DEBASEMENT OF THE CURRENCY

Hans Sennholz

IT IS NOT money, as is sometimes said, but the depreciation of money - the cruel and crafty destruction of money - that is the root of many evils. For it destroys individual thrift and self-reliance as it gradually erodes personal savings. It benefits debtors at the expense of creditors as it silently transfers wealth and income from the latter to the former. It generates the business cycles, the stop-and-go boom-and-bust movements of business that inflict incalculable harm on millions of people. For money is not only the medium for all economic exchanges, but as such also the lifeblood of the economy. When money suffers depreciations and devaluations it invites government price and wage controls, compulsory distribution through official allocation and rationing, restrictive quotas on imports, rising tariffs and surcharges, prohibition of foreign travel and investment, and many other government restrictions on individual activities. Monetary destruction breeds not only poverty and chaos, but also government tyranny. Few policies are more calculated to destroy the existing basis of a free society than the debauching of its currency. And few tools, if any, are more important to the champion of freedom than a sound monetary system.

Inflation is defined here as the creation of new money by monetary authorities. In more traditional usage, it is that creation of money that visibly raises goods prices and lowers the purchasing power of money. It may be creeping, trotting, or galloping, depending on the rate of money creation by the authorities. It may take the form of "simple inflation," in which case the proceeds of the new money issues accrue to the government for deficit spending. Or it may appear as "credit expansion," in which case the authorities channel the newly created money into the loan market. The government may balance its budget, but in order to stimulate business and promote full employment it may inject new credits into the banking system. Both forms are inflation in the broader sense and as such are willful and deliberate policies conducted by government.

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Our is the age of inflation. All national currencies have suffered serious depreciations in our lifetime. The British pound sterling, the shining example of hard money for one hundred years, has lost almost 90 per cent of its purchasing power and suffered four devaluations since 1931. The powerful US dollar of yesteryear has lost at least two-thirds of its purchasing power and continues to shrink at accelerating rates. In the world of national currencies there have been nearly 400 full or partial devaluations since World War II. Many currencies have suffered total destruction and their replacements are eroding again.

Ideas Shape Policies

To inquire into the causes that induce governments the world over to embark upon such monetary policies is to seach for the monetary theories and doctrines that guide their policy makers. Ideas control the world, and monetary ideas shape monetary policies. Several distinct economic and monetary doctrines have combined their forces to make our age one of inflation. One doctrine in particular enjoys nearly universal acceptance: the doctrine that *government needs to control the money.*

Even many of the champions of private property and individual freedom stop short at money. They are convinced that money cannot be left to the vagaries of the market order, but must be controlled by government. Money must be supplied and regulated by government or its central bank. That money should be free is inconceivable to typical twentieth-century man. He depends on government to mint his coins, issue his notes, define "legal tender," establish central banks, conduct monetary policy, and then stabilize the price level. In short, he wholly relies on government regulation of money. But this trust in monopolistic monetary authority operating through political processes inevitably gives rise to monetary destruction. In fact, money is inflated, depreciated, and ultimately destroyed wherever government holds monopolistic power over it.

Government Control of Money

Throughout the history of civilization, governments have been the chief cause of monetary depreciation. It is true, variations in the supply of metallic money, due to new gold and silver discoveries, occasionally affected the value of money. But these changes were rather moderate when compared with those caused by government coin debasements or note inflations. Especially since the rise of statism and the "redistributive society," governments all over the world have embarked upon unprecedented inflations the disastrous effects of which can only be surmised. To entrust our money to government is like leaving our canary in trust with a hungry cat.

From the Roman caesars and the Medieval princes to contemporary presidents and prime ministers, their governments have this in common: the urgent need for more revenue. The large number of spending programmes such as war or preparation for war, care of veterans and civil servants, health, education, welfare, urban renewal, and the like, places a heavy burden on the public treasury, which is finally tempted to provide the necessary funds through currency expansion. True, government at first may merely endeavour to tax wealth and income - tax Peter to pay Paul. But this convenient and popular source of government support is practically exhausted when Peter's income tax reaches one hundred per cent. At this point, for additional revenue, the government must either raise everyone's taxes or turn to currency expansion. But the former is rather unpopular and therefore inexpedient politically. To win elections, the taxes may even be lowered and the inevitable deficits covered through currency creation, i.e., inflation.

The Steps Toward Monopoly

The first step toward full development of this source of revenue was the creation of a *government monopoly of the mint.* To secure possession of the precious metals that circulated as coins, the sovereign prohibited all private issues and established his own monopoly. Minting became a special prerogative of the sovereign power. Coins either carried the sovereign's picture or were stamped with his favourite emblems. But above all, his mint could now charge any price for the coins it manufactured. Or it could reduce the precious metal content of the coins and thus obtain princely revenues through coin debasement. Once this prerogative of sovereignty was safely established, the right to clip, degrade, or debase the coinage was no longer questioned. It became a "crown right" that was one of the chief sources of revenue.

