designed at Bretton Woods could no longer be supported. Admitting the failure of Bretton Woods would have clearly highlighted the fact that politicians were indeed incapable of fiscal restraint.

When Britain was forced on "Black Wednesday" to leave the ERM and allow the pound to float, it was humiliating to the Conservative Party. While it is often said that this single collapse of the British pound cost every British citizen 20 pounds, it did so only because the government sought to reenter the ERM setting the value of the pound at the highest possible price for the three previous year period. Politicians chose the highest price for the pound as a symbol of how good a job they had done with the British economy. Unfortunately, while the economy in Britain had turned the corner, the pound was being priced too aggressively for the world economy.

Every currency collapse in the past 200 years has taken place NOT due to speculators, but due to politicians attempting to fix currencies based upon their personal careers rather than underlying economic considerations. The coming Euro is nothing different and given a transition period where each individual currency will co-exist alongside the Euro until 2002, the opportunities for readjustments at the hand of capital markets could be endless.

Phase I of the European Monetary Union is a transition period. This means that each country will continue to maintain its own currency while attempting to pledge its link to the Euro. In other words, it is not much different than the gold standard where everyone tried to keep their currency fixed to gold. Some have argued that if currency speculators try to play around with the individual currencies, nobody will care since it is the Euro that will survive. Keep in mind one fact. Even Russia could not stop black markets and net capital movements despite torture, tanks and guns. If anyone believes that the currency speculators will be defeated by merely pegging the currencies to the Euro, you better take another close look.

There is only one way that speculation within Europe between one nation and another will be defeated. That exclusive secret weapon can only mean the full and unquestioned federalization of Europe. Even if the individual currencies dwindle and die between 1999 and 2002, net capital movement and speculation will merely take the form as it does within the United States – bonds and interest rates.

It is ABSOLUTELY IMPOSSIBLE for Europe to impose a single interest rate upon the whole membership of states. As long as some sovereign rights reside with the individual nations of Europe there will be differences in credit risk as there is today between all 50 states within the US. Therefore, even if the single currency succeeds, speculation will be shifted from currencies to the bond markets. The socialistic dreams of Europe that paint a utopia where everyone will enjoy the same interest rate and stability simply cannot materialize as has been the case throughout the past. If capital perceives that the French are going in their separate direction from that of Germany, France will find it cannot sell its bonds at the same rate as Germany. France will be forced to sell its bonds at a discount such as 98 to Germany's 100. In effect, Europe will be no different in 2002 than it is today. All that will be saved is mere currency costs of transactions within Europe but not external to Europe. In order to deliver the dreams of European politicians as related to the people, only a federalized Europe with dictatorial powers over domestic policy in each nation can deliver. If this is the ultimate true goal, then devolution in Britain has come at the precise wrong time.

A close examination of the United States economy reveals that its success is due to a standard uniform code of law throughout all 50 states. Federal taxes are the same in Texas as they are in Hawaii or New York. Who is taxed in the social code is also the same in all states. The issue of inheritance taxes, retirement customs, pensions and the general rule of law are uniform. In order for Europe to succeed in this ultimate quest, Westminster must be reduced to a parish council subservient to Brussels as every state is to Washington in the US.

What is frightening for Europe is that there seems to be a political drive with its spin-doctors who deflect any and all serious investigation. If the goals are to produce a single economy with federalized powers or somehow a loose economic co-operation zone with a figure-head with about as much teeth as the United Nations when it comes to enforcing.

What does appear to be clear is that at least short-term interest rates will be federalized. This will not end speculation but could promote excessive speculation in the bond markets. If France is not following the same economic agenda, then it may find that if short-term rates cannot differ throughout Europe, then it will be forced into shifting its national debt into long-term funding where the market will dictate the interest rates – not Brussels.

The single currency cannot produce utopia without pain unless everyone is on drugs. Each nation must meet the criteria of the whole and be willing to send its own economy into deep recession for the good of the whole. If Europe cannot meet the criteria today without playing all sorts of games with its numbers, are we to take Europe seriously in the future?

