than an accident of timing or geography." He notes the historical emergence of all kinds of theories that justified "brutal forms of exploitation of the poor through colonial rule, dispossession of the properties and lands of the poor by the rich and even slavery."\(^{40}\)

President Bill Clinton's mentor at Georgetown University, Professor Carroll Quigley, has candidly revealed that

the powers of financial capitalism had another far-reaching aim, nothing less than to create a world system of financial control in private hands able to dominate the political system of each country and the economy of the world as a whole. This system was to be controlled in a feudalist fashion by the central banks of the world acting in concert, by secret agreements arrived at in frequent private meetings and conferences. The apex of the system was to be the Bank for International Settlements in Basle, Switzerland, a private bank owned and controlled by the world's central banks which were themselves private corporations. Each central bank...sought to dominate its government by its ability to control Treasury loans, to manipulate foreign exchanges, to influence the level of economic activity in the country, and to influence cooperative politicians by subsequent economic rewards in the business world.\(^{41}\)

In the following chapters, we shall describe the evolution of the mechanisms by which these goals have been achieved.

Central Banking and the Rise of the Money Power

It should be evident that any effort to alter the status quo must be informed by a thorough understanding of the mechanisms that have been used to consolidate power and wealth. In our modern era, the chief instrument by which that consolidation has been achieved is by control of the machinery for creating money. Money has consistently been abused by those who have had authority over it. In medieval times, it became common for princes and kings to recall and reissue the gold and silver coins that then served as money, each time enriching themselves by reducing the precious metal content of the new coins and forcing their subjects to accept them at the same nominal value as the old.

But it is only within the past three centuries that the machinery of money and banking has been refined to enable levels of control approaching the absolute to be wielded on a worldwide basis by a handful of individuals. In something resembling "the divine right of kings" they must imagine themselves to possess superior qualities that entitle them to their positions of privilege, dominance, and rulership. This privilege, they claim in private to be their legitimate reward or bringing order to the "unruly mob." Surely the most valuable and effective privilege for maintaining control and appropriating wealth in the modern world has been the privilege of controlling the machinery of money and bank-

Meyer Amschel Rothschild, the patriarch and founder of the celebrated banking dynasty, is quoted as having said, "Give me the power to create a man's money and I care not who makes the laws." And from whence does power derive? It is the corruption of government that Hamilton spoke of. There is no mistake about it; government—of whatever shape or description—dispenser of privilege. It favors the few at the expense of the many and times ever more corrupt as it arrogates ever more power. This is the seed from which central banking has sprung.
Central Banking, an Unholy Alliance

Imagine being able to borrow and spend as much money as you want and never having to pay any of it back. Imagine being able to write an IOU for each purchase you make and have someone else redeem it, or being able to write checks against someone else’s bank account. Imagine having the legal privilege to create virtually all of the nation’s money by making a few bookkeeping entries and lending it out at interest. Shocking as it may seem, this is the nature of the monetary and financial regime that has spread around the world. But who holds these privileges and how are they exercised?

The Bank of England

That story begins with the founding of the Bank of England more than three hundred years ago. William III (William of Orange) and Mary II had ascended to the throne of England as coregents in 1689. William was at war with France (under Louis XIV) in what is known as the War of the League of Augsburg (1688-97). War is an expensive proposition, and William needed to raise money to finance it. Another William, the Scotsman William Patterson, provided the solution to the king’s financial problem—“he proposed a loan of £1.2m to the government; in return the subscribers would be incorporated as The Governor and Company of the Bank of England with long term banking privileges including the issue of notes.” By 1708, the government had fallen more deeply into debt to the bank, and as a result the bank’s privileges were extended—giving it a virtual monopoly in the issuance of banknotes.

That was the beginning of the unholy alliance between politics and finance that has enabled governments to spend without being limited by tax revenues, and has given bankers the privilege of creating credit money (originally, in the form of banknotes, now as “deposits”) and lending it out at interest. The Bank of England became the prototype for central banks that were eventually to be established in virtually every country of the world.

Riegel provides this summary of the matter:

Throughout the ages the devices of cunning men have turned money to their nefarious purposes. Money, beginning with private enterprise as a means of escaping the limitation of barter soon developed the

cheat to exploit the honest trader who in an effort to protect himself turned to government for protection, only to find that now he had two thieves, the private money changer and the political plunderer working hand in glove against him. By this combination the money changer gained the prestige of political sanction through legislative license and the state secured a deceptive device for laying taxes upon the citizenry [by means of the hidden tax called inflation]. It was and remains a vicious alliance.

Professor Quigley regarded “the founding of the Bank of England by William Paterson and his friends in 1694” as “one of the great dates in world history.” Quigley observed that

this organizational structure for creating means of payment out of nothing, which we call credit, was not invented by England but was developed by her to become one of her chief weapons in the victory over Napoleon in 1815. The emperor, as the last great mercantilist, could not see money in any but concrete terms, and was convinced that his efforts to fight wars on the basis of “sound money,” by avoiding the creation of credit, would ultimately win him a victory by bankrupting England. He was wrong, although the lesson has had to be relearned by modern financiers in the twentieth century.

Central Banking in the United States

No sooner had the colonies taken steps to sever their ties with Britain, than the elite forces set about replicating the Bank of England model in America. The first attempt in that direction had been made even prior to the end of the Revolutionary War with the chartering by Congress of the Bank of North America on the very last day of 1781. Wikipedia provides this account:

Earlier, on April 30, 1781, Alexander Hamilton, then only twenty-three years old and still serving in the military, had sent [Finance Minister, Robert] Morris a letter. First, Hamilton revealed that he had recommended Morris for the position the previous summer
when the constitution of the executive was being solidified. Second, he proceeded to lay out a proposal for a National Bank. Morris, who had corresponded with Hamilton previously (1780) on the subject of funding the war, immediately drafted a legislative proposal based on Hamilton's suggestion and submitted it to the Congress. Morris persuaded Congress to charter the Bank of North America, the first private commercial bank in the United States.\textsuperscript{43}

As Murray Rothbard describes it, "This bank, headed by Morris himself [in an evident conflict of interest], . . . was not only the first fractional reserve commercial bank in the U.S.; it was to be a privately owned central bank, modeled after the Bank of England. . . . [The Bank] received the privilege from the government of its notes being receivable in all duties and taxes to all governments, at par with specie. In addition, no other banks were to be permitted to operate in the country. In return for its monopoly license to issue paper money, the bank would graciously lend most of its newly created money to the federal government to purchase public debt and be reimbursed by the hapless taxpayer."\textsuperscript{44} The Bank of North America, despite its monopoly powers, did not fare well. By the end of 1783, it had ceased to function as a central bank and shifted its status by obtaining a state charter in Pennsylvania.

**The First Bank of the United States**

The next attempt came a few years later, after the Articles of Confederation had been replaced by the Constitution. Led by Alexander Hamilton, who had fought alongside George Washington in the Revolutionary War and now served in his cabinet as Secretary of the Treasury, the elite interests proposed that a Bank of the United States be chartered to serve as the depository of federal government funds. The bank also, like the Bank of England, was to enjoy certain privileges. It would have the power to issue notes that would be acceptable by the government in payment of taxes. In 1791, Congress approved the charter and the bill was signed by President Washington. Thus, the first Bank of the United States came into being. It was a private corporation owned mainly by foreign, mostly British, interests. This bank lasted until 1811 when its twenty-year charter expired and the bill to renew it failed by one vote in Congress.

Andrew Jackson and the "Bank War"

The Second Bank of the United States, chartered in 1816, was essentially a replica of the first Bank of the United States. It also had a twenty year charter that was due to expire in 1836, at which time the bank's proponents expected that it would be renewed, but the election of Andrew Jackson as President in 1828 threw a wrench into that plan. In 1832, during Jackson's campaign for a second term, the bank became a major issue. Jackson argued that "The Bank of the United States is in itself a Government which has gradually increased in strength from the day of its establishment."\textsuperscript{45} He said of the bankers, "You are a den of vipers and thieves. I intend to rout you out, and by the Eternal God, I will rout you out." He saw himself as a champion of the people against "a heartless monied aristocracy."\textsuperscript{46} In his view, the "bank war" was a contest for rulership—would the United States be governed by the people through their elected president and representatives, or by an unelected financial elite through their central bank instrument?

Nicholas Biddle, then president of the bank, had lobbied Congress to pass a bill to recharter the bank early. The sentiments of the antibank forces were ably expressed by Thomas Hart Benton on the floor of the Senate:

First: Mr. President, I object to the renewal of the charter... because I look upon the bank as an institution too great and powerful to be tolerated in a government of free and equal laws.... Secondly, I object... because its tendencies are dangerous and pernicious to the government and the people... It tends to aggravate the inequality of fortunes; to make the rich richer, and the poor poorer; to multiply nabobs and paupers.... Thirdly, I object... on account of the exclusive privileges, and anti-republican monopoly, which it gives to the stockholders.\textsuperscript{47}

Despite such pleas as Benton's, Congress did pass the recharter bill—but on November 24, 1832, Jackson vetoed it. While Jackson acknowledged in his veto message that "A bank of the United States is in many respects convenient for the Government and useful to the people," he argued that the bank as constitutes was a privileged monopoly created to make rich men "richer by act of Congress." The bank, he declared, was "unauthorized by the Constitution, subversive of the rights of the States, and dangerous to the liberties of the people."\textsuperscript{48} In the penultimate paragraph of his veto message, Jackson provided this inspiration and challenge:
Experience should teach us wisdom. Most of the difficulties our Government now encounters and most of the dangers which impede over our Union have sprung from an abandonment of the legitimate objects of Government by our national legislation, and the adoption of such principles as are embodied in this act [to recharter the Bank]. Many of our rich men have not been content with equal protection and equal benefits, but have besought us to make them richer by act of Congress. By attempting to gratify their desires we have in the results of our legislation arrayed section against section, interest against interest, and man against man, in a fearful commotion which threatens to shake the foundations of our Union. It is time to pause in our career to review our principles, and if possible revive that devoted patriotism and spirit of compromise which distinguished the sages of the Revolution and the fathers of our Union. If we can not at once, in justice to interests vested under improvident legislation, make our Government what it ought to be, we can at least take a stand against all new grants of monopolies and exclusive privileges, against any prostitution of our Government to the advancement of the few at the expense of the many, and in favor of compromise and gradual reform in our code of laws and system of political economy.  

Those words seem even more relevant today than they were when Jackson wrote them.

It was Jackson's intention to begin withdrawing the government's funds from the central bank in 1833, a feat that he was able to accomplish only after replacing two secretaries of the treasury who had refused to carry out his order. When Jackson appointed Roger B. Taney to the post, the instructions were carried out. Government funds were withdrawn from the bank and federal tax revenues were subsequently deposited in various state banks.

Biddle was outraged at Jackson's actions and retaliated by constricting credit throughout the country. He attempted to pressure Jackson to change his policies toward the bank by calling in loans and refusing to make new ones. This all but crashed the economy, causing widespread distress by depriving legitimate business of the credit money it needed to conduct normal operations. Arthur Schlesinger describes the situation thusly: "The determination which enabled Jackson to resist the hysteria of panic came basically from the possession of an alternative policy of his own. Madison had surrendered to a corresponding, though less intense, pressure in 1816 [when he allowed the Second Bank of the United States to be chartered] because he had no constructive program to offer. But, for Jackson, the emotions and ideas which underlay the hard-money case against the Bank were crystallizing into a coherent and concrete set of measures, designed to capture the government for 'the humble members of society,' as Hamilton's system had captured it for 'the rich and powerful.'" Initially, the business community blamed Jackson for their distress, but they eventually came to realize that the fault lay with Biddle and the Second Bank.