An essential step toward gradual debasement of the coinage was the separation of the name of the monetary unit from its weight. While the original names of the coins designated a certain weight and thus afforded a ready conception of their gold or silver contents - pound, libra or livre, shillings, mark, and so on - the new names were void of any reference to weight. The pound sterling was no longer a pound of fine silver, but anything the sovereign might designate as the national monetary unit. This change in terminology widely opened the door to coin debasement.

The next step toward full government control over money was the passage of *legal tender laws,* which dictates to people what their legal money can be. Such laws are obviously meaningless and superfluous wherever the ordinary law of contract is respected. But where government wants to issue inferior coins or depreciated paper notes, it must use coercion in the form of legal tender legislation. Then it can circulate worn or debased coins side-by-side with the original coins, falsify the exchange ratios between gold and silver coins, and discharge its debt with the over-valued coins, or make payments in greatly depreciated fiat money. In fact, once legal tender laws were safely established, debt repudiation through monetary depreciation could become one of the great injustices of our time. Contemporary jurisprudence and jurisdiction were utterly paralyzed in their defense and administration of justice once they accepted legal tender laws. A dept of a million gold marks thus could be legally discharged with one milion paper marks that bought less than one US penny. And a goverment debt of fifty billion 1940 dollars can now be paid or refunded with a 1971 dollar issue that is worth less than one-third of the original amount. With the blessings of the courts, millions of creditors can now be swindled out of their rightful claims, their property legally confiscated.

But absolute government control over money was only established when money substitutes in the form of *paper notes and demand deposits* came into prominence. As long as governments had to make payments in commodity money, inflationary policies were limited to the primitive methods of coin debasement. With the advent of paper money and demand deposits however, the power of government was greatly strengthened, and the scope of inflation vastly extended. At first, people were made familiar with paper money as mere substitutes for money proper, which was gold or silver. Government then proceeded to withdraw the precious coins from individual cashholdings and concentrate them in its trea-

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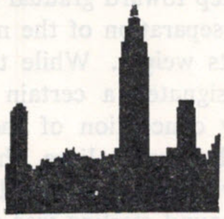
sury or central bank, thus replacing the classical gold-coin standard with a gold-bullion standard. And finally, when the people had grown accustomed to



paper issues, government could deny all claims for redemption and establish its own fiat standard. All checks on inflation had finally been removed.

The Role of the Central Bank

The executive arm of government that conducts the inflation usually is the central bank. It does not matter who legally owns this bank, whether private investors or the government itself. Legal ownership always become empty and meaningless when government assumes total control. The Federal Reserve System which is legally owned by the member banks is the monetary arm of the US Government and its engine of inflation. It enjoys a monopoly of the note issue which alone is endowed with legal tender characteristics. Commercial banks are forced to hold their reserves as deposits with the central bank, which becomes the "banker's bank" with all the reserves of the country. The central bank then conducts its own inflation by expanding its notes and deposits while maintaining a declining reserve ratio of gold to its own liabilities, and directs the bank credit expansion by regulating the legal reserve requirements the commercial banks must maintain with the central bank. Endowed with such powers, the central bank now can finance any government deficit, either through a direct purchase of treasury obligations or through open-market purchase of such obligations, which creates the needed reserves for commercial banks to buy the new treasury issues.

The final step toward absolute government control over money, and its ultimate destruction, is the *suspension of international gold payments,* which is the step President Nixon took on August 15, 1971. When a central bank is hopelessly overextended at home and abroad, its currency may be devalued, which is a partial default in its international obligations to make payment in gold or, in an outburst of abuse against foreigners and speculators, the government may cease to honour any payment obligations, as in the case of the US default. All over the world, government paper now forms 120 national fiat standards that are managed and depreciated at will.

The decline of monetary freedom and the concomitant rise of government power over money gave birth to our age of inflation. Step by step, government assumed control over money, not only as an important source of government revenue but also as a vital command post over our economy. The result is continuing inflation. Only monetary freedom can impart stability.

Welfarism and Inflation

Even the noblest politicians and civil servants can no longer be expected to resist the public clamour for social benefits and welfare. The political pressure that is brought to bear on democratic governments is rooted in *the popular ideology of government welfare and economic redistribution.* It inevitably leads to a large number of spending programmes that place heavy burdens on the public treasury. By popular demand, weak administrations seeking to prolong their power embark upon massive spending and inflating in order to build a "new society" or provide a "better deal." The people are convinced that government spending can give them full employment, prosperity, and economic growth. When the results fall far short of expectations, new programmes are demanded and more government spending is initiated. When social and economic conditions grow even worse, the disappointments breed more radicalism, cynicism, nihilism, and above all, bitter social and economic conflict. And all along, the enormous increase in government spending causes an enormous increase of taxes, chronic budget deficits and rampant inflation.