There does not appear to be a political will to tell the truth. Kohl ignored all the experts who warned that German unification would cost far more than he was telling the German people. Kohl feared that if the people knew the truth about the cost, they might vote against unification. Perhaps there was a risk. The point is we will never know if there even was a risk that the German people might have turned down unification. This same tactic is now being used with regard to EMU. The promises being made simply cannot take place without a full-scale federalization of Europe. Anything shy of that will merely transform currency speculation into bond speculation assuming the Euro is successful.

From a historical perspective, it was the revolution in the United States that finally forged the bonds of brotherhood within the 13 colonies. Previously, each competed against the other and even tried to block free trade. If Europe is to one day emerge as a new federalized state, it may need to go through the pains of severe economic hardship before individual states are willing to give true control over their economic and political social goals to a new federal government.

The winds of change are subtle yet continual. Tony Blair is up for the head of the EC in 1998. His recent verbal slips stating that if Britain wanted to join the first wave of the Euro in 1999, it would need to make up its mind in early 1998. Some have not panicked just yet arguing that a referendum would need to be called before Blair could take Britain headfirst into the Euro. However, keep in mind that Tony's role model is Bill Clinton who motto is "never tell the truth until you are served with a subpoena and then stall." Tony does not have to call a referendum simply to go in on the first wave. Sources tell me that he only promised a referendum before the abandonment of the pound. Tony wants to be President of Europe. He is up for the slot in 1998 and he wants to lead Europe into the millennium. A referendum in Britain may not be necessary until 2002. The argument is that Tony view 1999-2002 as a trial run and his political spin-doctors are preparing scenarios along those lines. If they think they can sell the Euro and are assured of victory, then Tony may call for a referendum even by March 1998 while his popularity is still soaring. If not, then look for the trial run argument to emerge pushing the referendum off until 2002. Germany desperately needs Britain as a counter-balance against the new ultra-(far-out)-left in France. Kohl is using Tony Blair's personal career desires to be head of Europe and maybe its first President to entice the UK into EMU. After all, Tony cannot become head of the EC in 1998 if Britain is not in EMU.

These revelations are already starting to move and shake capital. The British economy is in serious danger of imploding. Britain attracted vast amounts of capital from the continent and around the world because it had the best of both – in the EC but out of the Euro. Over 2,000 companies from Germany alone opened offices in the UK as a hedge against the uncertainty of EMU. Japanese investment into

Europe was all attracted to the UK for the very same reasons in addition to the significant lower tax rates. If Mr. Blair is going to take Britain into the Euro, capital will flee Britain as it appears it is now starting to do since it has become public knowledge that Tony is looking at joining as early as 1999. Even our computer model now warns that a year-end closing BELOW $1.58 could signal a 10-year bear market is underway going into 2002-2003 before its completion.

What EMU is all about is something very basic. It is the last gasp for a dying system of socialism. Russia collapsed; China also was forced into a more capitalistic system. Europe must break the cord with socialism and adopt a true free market system. EMU is the last attempt to hold onto a system that has made Europe the worst economic growth center in the western world. Its unemployment on a good day is double that of the US on a bad day. Failing to simply set the economy free from the heavy-handed control of government will raise the risk of total collapse. Europe simply cannot maintain an inefficient economic system that continually amasses debt at the expense of the future. Unfunded social programs cannot be maintained. No government can force capital to buy its debt not even at the point of a gun. The lack of capital broke the back of Russia and China. In the end, EMU must embrace SERIOUS economic reforms that go beyond merely the monetary reform issues and into the realm of a fiscal union. Perhaps it will be the birth of the EMU that will finally reveal that fiscal responsibility is as important as monetary union.

