The Rise and Fall of the Reserve Currency Dollar

The Curse of the Paper Dollar

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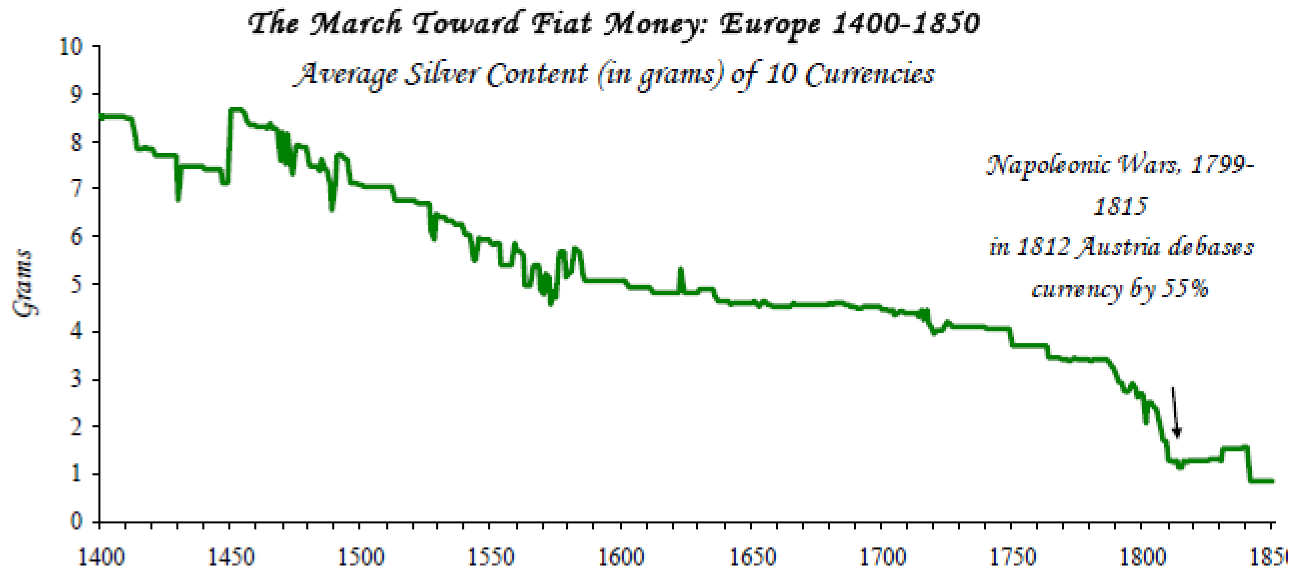
Vancouver January 2010

Continual Debasement of Currency in Europe Over 450 Years

Reinhart and Rogoff, ***This Time Is Different*** April 2008



Sources: Primarily Allen and Unger and other sources listed in Table AI.4.
Notes: In the cases where there is more than one currency circulating in a particular country (in Spain, for example, we have the New Castille maravedi and the Valencia dinar) we calculate the simple average.

Expropriation Through Currency Debasement Europe 19th Century

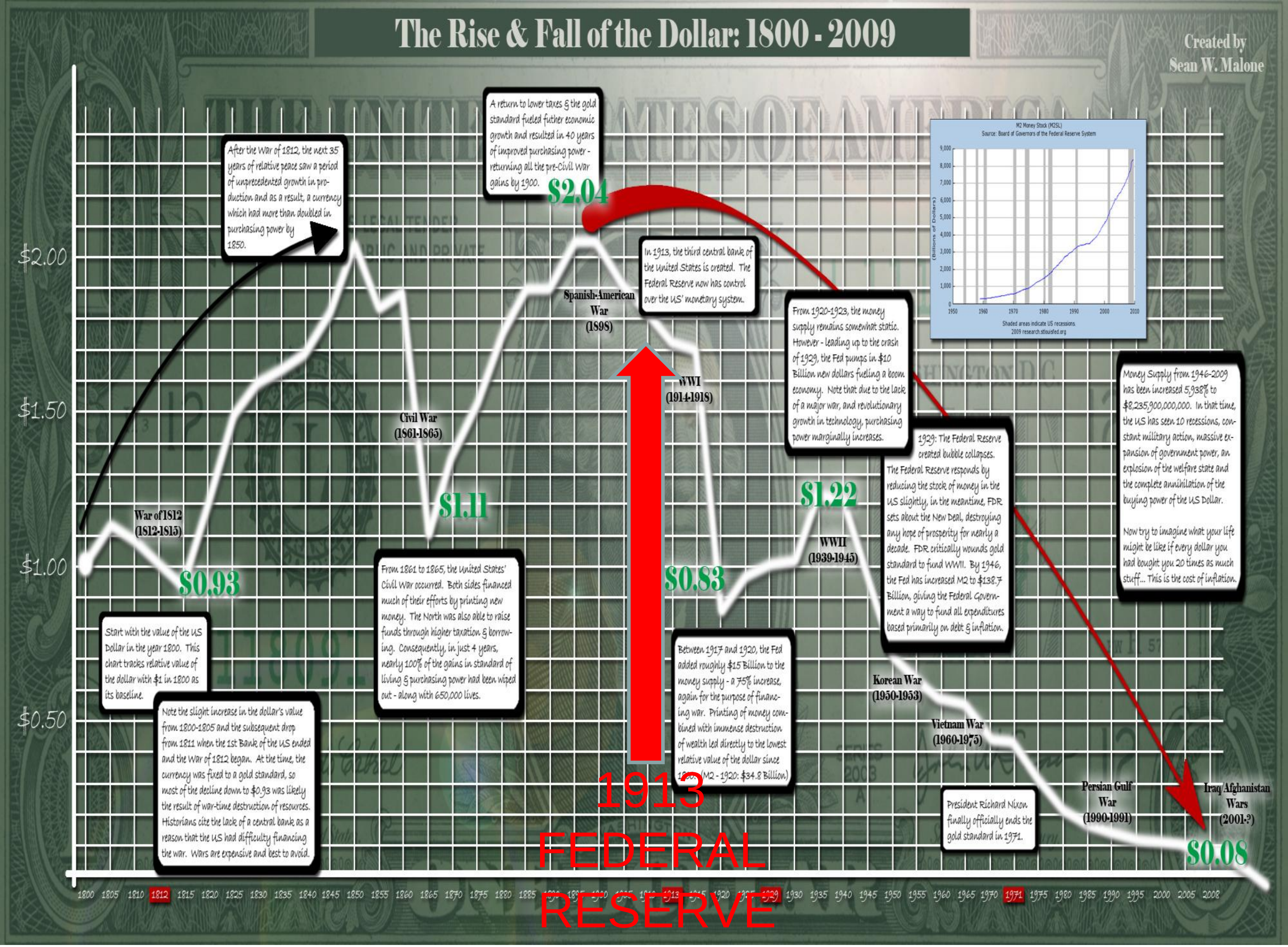
Country	*Period covered*	*Cumulative decline in silver content of currency (percent)*	*Largest debasement (percent) and year*		*Share of years in which there was a debasement of the currency (i.e. a reduction in the silver content)*	
					All	*15 percent or greater*
Austria	1800–1860	–58.3	–55.0	*1812*	37.7	11.5
Germany	1800–1830	–2.2	–2.2	*1816*	3.2	0.0
Italy	1800–1859	0.0	0.0		0.0	0.0
Portugal	1800–1855	–12.8	–18.4	*1800*	57.1	1.8
Russia	1800–1899	–56.6	–41.3	*1810*	50.0	7.0
Turkey	1800–1899	–83.1	–51.2	*1829*	7.0	7.0
United Kingdom	1800–1899	–6.1	–6.1	*1816*	1.0	0.0