Andrew Jackson is not the only American president to have warned against the money power. Thomas Jefferson said, "I sincerely believe ... that banking establishments are more dangerous than standing armies." President James A. Garfield, who had previously been chairman of the Banking Committee in the House of Representatives, said, "Whoever controls the money in any country is master of all its legislation and commerce."
The Free Banking Era

The demise of the Second Bank was followed by a period known as the “free banking” era (1837–63), during which the credit creation process was opened up to competition and oversight of banking activities devolved to the various states. While critics have pejoratively referred to this time as the era of “wildcat banking,” a defensive statement has come from no less a personality than former Federal Reserve Chairman Alan Greenspan, who said:

Free banking meant free entry under the terms of a general law of incorporation rather than through a specific legislative act. The public, especially in New York, had become painfully aware that the restrictions on entry in the chartered system were producing a number of adverse effects. For one thing, in the absence of competition, access to bank credit was perceived to have become politicized—banks’ boards of directors seemed to regard those who shared their political convictions as the most creditworthy borrowers, a view not unknown more recently in East Asia. In addition, because a bank charter promised monopoly profits, bank promoters were willing to pay handsomely for the privilege and legislators apparently eagerly accepted payment, often in the form of allocations of bank stock at below-market prices.

While free banking was not actually as free as commonly perceived, it also was not nearly as unstable. The perception of the free banking era as an era of “wildcat” banking marked by financial instability and, in particular, by widespread significant losses to noteholders also turns out to be exaggerated. Recent scholarship has demonstrated that free bank failures were not as common and resulting losses to noteholders were not as severe as earlier historians had claimed.65

During that time, each bank issued its own currency notes and it was left to the market to evaluate their soundness. Fractional reserve banking prevailed and banknotes were still redeemable for specie (gold or silver). Typically, the farther a banknote strayed from its home territory, the more it would be discounted from face value—or sometimes completely refused as payment. The plethora of currencies in circulation gave rise to a large number of “note brokers,” who made a profit by buying banknotes at a discount then presenting them at the issuing banks for redemption at par. The activities of the note brokers provided an important element of discipline to the issuing banks, since they had to be prepared to redeem their notes that were rapidly returning from the hinterlands. These brokers also published periodic directories called “banknote reporters,” which listed the prevailing discounts on the notes of thousands of banks. This information was invaluable to merchants and other banks. Greenspan describes it thusly:

Throughout the free banking era the effectiveness of market prices for notes, and their associated impact on the cost of funds, imparted an increased market discipline, perhaps because technological change—the telegraph and the railroad—made monitoring of banks more effective and reduced the time required to send a note home for redemption. Between 1838 and 1860 the discounts on notes of new entrants diminished and discounts came to correspond more closely to objective measures of the riskiness of individual banks.67

In an unexpectedly friendly gesture toward free banking, Greenspan goes on to say,

During the Civil War, today’s bank structure was created by the Congress. It seems clear that a major, if not the major, motivation of the National Bank Act of 1863 was to assist in the financing of the Civil War. But the provisions of the act that incorporated key elements of free banking provide compelling evidence that contemporary observers did not regard free banking as a failure. These provisions included free entry and collateralized bank notes.68

As financial crises proliferate in our own time, economists would do well to make a careful study of the free banking period and to propose the reimplementation of those “key elements.”

The Federal Reserve

The interests of international banking and finance might be delayed, but they were not to be defeated. From the time of the Civil War onward, they gradually resumed control and eventually managed to get a new central bank in the form of the Federal Reserve. The act to create the Fed was passed by Congress in 1913—just before Christmas, when most representatives had already gone home for the holidays. The secret meetings and other events leading up to
its passage are well told in a book, The Creature From Jekyll Island, and in various other sources.60 Rothbard offers this critical assessment: "The financial elites of this country, notably the Morgan, Rockefeller, and Kuhn, Loeb interests, were responsible for putting through the Federal Reserve System, as a governmentally created and sanctioned cartel device to enable the nation's banks to inflate the money supply in a coordinated fashion."61

President Woodrow Wilson, who ironically supported the creation of the Fed, also expressed dismay over the concentration of power in the hands of a financial elite. In his book, The New Freedom, Wilson said, "Some of the biggest men in the United States, in the field of commerce and manufacture, are afraid of somebody, are afraid of something. They know that there is a power somewhere so organized, so subtle, so watchful, so interlocked, so complete, so pervasive, that they had better not speak above their breath when they speak in condemnation of it." He made it clear that he understood the nature of that "power" saying,

there has come about an extraordinary and very sinister concentration in the control of business in the country. However it has come about, it is more important still that the control of credit also has become dangerously centralized. It is the mere truth to say that the financial resources of the country are not at the command of those who do not submit to the direction and domination of small groups of capitalists who wish to keep the economic development of the country under their own eye and guidance. The great monopoly in this country is the monopoly of big credits. So long as that exists, our old variety and freedom and individual energy of development are out of the question. A great industrial nation is controlled by its system of credit. Our system of credit is privately concentrated. The growth of the nation, therefore, and all our activities are in the hands of a few men who, even if their action be honest and intended for the public interest, are necessarily concentrated upon the great undertakings in which their own money is involved and who necessarily, by very reason of their own limitations, chill and check and destroy genuine economic freedom. This is the greatest question of all, and to this statesmen must address themselves with an earnest determination to serve the long future and the true liberties of men. This money trust, or, as it should be more properly called, this credit trust, ... is no myth; it is no imaginary thing.62

Congressman and 2008 presidential candidate Ron Paul has called for the abolition of the Federal Reserve. During a hearing before the House Financial Services Committee on February 11, 2004, Paul, referring to the Federal Reserve, suggested that "maybe there's too much power in the hands of those who control monetary policy. The power to create the financial bubbles. The power to maybe bring the bubble about. The power to change the value of the stock market within minutes. That to me is just an ominous power and challenges the whole concept of freedom and liberty and sound money." The then Fed Chairman, Alan Greenspan, appearing before that committee, responded, "Congressman, as I've said to you before, the problem you are eluding [sic] is called the conversion of a commodity standard to fiat money. We have statutorily gone onto a fiat money standard and as a consequence of that it is inequitable that the authority, which is the producer of the money supply, will have inordinate power... And the power that we have is all granted by you [the Congress]. We don't have any capability whatsoever to do anything without the agreement or even the acquiescence of the Congress of the United States."63

That, of course, is technically correct, but very few members of Congress have been willing to challenge the power of the Fed or even to exercise the most perfunctory degree of oversight. Most are beholden to the same interests that have created the Fed and the global money and banking regime.

Central Banking Spreads around the World

Central banking, with its inherent privileges and conflicts of interest, has spread around the world. Quigley has pointed out that, "In most countries the central bank was surrounded closely by the almost invisible private investment banking firms. These, like the planet Mercury, could hardly be seen in the dazzle emitted by the central bank which they, in fact, often dominated. Yet a close observer could hardly fail to notice the close private associations between these private, international bankers and the central bank itself."64

Although the Bank of England was the archetypical central bank, it was not necessarily by direct emulation that central banks were established in virtually every country. But there can be little doubt that it has been brought about by the same objectives, along with pressures from the international banking establishment. The same circumstances seem to have led to similar outcomes
of collusion between the financial powers and the political powers. Professor Heinrich Rittershausen traces the development from private issuing banks to modern central banks through the following stages:

A) The exclusive license to issue notes is granted to a bank as a state privilege.
B) The state discovers that the bank is a source of credit.
C) The government tax offices begin to accept the still purely private notes in tax payments instead of metallic money.
D) The state needs money in times of emergencies [like wartime]. The bank cannot refuse large loans to the government [for deficit spending]. Economically, these loans are long term.
E) In this way the note issuance becomes excessive. Redemption (in metallic money) becomes impossible and therefore is abolished by law.
F) In anticipation of feared reactions of the public, i.e., discounting the notes or refusal of acceptance, the notes are given legal tender power, i.e., compulsory acceptance. By this means, the notes lose their character as an issue of a private bank currency note.
G) Legal tender (forced acceptance of the notes) and repudiation of note redemption make the metallic standard inoperable. The measure of value now becomes the paper currency itself. The automatic regulation of the note supply by market forces comes to an end.

Riegel warned us that, "In the exercise of the money power, under the dictates of political expediency, the state is driven inevitably from libertarian forms of democracy and republicanism to the autarchic forms of fascism, socialism and communism." Ultimately, these three come to look very much alike, and in recent decades we have seen this tendency become ever more a reality, particularly in the United States. This sad state of affairs is well documented by Chalmers Johnson in his recently published Blowback trilogy.

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Benjamin Disraeli, the British prime minister under Queen Victoria, once said that, "The world is governed by very different personages from what is imagined by those who are not behind the scenes." Those who are set before the public often do us the favor of boldly describing just what it is that might otherwise be hard to imagine. From Disraeli’s revelation to the first President Bush’s proclamation of an impending “new world order,” many of the elites appear sufficiently comfortable with the use of their power that they need not always keep it strictly secret.

**The Power Behind the Central Banks**

In the previous chapter we described the emergence of central banks and their role in making money an instrument for consolidating political control. Carroll Quigley helps us to understand the connection between central banks and the financial elite. He writes:

It must not be felt that these heads of the world’s chief central banks were themselves substantive powers in world finance. They were not. Rather, they were the technicians and agents of the dominant investment bankers of their own countries, who had raised them up and were perfectly capable of throwing them down. The substantive financial powers of the world were in the hands of these investment bankers (also called “international” or “merchant” bankers) who remained largely behind the scenes in their own unincorporated private banks. These formed a system of international cooperation and national dominance which was more private, more powerful, and more secret than that of their agents in the central banks. This dominance of investment bankers was based on their control over the flows of credit and investment funds in their own countries and throughout the world.
They could dominate the financial and industrial systems of their own countries by their influence over the flow of current funds through bank loans, the discount rate, and the re-discounting of commercial debts; they could dominate governments by their control over current government loans and the play of the international exchanges. . . .

In this system the Rothschilds had been preeminent during much of the nineteenth century, but, at the end of that century, they were being replaced by J. P. Morgan whose central office was in New York, although it was always operated as if it were in London (where it had, indeed, originated as George Peabody and Company in 1838). Old J. P. Morgan died in 1913, but was succeeded by his son of the same name (who had been trained in the London branch until 1901), while the chief decisions in the firm were increasingly made by Thomas W. Lamont after 1924.  

Quigley tells us that these investment bankers differ from ordinary bankers in distinctive ways: (1) they were cosmopolitan and international; (2) they were close to governments and were particularly concerned with questions of government debts; (3) their interests were almost exclusively in bonds and very rarely in goods, since they admired liquidity; (4) they were, accordingly, fanatical devotees of deflation; (5) they were almost equally devoted to secrecy and the secret use of financial influence in political life. These bankers came to be called “international bankers” and, more particularly, were known as “merchant bankers” in England, “private bankers” in France, and “investment bankers” in the United States. In all countries they carried on various kinds of banking and exchange activities, but everywhere they were sharply distinguishable from other more obvious kinds of banks, such as savings banks or commercial banks.  

Quigley goes on to spotlight the increasingly obvious superficiality of differences between political parties and to demonstrate their subservience to the money power, saying, “To Morgan all political parties were simply organizations to be used, and the firm always was careful to keep a foot in all camps.”  