EMU will NOT bring utopia to Europe. EMU will not bring a single interest rate across the continent. If each nation retains the right to issue its debt in Euros at will, the system will collapse as surely as it did in the United States pre-1792. When the US became a federalized body, each state gave up its monetary authority to Washington. The Constitution specifically prohibited the states from issuing money on their own and that power was given to the federal government. Can you image the US if each state had the authority to issue more dollars at will? Such a system collapsed before as surely EMU will collapse within Europe. Ironically, it may be the collapse of the EMU that finally leads to true economic reform throughout Europe. Either Europe federalizes and imposes uniformity, or it collapses back into a confused state of tribal self-interests.

These very basic issues concerning Europe will continue to force capital to move short-term as confusion rises to the surface between those who simply believe in fairy tales and those who ask the hard questions. Volatility will continue to rise spreading from the FX markets into stocks and bonds as well. Speculators will prosper. Capital will suffer and pull away preferring to hoard its assets in an atmosphere of certainty. But the wage earner will endure the worst for it cannot place his labor offshore nor can he hoard his labor in fear of volatility, political uncertainty and devaluation. In that atmosphere, political change is born.

It is this very uncertainty over the Euro that is driving the dollar higher. The first casualty has been South East Asia where governments have tried to maintain a currency peg to the US dollar. But the dollar is being driven higher by a flight of international capital while Asia has been experiencing a net capital outflow. Asia fails to understand that the attack upon their currencies is nothing personal. It is merely that their currencies had become grossly overvalued given the US dollar's rise due. The rising US dollar has destabilized the Asian markets due in part to EMU and threat of the Euro combined with an economic depression in Japan. This cocktail of international confusion and chaos is tearing the global economy apart causing capital to lack its very basic requirement – some sense of certainty. The end result is an explosion in volatility over the period just ahead turning the global economy upside-down and driving it to the brink of sheer and utter chaos.

We do not live in a world where capital can be forced to invest against its will. We do not live in a world where the marketplace can be artificially dictated to by politicians. While there will be a major thrust to ensure that EMU and the Euro succeed, we must realize that if the Euro succeeds, then Europe may fail. The Euro will NOT erase all the sins of the world. It will not redeem mankind from the savages of speculation. It will not even transform politicians into benevolent saints. It could merely prove to be a Band-Aid when what Europe needs most is stitches to binds its deeply rooting historical wounds.

Building the Foundation for the Next Great European Economic Disaster

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EMU

Building the Foundation for the Next Great European Economic Disaster

by Martin A. Armstrong

There is a huge debate fermenting over the future of Europe. In Britain, this debate is also heating up as the infamous date of 1999 moves closer to our focus. Many argue that Europe must pull together to fight off the rising tide of trade around the globe. A united Europe is seen as the answer to keeping the Marxist foundation of socialism a live. To some observers this appears as a close parallel when Rome tried desperately to fend off the invasions of barbarians that also proved fruitless in the final historical analysis.

The one sales pitch that has been used to sell this revived dream of a united Europe is none other than the currency. It has been pointed out that if one begins in London with say a 100 pounds, after traveling around Europe exchanging the currency in every port, when you return to London you will have only 60 pounds left after spending nothing.

While this argument appears to invoke much common sense about how inefficient currency transaction might be between nations, at the same time, it fails to deal with the reality behind creating a single currency. The proponents of a single currency for Europe often point to the success of the United States, albeit behind closed doors and far away from the public eye, as the justification behind a single currency. Many fund managers and multinational corporations also hail the move to a single currency as the future for Europe simply because they are finding it extremely difficult to cope with the rising volatility in foreign exchange.

Nonetheless, Europe does not quite understand the United States model of a single currency. Europe looks at the US and sees one single currency as being extremely efficient with a byproduct of consistently lower unemployment as one goal. However, it is in fact a single currency policy that is actually part of the internal problems that is causing much concern within both the United States and even Canada for that matter.

It is of vital importance that we understand the benefits as well as the nasty side-effects of a single currency for Europe as a whole and in that context US and Canada do serve as an excellent model to explore for answers. Prior to 1927 the central banking system in the US was established in 1913 with 12 INDEPENDENT branches. Each branch maintained its own separate discount rate. This is very important to understand. It was not uncommon to find rates at 7% in California and 3% in New York.
This is far too often a point totally lost in history, but it is paramount in trying to define whether or not EMU will succeed or fail for Europe.