The "redistributive" aspirations of the voting public often induce their political representatives in Congress to authorize and appropriate even more money than the President requests. Such programmes as social security, medicare, anti-poverty, housing, economic development, aid to education, environmental improvement, and pay increases for civil servants are so popular that few politicians dare to oppose them.

The government influences personal incomes by virtually every budget decision that is made. Certainly its grants, subsidies and contributions to private individuals and organisations aim to improve the material incomes of the beneficiaries. The loans and advances to private individuals and organisations have the same objective. Our foreign aid programme is redistributive in character as it reduces American incomes in order to improve the material condition of foreign recipients. The agricultural programmes, veteran's benefits, health, labour, and welfare expenditures, housing and community development, Federal expenditures on education, and last, but not least, the social insurance and medicare programmes directly affect the incomes of both beneficiaries and taxpayers. As the benefits generally are not based on tax payment, but rather on considerations of social welfare, these programmes constitute redistribution on a nationwide scale. Foreign aid programmes have extended the principle of redistribution to many parts of the world.

Whenever government expenditures exceed tax collections and the government deficit is covered by currency and credit expansion, we suffer inflation and its effects. The monetary unit is bound to depreciate and goods prices must rise. Large increases in the quantity of money also induce people to reduce their savings and cash-holdings which, in the terminology of mathematical economics, increases money "velocity" and reduces money value even further. It is futile to call these people "irresponsible" while the government continues to increase the money stock.

Labour Union Pressures

A very potent cause of inflation is the unrelenting wage pressure exerted by labour unions. It is true, labour unions do not directly enhance the quantity of money and credit and thus cause the depreciation. But their policy of raising production costs inevitably causes stagnation and unemployment. This is why the union strongholds are the centres of unemployment. Faced with serious stagnation, the labour leaders are likely to become spokesmen for all schemes of easy money and credit that promise to alleviate the unemployment plight. The democratic government in turn does not dare to oppose the unions for political reasons. On the contrary, it does everything in its power to reduce the pressure which mass unemployment exerts on the union wage rates. It grants ever larger unemployment benefits and embarks upon public works in the depressed unionised areas. At the same time it expands credit, which tends to reduce real wages and to encourage employment.

The demand for labour is determined by labour costs. Rising costs reduce the demand, falling costs raise it. Inasmuch as inflation reduces the real costs of labour, it actually creates employment. When goods prices rise while wages stay the same, or prices rise faster than wages, labour becomes more profitable to employers. Many workers, whose employment costs heretofore had exceeded the value of their productivity so that they were unemployable, now can be profitably re-employed. Of couse, this employment-creating policy is then counteracted by such unemployment factors as rising minimum wage rates, higher unemployment benefits and welfare doles, and rising union wage scales and fringe-benefit costs. In many industries, the labour unions have introduced "cost-of-living clauses" that aim to prevent the decline of real wages through monetary depreciation. Or their wage demands take into consideration the rising rates of monetary depreciation. Their demands may become "exorbitant," their strikes longer and uglier, and the economic losses inflicted on business and the public ever more damaging until businessmen clamour for government wage controls. With wage controls come price controls and the whole paraphernalia of the command system.

The "New Economics"

To give "scientific" justification to the policy of inflation, a host of contemporary economists have developed intricate theories, commonly known as the *new economics*. Basically, they all ascribe to government the magic power of creating real wealth out of nothing, of raising the "national income" through minute efforts of the central bank and its printing presses. They are unanimous in their condemnation of the gold standard, which to them means domination by "external forces" and denial of national independence in economic policies. Of course, the "independence" they so jealously uphold is tantamount to government control over money matters. They want "fiat money," i.e., government money without restraint by a commodity such as gold. Though some would allow us the freedom to buy and hold gold coins or bullion, they know very well that the legal tender laws that support the fiat standard deny us the rights to use gold in economic exchanges, which relegates all coins to hoards and coin collections.

Only free money is sound money. This is why one should be suspicious of any and all proposals that would enhance the power of government over money. A currency reform, whether domestic or international, that does not endeavour to dismantle this power, cannot provide monetary stability. It is destined to lead to more inflation and depreciation, to economic upheaval and decline. Sound money means the gold-coin standard; it makes the value of money independent of government, as the quantity of gold is independent of the wishes and manipulations of government officials and politicians. It needs n o "rules of the game," no arbitrary rules people must learn or government must observe. It is born in freedom and follows inexorable economic law.

IF IRELAND goes into the EEC all the ills we've suffered from being "an island behind an island" will be compounded. Our surplus labour will move to Munich instead of Liverpool. Our Western towns and villages will die as the small farmers are driven off the land. Our home industries will collapse with a tiny squeak under the international business conglomerates. Our almost extinguished spark of national identity, national culture, national drive, will go out with a whimper.

Rosite Sweetman, in *On our Knees* (Pan Special, 1972)