Quigley's description of the various organizations established to influence public policy and the particular individuals who founded, ran, and financed them becomes tedious in its detail—but it is the forest that we need to see and not the trees. Naturally, in the more than four decades since Quigley wrote his book, the names of the personages (and even some of the organizations) have changed, but the goals and general structure of this elite establishment remain the same. While Quigley seemed to think that the power of the Anglo-American establishment was on the wane, it seems clear that the trend toward greater elite control has continued, though with a more diverse composition. Among those organizations and groups that are prominent on the current scene in advancing the elitist agenda are the Council on Foreign Relations, the Trilateral Commission, the Bilderberg groups, and the banking companies and the families that control them.

It is a curious thing that Quigley, in his book, would so frankly expose the machinations of the elite “money masters” and their plans to gain total global control, while warmly supporting their purposes and goals. I agree with W. Cleon Skousen's assessment that, “The real value of Tragedy and Hope is not so much as a ‘history of the world in our time’ (as its subtitle suggests) but rather as a bold and boastful admission by Dr. Quigley that there actually exists a relatively small but powerful group which has succeeded in acquiring a chokehold on the affairs of practically the entire human race.”  

A Merging of Interests

The politicization of money, banking, and finance (which prevails throughout the world today) has enabled the concentration of power and wealth in few hands—a situation that has been extremely damaging to societies, cultures, economies, democratic government, and the environment. National governments have arrogated to themselves virtually unlimited spending power, which enables them to channel wealth to favored clients, to conduct wars on a massive scale, and to subvert democratic institutions and the popular will. The privileged private banking establishment has managed to monopolize everyone's credit, enabling the few to exploit the many through their partiality in allocating credit, by charging usury (disguised as “interest”) and increasingly exorbitant fees, and by rewarding politicians for their service in promoting their interests.

These two, government and banking, have colluded to create a political monetary system that embodies a “debt imperative” that results in a “growth
imperative," which forces environmental destruction and rends the social fabric while increasing the concentration of power and wealth. It creates economic and political instabilities that manifest in recurrent cycles of depression and inflation, domestic and international conflict, and social dislocation. (All of this will be addressed more fully in Chapter 6.)

The balance of power in this collusion has at some times tended toward greater power for politicians and government and less for the financial interests, while at other times it has tended in the opposite direction. Either way, autocratic government is the outcome. Now, these forces seem to be more unified than ever in pursuing their common agenda to disempower democratic government and to assume power around the globe. Within the past several decades, we have seen a massive shift of power toward the financial establishment as their friends in government have lobbied hard for, and won, "deregulation" of the financial industry, and under the guise of "free trade" have pushed forward a neocolonial agenda. In the United States, the controls and oversight bodies that were painstakingly built up following the Great Depression have been systematically hobbled or dismantled.

Wars, Internal and External

The past few decades have seen a diminished middle class in America, and government power has been increasingly turned against the people as a way of forestalling dissent and suppressing reaction against the growing inequities. In February 2008, the United States and Canada agreed to help each other to quell civil disturbances. The February 22 edition of the Ottawa Citizen ran a story under this headline: "Canada, U.S. Agree to Use Each Other's Troops in Civil Emergencies." Here is part of that article:

Canada and the U.S. have signed an agreement that paves the way for the militaries from either nation to send troops across each other's borders during an emergency, but some are questioning why the Harper government has kept silent on the deal. Neither the Canadian government nor the Canadian Forces announced the new agreement, which was signed Feb. 14 in Texas. The U.S. military's Northern Command, however, publicized the agreement with a statement outlining how its top officer, Gen. Gene Renuart, and Canadian Lt.-Gen. Marc Dumais, head of Canada Command, signed the plan, which allows the military from one nation to support the armed forces of the other nation during a civil emergency. 79

I leave it to the reader to imagine what kind of civil emergency might require the United States, the most powerful nation on earth, to ask for help from abroad. If there was ever a time when such help was needed it was during the Katrina hurricane disaster of 2005, but offers of help from many nations were refused. Under the present monetary system, policy makers must choose between two distasteful outcomes. The only thing that can prevent crippling high food and fuel prices is a worldwide economic recession. In either case, and exacerbated by the hobbling of our civil rights and traditional outlets for expressions of dissent, the citizenry is sure to become ever more restive. The peaceful public demonstrations that were so common during the 1960s and 1970s are no longer tolerated. Police have become increasingly heavy-handed and brutal in their dealings with assemblies of significant numbers of people in public places. The 1999 "Battle of Seattle" seems to have marked a turning point. In that case an estimated crowd of 40,000 people assembled to protest the meeting of the World Trade Organization and its undemocratic approach to economic globalization. Police, clad in black riot gear, used pepper spray, tear gas, and rubber bullets to disperse the crowd. Subsequent demonstrations in Miami and elsewhere have been similarly met. Contrary to the expectations of most Americans, particularly those with liberal or leftist leanings, these sorts of abuses by the police have become increasingly frequent even in such "social democracies" as Denmark. 74

With regard to wars, it is fairly well recognized that every war creates innumerable opportunities for profit, but the extreme magnitude of the resultant profits escapes general notice. The most recent war in Iraq seems to have taken profiteering to a new level with contractors like Blackwater, Halliburton, and KBR racking up obscene profits on contracts from their Bush administration cronies. More important and obscure is the opportunity that war presents for further elite concentrations of power and wealth when the rebuilding begins. The vested interests of the financial elite will rarely lead them to be vocal opponents to war, and may in fact bias them toward favoring war, even if psychologically they delude themselves into thinking this is because the war is somehow necessary. Consider the devastation of Europe and Japan during World War II. Most of the destroyed properties had been owned free-and
clear by diverse individuals and companies beyond the influence and control of western banks. In order to rebuild the destroyed infrastructure, governments, individuals, and companies had to take on enormous debts. The bankers of the world were, of course, ready to work their alchemy of turning those debts into spendable cash. In this way, the usury net encompasses ever greater portions of the world’s real wealth and the financial elite gain greater political and economic leverage.

Money Power, the Key Element in the New World Order

I have argued that control of money and exchange mechanisms is the key structural element that determines the distribution of power, and that it must be the main focus if any degree of community empowerment and self-determination is to be achieved. A money monopoly, whether in private hands or government controlled, is inimical to freedom and equity. As E. C. Riegel has expressed it:

The money mechanism, under the concept borrowed from England, is a contrivance that is both political and private but is strictly neither. It is a hybrid, and its name is finance. Compounded from both political and private interests, it compromises both private enterprise and public service. It confounds students of money and causes them to take sides for either the banking end or the government end when in fact a plague should be put upon both their houses. Control over money should be denied to both government and banks. Finance is the evil genius that brings discredit upon both the state and private enterprise and raises the threat of fascism and communism.73

Since those words were written, the “powers of financial capitalism,” as Carrol Quigley called them, have been hard at work to complete their plan “to create a world system of financial control in private hands able to dominate the political system of each country and the economy of the world as a whole.”74 Their control has now become almost total. Besides controlling the creation of money and its source allocation, they also have firm control over the flow of money through the banking and financial channels. In the name of financial security, the war on terror, and the war on drugs, it has become almost impossible for the individual to maintain any degree of financial privacy—while government and the inner sanctum of high finance become ever more opaque, enabling the well-connected and those at the top to launder and hide their ill-gotten gains. In today’s world of greatly diluted civil protections, if you do something to displease the “masters,” you may well find your name on a “no-fly list,” have your bank and credit card accounts frozen, or be abducted in an “extraordinary rendition” from anywhere you might be in the world to some secret prison camp that could be anywhere else in the world. “But I’ve done nothing wrong,” you say. Well, that depends on who defines “wrong.” President George W. Bush, shortly after the destruction of the World Trade Center in New York in 2001, vowed to “rid to world of evildoers.” In the aftermath, Congress has allowed the executive branch to assume all but dictatorial powers that have sharply curtailed government’s respect for American traditions, the Bill of Rights, and limitations on government abuse of power that go all the way back to the Magna Carta (such as habeus corpus), and allowed it to define on an ad hoc basis what is good and what is bad, what is legal and what is not. How President Obama utilizes those powers is yet to be seen, but their existence in the first place is cause enough for alarm. The tools are already in place for him or some future president to use as they see fit.

Erosion of National Sovereignty

One element in the elite plan is to further reduce the amount of discretion that national governments, particularly in the third world, have over their own economies and finances. The primary strategy thus far has been to encumber countries with debt that is supposed to be used for development projects; when they are unable to repay, the International Monetary Fund imposes “structural readjustment” programs that favor western banks, wrest away control of national resources, and create hardships for the local population.

Now these countries are being asked to give up their own national currenies. Granted, most governments have abused the issuance of their national currencies, but the powers that be are asking them to adopt global currencies that have also been abused. Benn Steil, Director of International Economics at the Council on Foreign Relations, in an article titled, “The End of National Currency,” says that “The world needs to abandon unwanted currencies, replacing them with dollars, euros, and multinational currencies as yet unborn.”77
The ostensible plan is to reduce global exchange media to three—one each for Europe, the Americas, and Asia. One might reasonably suppose that at a later stage, those three would be combined into one currency also under the control of the global banking elite. Already, some countries (such as Ecuador) have taken that advice and chosen to use the U.S. dollar as their national medium of exchange. Federal Reserve notes are just as necessary in Quito as they are in New York.

Political consolidation is also on the agenda. There is increasing talk, for example, of a North American Union similar to the European Union. In another recent article from the Council on Foreign Relations, professor Robert Pastor suggests that, “It’s time to integrate further with Canada and Mexico, not separate from them.” This article is a follow-up to a report by a 2005 Council on Foreign Relations task force that Pastor co-chaired, which shows it to be more than just one man’s opinion.

So there we have a brief sketch of the power structure in today’s world, how it came about, and how it is proceeding with its program. We’ve revealed here only the barest tip of the iceberg, but it is perhaps enough to help a few escape from the delusional “matrix.” With America’s emergence in the twentieth century as the world’s only superpower, and the global economic imperium advancing under the banner of “free trade,” the plan referred to by Quigley has been realized to a very high degree. The new world order is upon us. The demands of our would-be masters will become increasingly onerous as we enter the final stages. One need not be a Christian, or even religious, to wonder at the fact that we are now very close to an oppressive global system of order and control based on economic exchange, a system that was amazingly foretold almost two thousand years ago:

And he causeth all, both small and great, rich and poor, free and bond, to receive a mark in their right hand or in their foreheads:

And that no man might buy or sell, save he that had the mark, or the name of the beast or the number of his name.

—Revelation 13: 16-17 (KJV) [emphasis added]

SIX

Usury and the Engine of Destruction

The growth god is dead. The era of seemingly endless growth is, in fact, coming to an end. Shall we lament its passing and try to sustain it a little bit longer, shall we passively watch as our world crumbles into ashes, or shall we welcome this crisis as the opportunity we’ve been hoping for to create the kind of world we want to live in and leave for posterity? That is not to say that growth per se has been all bad. The enormous expansion of economic output throughout the industrial era has provided material benefits and more comfortable lives for a substantial portion of the world’s people. Yet billions of others have been excluded and exploited in the process. Our current system condemns them to ongoing destitution and drives the overall economy to grow for growth’s sake. Like cancer, much of the growth now is the wrong kind of growth, out of control and in the wrong places, generating ever greater disparities of power and wealth, wasting valuable resources, and producing side effects that are ultimately harmful to the earth’s capacity to support life.