The central banking system known as the Federal Reserve emerged as a solution out of the disaster of the financial Panic of 1907. The Federal Reserve was formed in 1913 because the evidence revealed in the investigations by Congress discovered that even though a single currency had existed in the US since 1792, the regional capital flows within the US were often to blame for numerous financial panics
- 1907 being the primary Panic that drew the attention of government to this problem.

The differences on a regional basis within the US economy as a whole were the source of Panics due to cash flow problems on a nationwide scale. Even today, the differences between the local economies in Texas and New York are staggering. We call this the Texas/New York arbitrage. When Texas is booming, New York is in the depths of a recession and vice versa. The New York economy is more financial, and business related today while Texas is more commodity oriented with farming and oil production. Therefore, when inflation is running high, we then find that Texas booms at the expense of New York.

This is the same regional capital flow problem is silently tearing Canada apart. When real estate was booming in 1987 in the Eastern regions of Canada, interest rates continued to rise in an attempt to stop the speculation. However, while there might have been a real estate boom in the East, the rising interest rates policies were driving farmers into bankruptcy in Alberta.

The Panic of 1907 followed on the heels of the Great San Francisco Earthquake. The claims were obviously on the West Coast, but all the insurance companies were of the East Coast. As capital flowed from East to West, shortages in money supply emerged among New York banks that culminated in bank failures.

A single currency does not necessarily make things great. In fact, there is more to the issue of a stable economy than merely a single currency.

The regional cash flow problems were initially resolved between 1913 and 1927. However, a very significant development took place in 1927 that would forever alter the course of our economic destiny for the entire century.

By the mid-1920s, it was noticed that there were significant problems emerging on a cash flow basis internationally. In a power struggle within the US Federal Reserve, the New York branch managed to convince the government that the same system of regional cash flow management should be extended to the international level. The New York Fed won the battle against Chicago who warned that changing the focus would undermine the domestic policy objectives of the bank. In the end, the entire power of the Fed was shifted into a single nationwide system where one interest rates policy would be used thus abandoning the original mission of the Federal Reserve as the guardian of domestic cash flow problems.

1927 this marked the beginning of the very first G4 effort at influencing international cash flows. The discount rate in the US was usurped into a single rate. The first action was to lower US interest rates in an attempt to divert capital back to Europe. The manipulation backfired because it gave credence to rumor that there was a problem with the escalating debt in Europe. As the cash flows into the US intensified, the Fed moved into a state of panic. Capital poured into the US driving the stock market up dramatically - doubling between 1927 and 1929 despite the Fed raising interest rates from 3% to 6%.

The post-1927 economy has remained on the international regional focus rather than on the original intent of domestic regional capital flow management. This is where our modern problems of regional disparities emerged. The ***one-size-fits-all*** approach to interest rate policy is now increasing the tensions between regions within most nations. It is this very issue that is tearing apart Canada pitting one province against another.

The theory that creating a single currency for Europe will solve all the problems is by no means the answer. It will not solve the vast disparities between the economies of Europe but in fact will be a means of exporting deflationary policies at work in Germany to other nations such as Britain and Greece. What EMU must be about is more than a single currency. While a single currency will ease some risk problems for business associated with currency, it poses significant dangers that would breed resentment between member states by exporting German economic policy to the rest of Europe. This is the similar problem whereby the dollar is the reserve currency and this results in the United States exporting its inflationary policies to the rest of the world caused by the lack of fiscal restraint.

If EMU were to adopt a single currency, it must NOT, under any circumstances, lead to a single monetary policy that would impose a ***one-size-fits-all*** approach. The basic sovereignty over establishing local interest rates must reside with each state. Allowing this vital power to be usurped into a single rate will undermine the entire framework of Europe much in the same manner as is taking place in Canada or even the United States.