Monetary Stringency, Past and Present

In the era of Columbus and the conquistadors, the world was obsessed with gold and silver. The Old World was ready for an explosion of commerce and trade but governments were deeply in debt and there was a general lack of one critical element—money. As long as people could see only precious metals as acceptable forms of payment (money), it became imperative that they acquire more of them. When Columbus embarked upon his historic voyages, that is mainly what he sought. Thus ensued the tragic genocidal conquest of the American natives from whom the world has gained so much. As Jack Weatherford describes it, “The Europeans sought desperately for ways to increase the trickle of gold that flowed up so slowly from the Gold Coast [of Africa] to Europe, and they wanted to find ways to circumvent the numerous Moslem merchants who monopolized the trade at each stage.” The enormous amounts of gold and silver that
were plundered from the Americas and shipped back to Europe provided the metal required for a tremendous expansion of the money supply—which, in turn, fueled a revolutionary economic expansion by facilitating exchange and encouraging a further specialization of labor.

Today, we face a similar dilemma, except it is not precious metal money we are obsessed with, but a different kind of money—interest-bearing, bank-created, debt-money—and it is not Muslim merchants who make it scarce and expensive, it is a global financial cartel headed by a few elite bankers, finance ministers, and wealthy speculators. The world is now stuck, as it was five hundred years ago, awaiting the creation of a more adequate, abundant, and inexpensive medium of exchange that will allow the world to make the transformational leap into a sustainable steady state economy, a restored global environment, and a life of freedom and dignity for all.

Increasing Instability

The recurrent disorder in the financial markets and the cascading failures of financial institutions should come as no surprise. It is not possible for humans to live sustainably on this earth under the present monetary regime. Why? The simple answer is, because money is credit created on the basis of loans made by banks at interest. Those who recognize the impossibility of perpetual exponential growth and who understand how compound interest is built into the global system of money and banking expect that there will be periodic “bubbles” and “busts,” each of increasing amplitude until the system shakes itself apart.

Engineers call this phenomenon “positive feedback.” Such a system cannot find equilibrium but eventually “explodes.” Imagine a heating system in which the thermostat, sensing a rise in temperature, calls for more heat instead of less. Such is the nature of the debt-money system. The imposition of interest on the debt by which money is created causes debt to grow exponentially with the passage of time. It therefore demands that more debt be created to enable the payment of the interest due. Such is the debt imperative that gives rise to a growth imperative. Among other things, it prevents the emergence of a steady state economy because no amount of production and increase in business activity can satisfy the lenders’ demands for repayment.

Is the final round at hand, or can the system be saved yet one more time? At this writing, the U.S. government has just passed legislation empowering the treasury secretary to spend (initially) up to $700 billion at his own discretion, including the financing of bank mergers and the bailout of bankrupt financial institutions by buying enormous amounts of their uncollectible junk, including that held by foreign institutions. Besides the $700 billion that has been appropriated, it is likely that additional amounts will shortly be needed to keep the global banking system from disintegrating.

The Magic of Compound Interest

Here's a little thought experiment. Take a dollar bill and bury it in the ground. Leave it there for fifty years, and then dig it up. What do you have? Depending on the care you took in burying it, you have either a dollar bill or a wad of soggy paper fragments. In the best possible case, you can go out and spend that dollar, but it probably won't buy much given the prospect of continued inflation.

Now take another dollar bill and deposit it in a savings account at a bank. Leave it there for fifty years, then withdraw your money. What do you have? Assuming an interest rate of 6 percent per year, you have $18.42. Amazing, isn't it, how money can grow? Even more amazing, if the interest rate had been 10 percent, you would have $117.39. How can this be? Well, that's the magic of compound interest. By leaving the interest earnings in your account, you earn more interest on the interest.

This kind of growth is called exponential or geometric, as we discussed in Chapter 2. If you can wait a while longer, the growth becomes really astonishing. After two hundred years at 6 percent interest, for example, your single dollar will have grown to over $115,000—at 10 percent interest, it will have grown to almost $190 million. These are shocking figures, but they are correct. Get a financial calculator and try it yourself. You see, anyone can become rich; all you have to do is lend a little money at interest—and wait. "I should live so long," you say. True enough. While these interest rates are pretty ordinary by contemporary standards, two hundred years is a long time for a natural person to wait—but it is not so long for a "legal person," like a corporation or a government. The government of the United States is more than two hundred years old, and it has been in debt for most of that time. Debts grow exponentially in exactly the same way. If you had borrowed a dollar instead of deposit-
ing a dollar, and never made any payments on the loan, your heirs would owe debts of these same colossal amounts. Which legacy would you prefer to leave them?

Now it's hard to criticize the taking of petty interest by individuals who need to save up for their education or retirement or to make some large purchase. Considering that in today's world the purchasing power of money is continually being eaten up by inflation, one needs to have an additional return just to maintain the purchasing power of their savings. Such a return can be considered as compensation for loss. The original distinction between interest and usury was just that—interest was compensation for loss. And who can argue against the obvious fact that any investment that is denominated in terms of a national currency experiences a loss as time goes on? The loss in the purchasing power of virtually every national currency results from the abusive way in which it is issued and managed. Today's dollar, for example, is worth but a fraction of its value just a few decades ago. The new car that I purchased in 1965 for two thousand dollars would cost ten times that amount today, even accounting for changes in the performance and features in today's cars. The preservation of capital therefore requires a rate of return sufficient to offset the loss due to inflation. That is not to say that I advocate a perpetuation of debt financing. It is said that "the borrower is servant to the lender." The interests of each party in debt transaction are antagonistic toward one another. For this reason, we would be better off seeing a general shift away from debt financing, toward temporary equity financing that shares both the rewards and risks involved in any venture.

What's Wrong with the Global System of Money and Banking?

Adam Smith observed, more than two hundred years ago, that "When the division of labor has been once thoroughly established, it is but a very small part of a man's wants which the produce of his own labor can supply." Since Smith's time the sources of those supplies have become ever more distant and impersonal. Consequently, we have come to be increasingly dependent upon devices like money and institutions like banks to help us in getting what we want and need from others through the marketplace. Those devices and institutions comprise what we will, for convenience, call "the money system."

It is a system that has been constructed over time, and because of its stra-
strategic importance has been an object of political contention. Today’s centralized global money system (controlled as it is by a small elite class) is from the standpoint of equity, harmony, and sustainability, fundamentally flawed—and in my view, is a root cause of the mega-crisis confronting civilization. When that flawed money system is transcended, resolution of the other aspects of the mega-crisis will then become possible.

How Debt-Money Is Dysfunctional

The truly devastating thing about the dominant monetary system is that usury has been built into its very foundation, resulting in a debt imperative and the growth imperative that derives from it. This dual imperative creates a Hobbesian war of “all against all” as those in debt to the banks vie with one another in the market to capture enough money from an insufficient supply to repay their loans with interest. This not only causes gross inequities and social strife, but it also drives the destruction of our physical environment.

Chapter 9 will provide a thorough explanation of the nature and evolution of money, but for the moment we will focus on one essential fact, which is that virtually all of the money throughout the world today is created by banks as debt. The various national currencies that we are so familiar with, the paper money we pass from hand to hand, are merely physical representations of some of that debt—but most of the money exists not as paper notes but as bank account balances (“deposits”). Those who borrow from the banks are required to pay interest on that debt. But compound interest is an exponential growth function. That means the debt grows simply with the passage of time, not at a constant steady pace (linearly) but at an accelerating rate (geometrically). This feature means that the debt growth must shortly outrun the increases in economic output needed to support it. Banks must continually expand their lending in order to avoid collapse of the global monetary and financial system, and to do so they must find additional bases for putting new money into circulation. Monetization of government debts seems to be their ultimate choice.¹¹

Kevin Phillips points out in his book, Bad Money, that over the past few decades there has been a reversal in the American economy. While manufacturing has declined from about 25 percent to 13 percent of GDP, financial services have grown from 11 percent to 21 percent.¹² And what is the stock in trade of the financial services industry? Debt. By promoting, packaging, and marketing debt, the financial services industry has thrived while domestic manufacturing has been dismantled in favor of imports from abroad. Over only the past twenty years, total public and private debt in the United States has quadrupled to $43 trillion. The money problem can be summarized thusly: the way in which money is created by the banking system today causes a debt imperative, which drives a growth imperative—this forces destructive competition for the available supply of money, which is never sufficient to enable all debtors to pay what they owe.

As borrowers compete with one another to try to meet their debt obligations in this game of financial “musical chairs,” they are forced to expand their production, sales, and profits. They must take measures to enhance revenues and reduce costs by controlling both the markets in which they sell their products and those in which they buy their productive inputs, including labor. A major reason why corporations merge and consolidate and increase in size is so that they can exercise both greater political influence and greater market dominance. The result of all this is ever-increasing environmental despoliation and social degradation. The rise of the power of corporations in relation to national governments has exacerbated the problems because legal restraints upon huge transnational companies are being systematically eliminated by politicians who are “hired” to do their bidding.

Three Aspects of Money Dysfunction

Bank created debt-money malfunctions in three primary ways. First is its artificial scarcity. There is never enough money to allow every debtor to pay what is owed to the banks. The debt grows simply with the passage of time but the supply of money to repay those loans plus the interest can only be maintained by the banks making additional loans to either current or new borrowers. These new loans have the same problem. Thus, debt continually mounts up, and businesses and individuals are forced to compete for markets and scarce money in a futile attempt to avoid defaulting on their debts. The system makes it certain that some must fail. Capital wealth becomes ever more concentrated in corporate conglomerates that must seek higher returns on their investments. They are driven to expand their markets and dominate economies, often enlisting the support of governments to apply military power both overtly and covertly to ensure the continued flow of low-priced raw materials, the availability of low-cost labor, and access to markets in which to sell their products.
Secondly, the requirement that interest be paid causes a net transfer of wealth from the debtor class to the moneyed class, or from producers to nonproducers. Besides the direct payment of interest on our own debts, we all pay the cost of interest that must be added at every stage of production to the price of everything we buy. It is easy to show statistically that lower-and middle-income households, because they are net debtors, pay much more interest than they receive; those in the highest income brackets, because they are net lenders, receive back more interest than they pay. Those who must earn their livelihood by selling their labor and talents in the market are kept at a disadvantage relative to those who live off returns from their capital.

Thirdly, the money created as bank credit is misallocated at its source. Much of it goes to finance government's deficit spending for weapons, military interventions, and transfer payments to corporate clients. The term “corporate welfare” has been used to describe not only direct government subsidies, but also “sweetheart contracts” to politically connected companies. Another large chunk is provided to the well-connected few who use it to finance such things as real estate developments, which are presumably well collateralized but are often supported by inflated land values and overblown prospects of profitability. Thus we find an abundance of hotels, resorts, and upscale residential construction but a chronic shortage of affordable housing.

This entire system favors authoritarian government, increasing concentrations of power and wealth, short-range planning, and the production of short-lived disposable junk over durable consumer products. That cannot continue. The global monopoly game is reaching its climax and coming to a close. As economist Michael Hudson concludes, "The economy has reached its debt limit and is entering its insolvency phase. We are not in a cycle but the end of an era. The old world of debt pyramiding to a fraudulent degree cannot be restored."

Moral Arguments, Laws, and Practical Solutions

Three major world religions—Judaism, Christianity, and Islam—all inveigh against the practice of usury. Volumes have been written about the morality or immorality of usury, the distinction between usury and interest, and the practical necessities of allowing it to enable industry and commerce to flourish. There has been no lack of arguments, well thought out and eloquently expressed, and legal statutes restricting the practice prevailed for more than a millennium. It is John Calvin (1509–64) who has been, depending on one's point of view, either credited or blamed for the eventual relaxing of the moral and legal rigidities, arguing that "if all usury is condemned tighter fetters are imposed on the conscience than the Lord himself would wish." At the same time he warned that, "if you yield in the least, with that pretext, very many will at once seize upon unlicensed freedom, which can then be restrained by no moderation or restriction." Calvin has certainly been proven right in the latter regard. Citing the changed conditions from the time of Moses and the Prophets, Calvin asserted, "Therefore usury is not wholly forbidden among us unless it be repugnant both to Justice and to Charity." And there lies the crux of the matter, as all considerations of justice and charity have been swept aside. Over time financial dealings have become ever more impersonal, economics has been separated from religion, and ethics has been separated from economics. Moral arguments have failed to hold sway, legal prohibitions have (rightly or wrongly) been totally obliterated, and usurious lending (even in its most oppressive form) has come to be part of the financial landscape. The "train of civilization" needs to be decoupled from the engine of destruction that is our present politicized system of money, banking, and finance. But if that is to be achieved, the problem needs to be framed not only in moral or ethical terms, but especially in practical terms.

Keys to Transcendence

We have discerned the patterns of action and relationships that have brought us to this point of mega-crisis, and now it is imperative that people effectively address it—not by opposing what is, or reverting to past primitive forms, but by reenvisioning and reinvention. There are "leverage points" at which the application of small forces can produce massive effects. My intensive and wide-ranging research has convinced me that a primary lever point is the process of economic exchange, and the device we call "money."

When the system spins out of control what will come out of the chaos? When the dollar crashes, the financial and political elite class will certainly try to orchestrate a new global monetary regime based on the same old mechanisms for centralizing power and concentrating wealth in their own hands, seeking to complete the new (feudal) world order that has been building for the past three hundred years. Indeed, some observers are arguing that we are experi-
encing the equivalent of a controlled demolition of the global financial system
as part of the plan to grab control of ever more of the world’s resources. 85

But the way is open for us to realize another possibility, which is the emergence
of a decentralized, democratic, and sustainable system of exchange — as well as more equitable methods of finance and investment, which can provide
the solid foundation needed for a different kind of new world order.

Exchange and Finance — Two Distinct Credit Functions

In achieving that, there are two basic questions that need to be addressed, one relating to the exchange function, the other relating to the financial
function. Both of these involve the use of credit. The exchange function has need
of short-term credit that bridges the gap between the delivery of goods to
market and the sale of those goods. It is this credit, and only this credit, that
should be embodied in modern money. Money, then, becomes a virtual representation
of real value in the form of goods and services that is ready to be bought and consumed. The question is, “What is the proper basis upon which
money should be issued? The principle that applies to proper operation of
the exchange function is this: money should be created on the basis of goods
and services that are already in the market, or shortly to arrive there. This is the
essence of what is called “the real bills doctrine.” 66

The finance function has need of long-term credit that enables “capital
formation,” i.e., it provides the means by which production capability can be
renewed or increased. The question here is, “How shall capital formation be
financed?” The applicable principle in this case is that long-term uses of credit
should be matched to long-term sources of credit. The logical conclusion is that
investments should be matched to savings. To use a simplified concrete analogy,
we might say that the seed that has been saved from the previous harvest is
invested in producing a new crop. A corollary to this is that new money should
not be created to finance capital formation. Why? Because money creation
should be matched to goods and services that are in the market now, but capital
investments deliver goods and services to market later. If more money is
put into the economy but more goods are not, the value of a currency will be
diluted. Under legal tender, that shows up as rising prices.

In practice today, these principles are commonly violated by banks. Banks
provide both functions by making loans, and make little distinction between

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them. As banks of issue, they create money; as depositories, they reallocate funds
from savers to investors. But as Ralph Borsodi observed, “Most [present-day
money] is ‘backed’ by loans which should never be made — loans made to
monetize the debts of government; loans made to finance war and the military-industrial complex, monetize the securities of giant corporations which should not
exist at all, and to finance speculations in securities, commodities, and land.” 87

All of those improper bases of issue are not only inflationary (when a
currency is given legal tender status), but also are preferential toward the centers
of power and wealth and against the interests of legitimate business, tending
to create ever greater monopolies and divisions among the classes. In today’s
world, credit is the substance of money and the means of payment. Precious
metals no longer play a monetary role. But credit is monopolized by a banking
cartel that keeps it scarce. As Riegel put it, “The political money system starves
productive enterprise but finances lavishly the destructive activities of war.” 69

The most damaging aspect of the political money system, as described
earlier, is the fact that the debts owed to banks and subject to compound interest
grow with the mere passage of time, but the money needed to pay those
debts does not. Additional money comes into circulation only as the banks
make additional loans. This is the engine of destruction that injures not only
the debtor, but also the entire society and the physical environment. The solution
for the exchange function under the old paradigm would be the creation
of money by the discounting of “real bills.”

On the other hand, a new paradigm approach to the exchange function,
which will be described in detail in later chapters, is to provide interest-free
credit to producers within the process of mutual credit clearing. That is the
process of offsetting purchases against sales within an association of merchants,
manufacturers, and workers. It will eventually include everyone who buys and
sells, or makes and receives disbursements of any kind. The costs of operating
such credit clearing exchanges can be managed by small fees applied to each
transaction.
The solution for the finance function would seem to lie mainly in making a shift from debt financing to temporary equity financing. Whereas debt makes borrowers and lenders antagonistic toward one another, equity (being shared ownership) tends to harmonize the interests of the user of capital with those of the provider of capital in that both the rewards and the risks are shared. But to make a permanent sale of one's future fortune for the sake of a temporary financial need is in most cases odious, hence the need that such investment claims be temporary. There are, to be sure, cases in which permanent equity shares might be appropriate, but these need not concern us here.

The solutions we propose here are based on private, voluntary initiative. So long as the right of contract and freedom of association are preserved, there is a chance that the "great leap forward" in exchange and finance can be made. We need not reopen the political debate about what constitutes usury, nor lobby for the restoration of usury laws, for these and other political solutions have receded far beyond our present grasp. But once these proposed approaches begin to gain a foothold, the distinction between usury and interest and debates about what levels of interest are justified will become moot. The problem of how to transcend the engine of destruction will have been elevated to a plane on which we may converge toward a solution.

I have only outlined a rough sketch of these ideas in this chapter. The remainder of the book will provide essential background and further elucidation that will enable a deeper understanding. For the moment it suffices to say that the most urgent need is for the implementation of new exchange systems (money systems) that do not force perpetual economic growth. Such exchange systems are a prerequisite for achieving the emergence of a steady state economy that can provide to every member of the human family the material benefits needed for a dignified and fulfilling life, while at the same time nururing the natural systems that support all life on our planet. Along with the elimination of the growth imperative from the exchange function, it is also necessary to shift the finance function away from interest bearing debt contracts toward equity investments that harmonize stakeholder interests. Economic development efforts must inevitably change their emphasis from quantitative to qualitative. Instead of aiming for ever greater quantities of output and consumption, the object should be to improve the quality of life—not only for a few, but for everyone. The prescriptions offered in the later chapters of this book are intended to accomplish those objectives.

Most bankers and politicians talk about inflation as if it were some mysterious natural phenomenon. The truth is that the only real mystery about inflation is why we allow it to continue. Most of the confusion about inflation comes from the failure to distinguish between cause and effect. Let us be clear, a general increase in the price level is the effect; inflation is the cause.

What is inflation?

Despite the morass of confusion that prevails even within the halls of ivy, there have been a few economists who have put the spotlight exactly where it belongs. Yale economist Irving Fisher, speaking of inflation and deflation as far back as 1928, maintained that "the extreme variability of money [meaning its purchasing power] is chiefly man-made, due to government finance, especially war finance, as well as to banking policies and legislation." He further acknowledged that "we may notice that the worst examples of inflation have come from unbalanced government budgets. As we have seen, when a government cannot make both ends meet, it pays its bills by manufacturing the money needed." More recently, and more emphatically, famed economist Milton Friedman has maintained that "inflation is always and everywhere a monetary phenomenon." Labor, with its supposed "excessive wage demands," is often blamed for inflation, but labor is a convenient scapegoat used to deflect attention from the real culprits.

The prices of individual commodities may increase because of changing conditions that affect their supply or demand. A widespread drought or crop failure, for example, might cause an increase in the price of food commodities—but this "dearness" is a different phenomenon, and it is unlikely that it would cause a general rise in all prices (unless it were a basic input to production, like petroleum).

It is common for pundits and academics to explain inflation as "too much
money chasing too few goods." But that does not really explain it because it
neglects to say how “too much money” comes into existence.

Who Has the Power to Inflate?

Inflation is simply the improper issuance of money into the economy, but how
is that accomplished and who might be responsible? These are the possible
inflators of money.

- Private counterfeiters
- Central banks
- Commercial banks
- Central governments

A legitimate issuer of currency knows that his currency is a credit instrument
representing a claim against his current and future production. It is his intention
to accept his currency back at some later time as payment for his own goods
and services that he offers for sale in the market. Everybody knows that currency
buys goods and services, but most fail to also recognize that goods and services
buy currency. Just as the issuer “sold” his currency at the point of issuance in
return for goods and services, so he must later buy his currency back by selling
his own goods and services. This cycle of issuance and redemption completes
the demands of reciprocity, which is the fundamental purpose of money.

In coming to understand inflation, the matter may be made clear if we first
consider the private counterfeiter. Private counterfeiters have the power to
inflate the money supply to the extent that their counterfeit bears an adequate
resemblance to official currency, and so long as they are able to avoid being
captured by the authorities. The private counterfeiter prints notes that he then
spends in the marketplace, receiving valuable goods and services from unsuspecting
vendors. The counterfeiter is a cheat and a thief because he has no
intention of reciprocating by accepting back his notes in payment for anything.
For him, the issuance of his (bogus) currency is a one-way street. Any kind
of issuance that expands the total supply of money without expanding the
amount of goods and services available in the market is inflationary, but the
damage done by counterfeiters is generally insignificant in comparison with the
official currency debasement that has become so prevalent.

Central banks also have power to inflate the money supply. They do it under
color of law by monetizing various kinds of long-term obligations, especially
the bonds of the federal government. This is accomplished by what the Federal
Reserve calls “open market operations,” whereby the Fed buys U.S. govern-
ment bonds in the open market. Since the Fed has the power to create from
nothing the funds with which to pay for these purchases, money is added to
the existing supply. Just as in the case of the counterfeit, such an expenditure
puts no additional goods or services into the market. Even worse, that newly
created money then goes into the banking system where it becomes additional
“reserves” that enable the banks collectively to lend many times that amount
of money into circulation. That is why this kind of money, created by the Fed,
is called “high powered money.”

Improper Basis of Issue by Banks Is Inflationary

As pointed out earlier, the vast majority of money is created by commercial
banks by the process of lending it into circulation. They have the power to
make loans (issue money) on either a proper basis or an improper basis. It
is not the amount of money per se that causes inflation, but the basis upon
which it is created. Loans made on an improper basis have the effect of inflat-
ing the money supply. What would be an improper basis?

An improper basis is any loan that does not put goods or services into the
market either immediately or in the very near term. Commercial banks play
a dual role. They act both as “depositories” and as “banks of issue.” In their
role of depository, banks lend out depositors’ funds (your savings and mine)
to those who have need of them. That may be for either consumption or the
creation of new productive capacity (capital formation). As banks for issue,
they create new deposits (money) on the basis of short-term commercial bills
that accompany the delivery of goods to market. That’s the way it is supposed
to work.