The individual nations of Europe have distinctly different economies as is the case among the 50 US states. When US autos lost market share to the Japanese and European cars, the economy of Michigan was devastated. When IBM was forced to restructure, Massachusetts was devastated. When oil prices fell sharply, million-dollar homes in Texas fell to $100,000. Regional problems exist today as they did prior to 1913. If Europe follows-through with its one-size-fits-all plans for EMU, it very well may lead to the worst economic disaster in the economic history of Europe.

Forex and Global Markets

Summer 1998 Issue

The Euro and the Future

by Martin A. Armstrong, Chairman of Princeton Economics International, Ltd.

The dreaded day that many argued would never dawn is rapidly approaching. Before we know it, the euro will be born. While we may be sure who the mother is, the question as to the identity of its father remains to be answered. Will the euro spring forth as a new hard currency or will it remain the object of political manipulation for years to come? Hard or soft debates may account for the leveling of forests given the paper they have used so far, but the real questions as to the nature of the euro, its true purpose and the future, never seem to be given their just due.

There is little doubt that the agenda behind the euro is not one of saving on FX fees or to lower unemployment. Indeed, the goal of the euro is not even to create an economy greater than that of the United States. All of these stories appear to be the smoke and mirrors that have been necessary to push the euro agenda ahead with as little honest debate as possible.

The myths about the euro are numerous. Everyone is amazed how Europe has managed to converge going into 1998. However, we must keep in mind that belief often clouds reality for brief periods of time. In the end, the underlying economics always, and without exception, rises to the surface to win the day. Such was the experience of Russia and China. For a while, they managed to muddle along somehow, someway. At the end of the day, a strong centralized planning model failed catastrophically. If we consider that this miraculous convergence throughout Europe has been achieved on the back of false hopes, dreams and a great deal of questionable bookkeeping, the eventual outcome presents far greater risks than rewards. We have stood by and listened to the hype about unbelievable economic potential once German unification took place. We have heard how Asia would be the powerhouse of the future and you'd better rush in before it's too late. We have also endured the hype of emerging markets and how this would be the next great investment opportunity. These are just a few of the headline scenarios of the past decade that have shown how man's hopes often triumph over his past experiences. The euro will prove to be no exception.

The true agenda behind the euro is to achieve European federalization. The political forces have realized that they cannot cope with the vast unfunded liabilities promised over the next decade. Unless something is done, surely virtually every western budget either moves into default or serious expansions in money supply must occur. The vast differentials throughout Europe exist in every category from taxes, labor rules, and wages to social customs. One cannot have a single currency without also standardizing all other economic regulation. Any attempt to merely establish the euro without a complete overhaul of European regulation and taxation by a new strong centralized government, will lead to the collapse of the euro system, as was the case in South East Asia. One cannot peg currency values to a political agenda when they are out of line with the underlying economic conditions.

The hype about how everyone will pay a single interest rate is yet another ploy to usher in the euro before the world realizes what is happening. Within the United States, there exists a single currency and a single national interest rate. However, this does not mean that each state pays the same interest rate in the open market. The overlooked variable here is what is known as 'credit risk' and this ultimately gives way to 'credit ratings'. The creation of the euro does not guarantee that each Member State will pay the same interest rate, unless it also surrenders all power to a new federal European government. As long as each state maintains its own economic and political budget process, as is the case in the US, then true convergence remains an impossible dream.

The problem faced by the euro in the future is that the very concept of a new federal Europe represents an attempt to hold on to a social-economic system that is suffocating under its own weight. A good day in Europe has unemployment at 12.5%. On a bad day it is closer to 25%. For a long time the rigid labor market and excessively high taxation placed on the back of business has worn down the European Community. This is reflected in the stagnant economic growth rates over the past 30 years, which have often been below population growth and have thus ensured high structural unemployment. The solution to these problems is not greater federalization and centralized planning, but less government control and interference within the free market system. The attempt by European governments to prevent companies from laying-off employees has only given rise to greater growth in part-time jobs at the expense of full-time security. Companies won't hire new full-time employees unless they are completely convinced that they need them, for fear of being unable to reduce their workforce during lean times. These old economic policies have been proven wrong in Russia and China. Economic growth has soared in both Britain and the United States, when regulation and labor markets were allowed to be competitive. The problems faced by Japan are again due to the over-regulation of every aspect of its economy from a centralized-planning perspective. Until Japan deals with this crisis and allows power to pass back to the free market, no solid recovery is possible.