In practice, however, banks these days make little distinction between these
two roles and they commonly create deposits (money) by making loans to
finance both the flow of goods and services into the market as well as making
loans that take them out of the market. When a bank makes a loan for the
purpose of financing consumer purchases or for investment in long-term
productive assets, those newly created deposits are inflationary—because they
deliver goods and services to the marketplace only in the distant future, or not at all. Improper bases of issue, then, include the purchase by banks of government bonds in excess of time deposits held by savers, as well as loans that finance market speculation.

**Government Deficits and Inflation**

Finally, we need to consider how governments inflate the money supply. In some countries governments spend their currency directly into circulation. The "greenbacks" that were spent into circulation by the United States government during the Civil War are one historical example. Such issuance is inflationary if it exceeds the short-term tax and other revenues of the government. In countries like the United States, the government does not inflate the money supply directly, but instead accomplishes it in collusion with the central bank and the banking system. When the Federal Reserve or a commercial bank buys government bonds as described above, money is added to the economy on an improper basis. The purchase of government bonds does not bring any additional goods or services into the market. Ron Paul has on many occasions reminded his colleagues in Congress how this collusion works. In 1997, he told them this:

> The Congress will spend too much because there is tremendous pressure to spend on all these good things we do; all the welfare programs, and all the military expenditures to police the world and build bases around the world... lo and behold, there is not enough money to borrow and not enough tax money to go around, so they have to have one more vehicle, and that is the creation of money out of thin air, and this is what they do. They send the Treasury bills or the bonds to the Federal Reserve, and with a computer they can turn a switch and create a billion or $10 billion in a single day and that debases the currency. It diminishes the value of the money and alters interest rates and causes so much mischief that, if people are concerned about the economy or their standard of living or rising costs of living, this is the source of the problem. . . . Why do we allow the Government to counterfeit the money and make it worthless all the time?

In response to inflation, vendors (including workers and professionals who sell their labor services) will raise their prices (if they have sufficient market power to do so) as the only way they have of compensating for the malfeasance of the government and banking sectors.

The process of inflation can be likened to a farmer adding water to his milk. Suppose the farmer were to divert half his milk production to his own use, leaving only half of the amount that he formerly delivered to his customers. With only half as much milk to sell now, he would have to leave many of his former customers to go without. In order to avoid a loss of income, a dishonest farmer might simply add water to the remaining milk to deceive his customers into believing that they were receiving just as much milk as before. If that process were extended little by little, with more and more water being added to less and less milk, it might go undetected. Thus there would be the appearance that customers would have the same amount of milk while they slowly starve to death. So it is with the creation of "money" that adds no value to the economy.
The German Hyperinflation—A Classic Case

Probably the most notorious case of hyperinflation was the one perpetrated by the Weimar government in Germany following World War I. At the beginning of the war the exchange rate of the German mark to the U.S. dollar stood at 4.2 to 1 (one mark was worth about 24 cents). By the end of 1922 the mark had fallen to 1,500 to 1, and by the end of November 1923 it had fallen to an astounding 4,200,000,000,000 to 1. The folklore about the incident includes images of people taking wheelbarrows full of German currency to bakeries to buy a loaf of bread. Robert Hetzel describes the situation this way:

In 1913, total currency in Germany amounted to just 6 billion marks. In November 1923 in Berlin, a loaf of bread cost 428 billion marks and a kilogram of butter almost 6,000 billion marks. From the end of World War I until 1924, the price level rose almost one trillionfold. The economic cause of this Hyperinflation was the monetization of public and private debt by Germany's central bank, the Reichsbank. The political cause lay in the inability of a fragile democracy to impose the taxes necessary to pay war reparations. . . . Unable to cover its expenditures through explicit taxes, the German government ran deficits exceeding 50 percent of its expenditures from 1919 through 1923. Reichsbank purchases of government debt made the printing press the ultimate source for funding these deficits.

The political circumstances of the German hyperinflation, while they cannot justify it, help us to understand why it occurred. A defeated Germany was forced to accept punishing terms under the Treaty of Versailles. These terms included the payment of reparations, the amounts of which were impossibly huge for an economy weakened by the war and stripped of some of its most valuable and productive resources. Even though a policy of inflation is ultimately self-defeating for a government, it is seen by politicians as being politically expedient. The then head of the German central bank himself maintained that, "So long as the reparations burden remains, there is no other means to procure the necessary means for the Reich than the discounting of Reich Treasury notes at the Reichsbank." In other words, the central bank created out of thin air the money needed to buy the government's debt instruments.

With the accelerating rates of currency debasement and increasing prices of goods, employers paid their workers daily—then several times a day. Cash would be handed over to family members so that it could be quickly spent before prices in the shops increased further. In the absence of a reliable currency, people increasingly reverted to barter—refusing to accept money for the things they had to sell to stay alive. Pensioners and others whose incomes were fixed saw their purchasing power evaporate into nothingness. The middle class was ruined as their savings and financial investments became worthless. "The poor became even poorer and the winter of 1923 meant that many lived in freezing conditions burning furniture to get some heat. The very rich suffered least because they had sufficient contacts to get food etc. Most of the very rich were land owners and could produce food on their own estates."

As the value of a currency continues to plummet, people naturally turn to more stable means of value reckoning. To protect the real value of their transactions they may express prices in some more stable currency unit, like the dollar, or some useful commodity. Hetzel reports that

The actual breakdown of German economic life came about because of interventions by the German government to maintain the paper mark as the medium of exchange. Holtschirch writes of hyperinflation Germany, "The economy had already largely turned over to a foreign,
hard-currency standard. The crisis arose out of the reluctance of the Reich to permit business to employ foreign means of payment in domestic transactions as desired; indeed the Reich could not permit the practice... as long as inflation remained as a ‘tax’ source.38

Ulrich von Beckerath provides an interesting anecdote relating to this. In a letter to one Dr. Runge, dated July 5, 1949, Beckerath mentions a meeting that took place in 1923 between Hans Luther, then minister of food and agriculture, and Herr Petersen, the mayor of the city of Hamburg. Beckerath said,

I do not know if you know what the currency meeting of Luther and Mayor Petersen in 1923 in Hamburg was about. Petersen had created a gold currency in Hamburg, and the wages of the Hamburg citizens were paid in gold marks. Luther went there horrified and tried to browbeat Petersen; he even talked about high treason, about the Reich army marching in, about having him arrested, etc. However, Luther had picked the wrong man to bully. Petersen announced that he would accept civil war. A city of 1 million can raise 100,000 armed defenders, he told him, and as for the arrest talk, Luther should be glad that Petersen was not inclined to have him arrested on the spot by his Hamburg police. He did not look as if he were joking, and he was also a man who did not issue idle threats. Luther returned to Berlin with his tail between his legs, and shortly thereafter the Reich’s printing press was shut down.39

How the Inflation Was Ended

Luther, however, should not be seen as the villain of the piece, for it is he who is credited with later saving the day by introducing the Rentenmark, as Beckerath explains.

Luther was attacked as partly responsible for the monetary crisis in Germany. But the crisis was due to circumstances not created by Luther. Where Luther was really unfettered, he not only proved to be of the greatest service to the German economy but also to the world economy. When in 1923 the German mark had fallen to a millionth part of a millionth part; when the social and political order was on the point of dissolving, Luther, who was then Minister of Finance, introduced the Rentenmark which saved Germany and thereby averted serious complications for Europe and the world. The Rentenmark offers an example of a gold-less gold currency being established in the course of a few days. It is well worth therefore a retrospective examination.40

What did Beckerath mean by a “gold-less gold currency”? Simply that the currency was denominated in gold units, but was not redeemable in gold. Then what was it that enabled the Rentenmark to maintain its value relative to gold? It was this set of provisions:

- the Rentenmark was acceptable by all tax offices at face value in payment of taxes;
- there was no legal compulsion for anyone else to accept it, thus it was made to stand on its own merits in the marketplace and might legally pass at a discount from face value in private transactions;
- the amount issued was modest in relation to the tax revenues that supported it.

There were other provisions that were intended to support the value of the Rentenmark, but these, according to Beckerath, proved to be unnecessary.
Beckerath maintains that, “The new currency could scarcely have been better devised; and if some foreign Finance Minister should ever be placed in a similar predicament, he would be well advised to study the German Rentenbank Act.” Bearing this in mind, we shall revisit the story of the Rentenmark in Chapter 19 where we will offer some advice to governments.

At about the same time as the issuance of the Rentenmark, the official currency (the reichsmark) was revalued and pegged to gold. According to Hetzel,

The November 1923 stabilization program committed Germany to exchange 1,392 reichsmarks for a pound of gold. However, German economic stability then became dependent upon the stability of the international gold standard. Starting in 1928, the deflationary monetary policies of two of the largest adherents to the gold standard, France and the United States, forced deflation and economic depression on Germany. Short-run salvation led to longer-run doom.\(^{101}\)

Hyperinflations always end in the utter worthlessness of the currency and the destruction of the monetary unit. Eventually a new unit is declared and a new currency issued. Obviously, the German authorities felt that monetization of the debt was the only politically feasible option. To be sure, there were pressures from many sides, but the bottom line is that only the monetary authority can cause inflation and only the monetary authority can stop it. The piper must be paid; the only question is, who will be made to foot the bill? Inflation is a tax imposed by underhanded means. Under a policy of inflation it is the pensioners and all who have fixed dollar claims, like bank accounts and bonds, who are made to pay this “hidden tax.” The middle class bears the greatest burden as the purchasing power of their savings evaporates. Whether the monetization of government debt is carried out by the government directly or indirectly by a private central bank, the result is the same.

Once inflation reaches a certain level, it begins to create behavioral effects that exacerbate the problem. Rising prices produce a psychology that tends to cause further price increases. As people lose confidence in the stability of money’s purchasing power, they try to spend it as quickly as they can before prices rise further. Vendors, seeing their shelves being quickly cleared, raise their prices more—causing ever-greater demand for goods, causing further price increases. Money becomes a “hot potato.” As it continues to lose value, nobody wants to hold money or financial claims that are denominated in the monetary unit; they seek to convert it quickly into goods that will maintain their value.

Professor Heinrich Rittershausen, in his book *The Central Bank*, explains that, “During extreme inflation, ‘businessmen go into commodities’; during deflation ‘they go out of commodities.’\(^{102}\) In the first instance, inflation, they become less liquid, preferring to hold commodities instead of deprecating money. Thus other sectors of the economy become more liquid, i.e., there is more money in the hands of consumers and an increased rate of circulation—because in a runaway inflation no one wants to hold large amounts of money. With this hoarding of commodities, there is a decreased supply of commodities in the market even while the money supply is being inflated—adding a further pressure to drive prices upward.

In the case of deflation, the money supply is being restricted by the monetary authorities so that it is insufficient to enable the available goods and services to be purchased except at reduced prices, often at less than their cost of production. In that case “cash is king,” and businessmen will prefer to hold money until prices bottom out.

Similarly, at the end of an inflation, merchants again begin selling commodities for the new money, which they will want to hold onto—thus tending to drive commodity prices further downward.

As we said before, without legal tender laws and forced circulation of a currency, such dishonest and disruptive actions cannot be sustained by any government. After Germany’s defeat in World War II, inflation was again becoming a problem. In an editorial he wrote to the *Freie Gewerkschaft [Free Union]*, dated December 10, 1945, Beckerath wrote,

Clear insight into these circumstances would give workers the ability to cope with inflation, precisely as they ultimately coped with it in 1923, namely by rejecting—in spite of all prohibitions—the money issued by the government, in this way forcing the government to change the monetary standard or by simply forcing a change from their employers. Essentially, that change was the transition from the paper mark to the “Gold reckoning standard.”\(^{103}\)

There have been numerous other cases of hyperinflation, some even worse than the German inflation just described. These include Hungary following
World War II and Yugoslavia between 1993 and 1995, in what is described to be the “worst hyperinflation in history.” According to Professor Thayer Watkins, “Between October 1, 1993 and January 24, 1995 prices increased by 5 quadrillion percent. That’s a 5 with 15 zeroes after it.”

Currently the government of Zimbabwe is abusing its money, economy, and citizens through currency inflation and draconian legal measures aimed at preventing people from protecting themselves. According to a March 2008 Voice of America report:

The Zimbabwean government has made it illegal for citizens to hold more than Z$500 million in cash, currently equivalent to just over 20 U.S. dollars. A recently introduced statutory instrument says anyone found in possession of more than this sum can be charged

with unlawful hoarding. Companies are barred from settling bills over Z$250 million, about US$10, with cash. In recent days the exchange rate against the U.S. dollar has soared to Z$24 million. The decree was issued in an effort to regain control over the money supply and to put what Reserve Bank Governor Gideon Gono calls “cash barons” out of business. He coined the phrase to describe large operators on the country’s bustling parallel markets in foreign exchange and most essential commodities.

Such measures of legal compulsion are typically employed by governments as they try to force others to suffer the burden of their profligate spending and fiscal mismanagement through official abuse of the money power.

Constraints upon Debasement of the Money

Are there any constraints upon the ability of these various entities to inflate? Gold convertibility of paper currency, while not an ideal approach, in the past did apply some discipline upon the overall volume of credit money (notes and deposits) creation, but that has long since been eliminated. It did not, however, force banks to conform to the requirements for proper issuance. That can probably be achieved only by the subjection of their currency to free market forces, i.e., the elimination of the legal tender privilege, about which there will be more in Chapter 19.

Recall that Irving Fisher mentioned three factors that underlie inflation: government finance, banking policies, and legislation. Each of these plays a role. We have seen that the first of these comes down to deficit spending and the accumulation of ever more government debt. We have seen that banking policies enable the creation of money on the basis of that debt (monetization), and on the basis of loans made to finance long-term assets or speculation. These add to the money supply without putting additional goods or services into the market. The third factor is the legislation that prevents the debased money from being refused or discounted in the market, i.e., legal tender laws. Such laws require that official money be accepted in payment of “all debts, public and private,” and that it be accepted at face value. The truth is that without legal tender, there can be no sustained inflation of the money.
Responding to Inflation

In the face of official currency debasement, people are not entirely powerless. In a 1948 letter to Henry Meulen, author of the book *Free Banking*, Beckerath wrote,

I may remind you of one of the greatest revolutions in history: The revolt of the German people against the government’s “exclusive currency” in the years 1922 and 1923. Every day new thousands declined the notes of the Reichsbank and accepted other kinds of money or money-substitutes. If at that time a programme of Free Banking had been known to the public, thousands of Free Bankers would have replaced the Reichsbank, the crisis of 1930/32 would not have occurred, Hitlerism would have been impossible, no war would have happened, Germany’s towns would still stand, I would still have my 3,000 books, you would still have your library—probably with a second copy of Greene’s “Mutual Banking”—a terrible loss—and we would correspond upon details of Free Banking in Germany. ¹⁰⁶

Among these “other kinds of money and money substitutes” are private or semiofficial claims on real value—typically goods and services, including telephone, gas, and electric utilities as well as various kinds of transport services. In a letter to a Mr. Walker, dated June 4, 1954, Beckerath referred to a very effective currency alternative to the inflated government currency of the time. This was the issuance of “German railway money by the Railway Minister Öser . . . in the years 1923 and 1924 amounting to several hundred million RM put in circulation, and thereby (in my opinion) Germany was saved.” Walter Zander wrote about the superiority of such service-based currencies in his article “Railway Money and Unemployment,” observing that when a business acquires what it needs by borrowing money, it promises to deliver

something [money] at a fixed date which at the time of the promise it only hoped to obtain. Whether its hope will materialize, is uncertain. The undertaking to pay at maturity contains therefore a speculative element, which is particularly hazardous in times of depression. It is therefore obvious that the Railway must be extremely circumspect in making credit purchases, i.e., in promising to pay at a later date with

resources which have yet to be secured. But the Railway may promise something else, namely, to transport commodities and persons, that is, to fulfill its function as a Railway. There is nothing speculative about that. The means required for this, rolling stock and other plant, are available . . . The capacity of the Railway to act as a carrier is at any rate unquestionable. ¹⁰⁷ [emphasis added]

Zander also mentions that a form of railway money had been issued a century earlier. When the Leipzig Dresden Railway was established, one third of the company’s capital (500,000 thaler) was in the form of “railway money certificates” that remained in circulation for forty years.

The actual value of every currency, whether issued by a government or a private entity, is established by there being, to quote John Zube,

a short-term continuous demand for it, be it coercively and wrongly, via compulsory taxes or tributes, or via the debt payment foundation of the private economy, where, e.g., department stores or shop associations issue their own currency and it is accepted because it has “shop foundation” as Rittershausen calls it, i.e., the local shops accept it as ready money—and must do so, because it amounts to their own IOUs. ¹⁰⁸

Unlike public legal tender currencies, the acceptance of private currencies in the market is voluntary. This makes private currencies self-regulating in that the issuers themselves will manage their issuance in such a way as to avoid having it discounted or refused in the market.
Money needs to be depoliticized, and the time has come for the separation of money and state to be accomplished.

Some will argue that money and state have already been separated, since the central bank in the United States, the Federal Reserve, is a privately owned corporation that operates independently of the U.S. government. But that separation is more apparent than real. In reality, the federal government and the central bank are both controlled by a small group of powerful men (mostly), and they work together in ways that are detrimental to the common good. The collusive arrangement between them, following the pattern that was instituted more than three hundred years ago with the founding of the Bank of England, is the pattern that prevails today in virtually every country of the world, regardless of whether the central bank is privately owned or government-owned.

Under this arrangement, the banking cartel gets the privilege of creating money as debt and charging interest on it, while the central government gets to spend as much as it wants without regard to its limited tax revenues or the popular will. Does anyone really believe that the U.S. government, for instance, will ever repay its accumulated debt that now amounts to more than $10.8 trillion? That’s more than $35,000 for each man, woman, and child in the United States, not counting the full extent of the ongoing bailouts and stimulus spending being enacted as this book is finalized in February 2009, nor the massive amounts of government guarantees that are not reported as part of the debt.

Through legal tender laws and banking regulations, governments endow their respective central bank currencies with the full support of the government, and give the banking establishment the privilege to effectively monopolize everyone’s credit and lend it out at interest. While the central government of the United States is precluded from directly monetizing its debts, that same result is achieved indirectly through the banking system. When government borrows money to finance its budget deficits, it sells its bonds on the open market. It is not only the portion which is bought by the Fed that gets monetized, but also the bonds that are bought by the commercial banks. This debt monetization process has the same effect as spending counterfeit money into the economy.

When it comes to financing its operations, government can look either to its current tax revenues or to its future tax revenues. If current tax revenues are deficient, as they almost always seem to be, government must borrow. When government borrows in order to finance its deficits it would appear that it is choosing to tax us later instead of taxing us now. Ordinarily, money borrowed must eventually be repaid out of future revenues. That means there must be eventual budget surpluses sufficient to offset the current budget deficits. But budget surpluses have been few and far between, so governments and central banks together have conjured up another possibility—monetization of the debt and legally enforced circulation of debased currency by means of legal tender laws.

It should be obvious by now that the debts of the central government will never be repaid. As described in the previous chapter, it is like the farmer adding water to his milk. The part of the debt that is monetized adds “empty dollars” to the money supply, dollars that are not matched by additional goods and services going to market. The part of the debt that is not monetized by the banking system is acquired by individuals and institutions who allocate our collective savings to be spent by the government. The situation is very much like the following: Suppose you are regularly putting money aside into a shoe box to save up for your college education, but your drug-addicted parent is regularly taking that money out and replacing it with their IOUs. Will that suffice to get you through college? Only if your parent changes their ways and repays what they owe you. Our government is the wayward parent. It has been taking real value out of the economy and providing empty promises in return. Will it ever reform itself and start paying back its debt? Judging from past experience, that will never happen. What then is the likely prospect?

Fiscally irresponsible government has only two choices: it must either eventually default on its debt repayments—acknowledging that its bonds, bills, and notes are worthless—or it must continue to monetize more and more of its debt. For a country like the United States which constitutes the world’s biggest market and whose currency serves as the global reserve currency for foreign governments and investors, the former course is unthinkable. That leaves continued monetization, continued bailouts, and inflation. According to official figures, inflation rates in the United States for the past several years
have been modest—in the range 3 percent—but at other times they have been much higher. Furthermore, these figures do not seem to reflect the true cost of living. The most common measure of inflation, the Consumer Price Index, has been widely criticized in this regard. In any case, the cumulative effect over time of government debt has been an enormous decline in the purchasing power of the dollar. The prospects are for that decline to accelerate as the budget deficits and trade deficits continue to mount up. On the global scene, the dollar has already lost a major part of its value and is beginning to lose its status as the preferred global reserve currency.

Under the central banking regime that prevails in virtually every country around the world, money has been politicized. The collusion between politicians and international bankers enables governments to extract wealth from the economy by deficit spending, and banks to extract wealth by charging interest on money as they create it by making loans. These two parasitic elements take wealth away from productive members of society and lavish it on military adventures, international intrigues, wasteful boondoggles, and financial finaglers. The truth of the matter is that central banks have one overriding function—to manage the effects of the parasitic drain, to decide who will pay the price and who will feel the pain. They can either (1) restrict credit in the private sector, thus causing recessions, bankruptcies, and unemployment; or (2) they can expand credit and inflate the money supply by monetizing debts (either public or private) that are ultimately uncollectible.

The Separation of Church and State—A Comparison

A useful parallel can be drawn between the necessary separation of money and state and the recently established separation of church and state. While controversy still persists over the constitutional mandate and the exact meaning of the latter phrase, there is general agreement on the point that each individual should have the freedom to practice whatever religion they might choose, and that the government should not favor any particular religious organization by granting it special recognition, privilege, or financial support.

Inspired most likely by the writings of John Locke, the idea of the separation of church and state was championed by Thomas Jefferson and James Madison, first in the Virginia Statute of Religious Freedom and later in the United States Constitution. Religious establishments, having been long accustomed to enjoying legal privileges from governments around the world, were reluctant to give them up. Even in the context of late eighteenth century America, there was serious dispute over the allowable extent of religious freedom. Jefferson's Virginia Statute of Religious Freedom was by no means an easy sell, and was bitterly opposed. It was eventually passed in 1786 after the assembly had made significant deletions to Jefferson's original draft.109

It is instructive to read the original with the deleted clauses (in bold).