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Prior to World War II, the world operated in a different manner. In the US, the purpose of the 12 branches of the Federal Reserve was to allow regional independence. When the economy was booming in Texas, New York suffered due to rising commodity prices. When New York booms, Texas is in depression. Each of the 12 branches of the Federal Reserve operated independently by establishing a discount rate for its region. When a shortage of cash appeared in one district, the local Federal Reserve would raise rates. The differential helped to attract internal capital flows and the economy was smoothed in this manner, thus avoiding financial panics, such as the one in 1907, which were created due to temporary shortages of cash in one region versus another. World War II provided the excuse to strengthen the central planning role of the Federal government. During the post-war period, that newly seized power was never handed back to the regions. Consequently, economics began to be established by Washington rather than locally. Monetary policy took the shape of one-size-fits-all. What emerged was a Fed that became fixated on New York and Los Angeles while ignoring Middle America. It was this trend of ignoring the majority of the nation that ultimately led to the Reagan revolution and the start of reform and devolution of power back to the regions. The same was true in the Canadian experience, caused by its central bank's focus on the eastern regions at the expense of the west, giving credence to separatist movements. The same has been true in Scotland vs. England, eastern vs. western Australia and the north vs. the south in both Japan and Europe.

The euro is flying in the face of experience. An attempt to strengthen centralized planning with the implementation of a one-size-fits-all monetary policy will only serve to highlight the differences within Europe as it did in the United States. The mere fact that the powers that be find it necessary to intervene in world currency markets is an indication that the free market is moving in the opposite direction to current political-economic policies. The attempt to fix the European currencies against the euro on May 3rd, while the euro does not actually come into existence until January 1999, merely opens the door to further evidence of the unspoken desire for a strong federalized Europe. The Current pressure being exerted on banks to discourage speculation between May and January is a sign of weakness, not strength. The pressure applied to analysts at major institutions is not merely an attempt to suppress free speech, but to ensure that no one issues a major sell alert to his/her clients before January.

Indeed, the entire purpose of the G7 is a vain and ill-founded scheme to control and intervene in the world economy in order to further political agendas. The formation of the G5 in 1985, with an attempt to lower the dollar by 40% to affect trade balances, merely produced the 1987 Crash when capital bailed out due to FX losses. Politicians will never learn. If the FX markets are not moving in the direction they want to go in, the answer is not artificial intervention—it is a reflection of political agendas that make no sense in the world of economic reality. The current attempts by the Bank of Japan to artificially force the yen higher will not save the nation. With the banking system in a shambles, confidence at historic all-time lows and a government that refuses to relax its control over every aspect of its economy, capital has little choice but to seek investment elsewhere. The longer Japan keeps the yen artificially high, the more manufacturing it will continue to lose, as its corporations migrate to more favorable economic climates. In the end, Japan will never be the same as long as the economy and the yen remain at odds.

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We are in a new era of political and economic intervention. The consequences of these strong-arm tactics and more are likely to increase volatility beyond our wildest imagination, as reality ultimately catches up with political-fiction. The lesson of Hong Kong should stand as a memorial in the FX community. Applying pressure on the banks to discourage the acceptance of orders to sell the HK dollar by threatening to raise any individual bank's interest rate exclusively, gave rise to the 'Hong Kong Crash'. When our own clients discovered that a legitimate hedge position was being blocked by the Hong Kong Monetary Authority, the only course of action was to sell assets. We cannot build a financial Berlin Wall to prevent capital from moving. If Europe continues to follow the Hong Kong intervention model by intimidating banks on an individual and exclusive basis, it may succeed in preventing a fluctuation in the euro—but it may, in turn, create the next Great Financial Crash in history.