Well aware that the opinions and belief of men depend not on their own will, but follow involuntarily the evidence proposed to their minds; that Almighty God hath created the mind free, and manifested his supreme will that free it shall remain by making it altogether insusceptible of restraint; that all attempts to influence it by temporal punishments . . . tend only to beget habits of hypocrisy and meanness, and are a departure from the plan of the holy author of our religion, who being lord both of body and mind, yet chose not to propagate it by coercions on either, as was in his Almighty power to do, but to extend it by its influence on reason alone; that the impius presumption of legislators . . . [who] have assumed dominion over the faith of others . . . hath established and maintained false religions over the greatest part of the world; . . . that the opinions of men are not the object of civil government, nor under its jurisdiction; . . . and finally, that truth is great and will prevail if left to herself; that she is the proper and sufficient antagonist to error, and has nothing to fear from the conflict unless by human interposition disarmed of her natural weapons, free argument and debate; errors ceasing to be dangerous when it is permitted freely to contradict them.

The object of these efforts was, in Madison's words, to "extinguished forever the ambitious hope of making laws for the human mind." Having spent considerable amounts of time in countries that still have an official religion, I have observed firsthand some of the "habits of hypocrisy and meanness" referred to in that statute.

The United States is recognized as the first country to completely disestablish its government from any religion. This separation was explicitly stated in the Bill of Rights of the U.S. Constitution that was ratified by the colonies in 1791.110 The First Amendment states, "Congress shall make no law respecting
an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances."

The pertinent "religion clauses" in that amendment (1) preclude Congress from passing any law that would establish a particular religion, i.e., require citizens to observe particular religious practices or support (financially) any particular church or other religious association; and (2) preclude Congress from prohibiting the free exercise of the religion of one's choice. James Madison, principle architect of the Bill of Rights, said that "practical distinction between Religion and Civil Government is essential to the purity of both." Similarly, I argue that the practical distinction between money and civil government is essential to the purity of both.

The Disestablishment of Monetary "Religion"

As I have maintained throughout, the fundamental purpose of money is to facilitate the voluntary exchange of objects of material value between independent persons. The long-established rights of contract and voluntary association argue in favor of the free selection of such facilitating mechanisms that buyers and sellers judge to best serve their mutual interests. To grant "legal tender" status to any particular brand of money, or to support by legislation any particular banking establishment or cartel, is akin to making a law respecting an establishment of religion. There should be no monopoly of credit, no central authority with exclusive power to issue money, and no forced circulation of any currency. The credit power must be decentralized, and every currency must be made to make its way in the marketplace on its own merits. Robert Somers, writing in 1873 about the superior system of Scottish banking, clearly posed the matter, saying:

The question between a central and a plural issue is in reality a question whether banking is to be confined to the great capitalists, or to a few of the greatest towns, and to the high commerce of nations, or opened up to all classes of people and made to embrace the industry, savings and interests of the many. The tendency of a State or central form of issue is to aristocratize banking. The effect of a plural issue is to popularize this powerful lever both of moral and material improve-

ment. The one seems, therefore, as comfortable as the other is counter to the social tendencies of the age, and to that ever-advancing impulse to raise, enrich, refine and brighten the whole body of a people, which is the crowning glory of all civilization. [emphasis added]

The fact that the establishment of monetary and banking privilege has become general throughout the world is not sufficient reason for its continuance. On the contrary, the evils that have been spawned by such collusion between political power and financial power are far worse even than those that arose historically from the collusion between political power and religious power.

Two Meanings of "Dollar"

Because of general legal tender laws, the "dollar" has come to have two meanings—(1) as a medium of exchange or payment (a currency) and (2) as the standard of value measurement or pricing unit. Any alternative currency or credit system must eventually decouple from both "dollars," but the more urgent need, by far, is decoupling from the official dollar currency as a means of payment. This means the independent creation of credits or currencies outside of the conventional banking system.

As I've pointed out in my previous books, a community currency that is issued on the basis of payment of a national currency (e.g., a local currency that is sold for dollars), amounts to a "gift certificate" or localized "traveler's check." It amounts to prepayment for the goods or services offered by the merchants that agree to accept the currency. As such, it substitutes a local, limited-use currency for a national, universal currency. That approach provides some limited utility in encouraging the holder of the currency to buy locally, but the option of redeeming the currency back into dollars without significant penalty raises the question of how many times it will mediate local trades before being redeemed and leaking back to the outside world. Most importantly, that sort of issuance requires that someone have dollars in order for the community currency to come into existence. No dollars; no community currency.
Delinking from the Dollar as a Payment Medium

To truly empower a community, a currency must be issued on the basis of goods and services changing hands, i.e., it should be “spent into circulation” by local business entities and individuals who are able to redeem it later by providing goods or services that are in everyday demand by local consumers. Such a currency amounts to a credit instrument or IOU of the issuer, an IOU that is voluntarily accepted by some other provider of goods and services (like an employee or supplier), then circulated and eventually redeemed—not in cash, but “in kind” by the original issuer, as depicted in Figure 8.1. In this way, community members “monetize” the value of their own production, just as banks monetize the value of collateral assets when they make a loan—except in this case, monetization is done by the community members themselves based on their own values and criteria, without the “help” or involvement of any government, bank, or ordinary financial institution, and without the need to have any official money to begin with. That is what I mean when I talk about liberating the exchange process, or restoring the “credit commons”* and bringing it under local control. In this way, the community gains a measure of independence from the supply of official money (dollars, euros, yen) and the policies and decisions of the central bank and the banking cartel. This is the primary mission that needs to be accomplished if we are to transcend the destructive effects of the global monetary and banking regime, devolve power to the local level, and build sustainable economic democracies.

Delinking from the Dollar as a Measure of Value

With regard to the second meaning, the dollar as a measure of value, we need to understand that a standard becomes established by common usage. We in the United States are accustomed to valuing things in dollar units. We know from our everyday shopping experiences what the value of the dollar unit is in terms of the things we buy and in terms of our own earning power. Any new “language of value” will have to be translated into the dollar language that we already understand. How we measure value is a separate question from how we create our own payment media. In the process of monetizing local production as described above, we can choose to give our credit unit any name we wish—be it a vai, an acorn, or a cru—but it makes sense to initially define the value of that unit as being equivalent to that of the national currency unit.

In an alternative exchange system, like a mutual credit clearing exchange, large credit balances will not be held for very long. Therefore even though the debasement of the dollar unit through monetization of government debt continues, defining our unit as being equivalent to the official unit (the dollar) will result in only slight losses for individual users of the exchange.*

* The concept of the “commons” is an ancient one referring to a resource for which there is open access to anyone within a community or geographic area, as opposed to private property or government-owned “public” property. Legal rules or social customs may govern some aspects of the use of the shared resource, but these rules or customs do not prevent people from gaining access to the resource in the first place. In the case of money, our collective credit which supports the money and banking system has been privatized and appropriated to serve the interests of a small elite class.
or community currency, and not a loss for the users collectively. It is only when the rates of inflation become large (generally meaning double digit), or we begin to hold long-term claims denominated in our own new value unit, that we will urgently need to define our unit in concrete, objective terms to avoid following the dollar or other political currencies into the abyss of worthlessness.

**Stable Value Reckoning**

The U.S. dollar was originally defined as a specified weight of fine silver, then later a specified weight of gold, but those objective definitions were obliterated by laws that made paper currency legal tender. So now the value of the dollar unit of measure of value depends entirely upon the value of the dollar currency, but the value of the dollar currency is continually declining as more of it is issued on an improper basis, particularly on the basis of government debts that will never be repaid and that bring no concomitant goods and services into the market.

In the previous chapter, we described at some length the hyperinflation of the German mark following World War I. It is difficult for people who have not lived through that kind of experience to appreciate what it means or to understand what it takes to avoid it. It was only by defining the mark in concrete, physical terms (in that case, gold) that the German people were able to end that nightmare. Britain, the United States, and the European Union have thus far seen only moderate rates of inflation—so people have been inured to it, accepting it as a natural part of the economic landscape. Neither have they developed the necessary skepticism against legal tender currencies and their issuing agencies. Goods and services and wages are still priced in legal tender currencies, so under these conditions it makes sense to talk about changes in the price of gold or silver or other commodities. But we need to shift our thinking to regard not that these commodities have a legal tender money price, but rather the other way round. We need to think of the currency having a price in terms of silver or gold or other commodities.

Applying that reasoning to the present day United States, we would say that the price of silver or gold should not be reckoned in Federal Reserve “dollars,” but that Federal Reserve dollars should be reckoned in, say, silver dollars. The simplest way to do that is to use the original definition of the U.S. dollar, which was 371.25 grains of fine silver. If there are 480 grains in a troy ounce, and the market price of silver is $16.50 per troy ounce (as it was on June 13, 2008) then a Federal Reserve dollar would be worth about 7.8 (silver dollar) cents. For most of 2005, silver traded at around $7 per ounce, making the Federal Reserve dollar worth about 18.5 (silver dollar) cents at that time. That means the Federal Reserve paper dollar has lost almost 58 percent of its previous value in just three years time based on a silver standard.

A stable value unit will eventually need to be defined in terms of some commodity or group of commodities that are commonly traded. Such a definition will then provide the “Rosetta stone” that can enable us to relate, from day to day and minute to minute, our own new value unit to the old dollar language. That process is explained in my first book, *Money and Debt: A Solution to the Global Crisis*, Part III and Appendices. An abridged description is also provided in Appendix B of this volume.

**Toward Freedom of Exchange**

The separation of money and state implies greater freedom of people to choose which currencies they will use and to create their own. Buyers and sellers, who are the affected parties in a transaction, should be able to choose the particular credit instrument (money) that enables their reciprocal exchange. Here are the basic principles that underlie a system of free exchange.

- Buyers and sellers should be free to use any payment medium that is mutually agreeable to them, including the issuance and acceptance of their own currencies.
- Only the issuer of a currency should be obliged to accept it as payment, and must always accept it at face value (“at par”).
- There should be no forced circulation of any currency. Legal tender should obligate government only, and should not apply to transactions between private parties.
- Governments should give legal tender status only to their own currencies that they spend directly into circulation, and should not grant privileged status to the currency of any particular issuer.
Government currencies should be denominated in objective units against which the market may evaluate them, and governments should oblige themselves to accept their currencies at par regardless of the market rate (discount).

As John Zube puts it, “Currency cannot be acceptable unless it is rejectable.” The freedom to use, refuse, or discount a currency is essential to its acceptability.

The Evolution of Money—from Commodity Money to Credit Money

It was in a dusty old bookshop close to the British Museum in London that I discovered a slim volume that was to complete for me the picture of how money has evolved over time. I had been traveling in Europe and the United Kingdom in the summer of 2001 with my then partner, Donna, partly to attend conferences in Germany and England, partly to spend time with friends and cohorts, and partly to do a bit of touring. It was actually Donna who discovered the book in the basement stacks and brought it to me, saying “what about this one?” The book was The Meaning of Money by Hartley Withers. Although I had already been engaged in intensive research into the subjects of money and banking for more than twenty years, and had written three books of my own on the subject, I had not previously heard of Withers. It was evident that Withers must have been, in his day, a recognized authority on the subject and that his book must have served for a long time as a leading text. I surmised that from the fact that the volume I held in my hands was the seventh edition, published in 1947, of a work that was first published in 1909. Reading Withers crystallized my understanding of the double transformation that money had undergone during the previous three hundred years, an understanding that allowed a clearer comprehension of the nature and significance of the changes that have taken place and that prepares the ground from which to launch the next great improvement in the exchange process.

What We Don’t Know Is Hurting Us

Money is clouded in mystery and there are few who really understand it. It is not that it is so difficult to understand, but because it is made to seem that way by financial journalists, bankers, and monetary economists who speak