Sources: Primarily Allen and Unger and other sources listed in Table AI.4.

This Time is Different: A Panoramic View of Eight Centuries of Financial Crises*

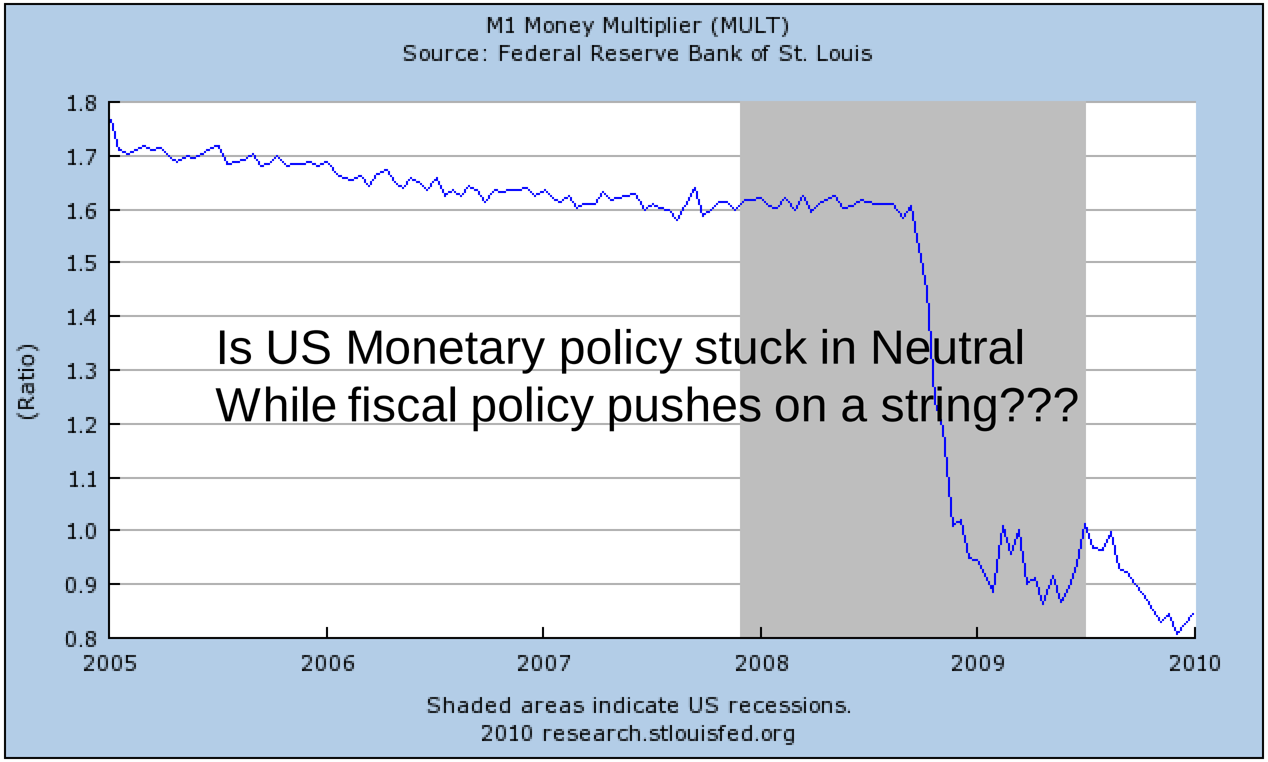
Carmen M. Reinhart, *University of Maryland and NBER*

Kenneth S. Rogoff, *Harvard University and NBER*



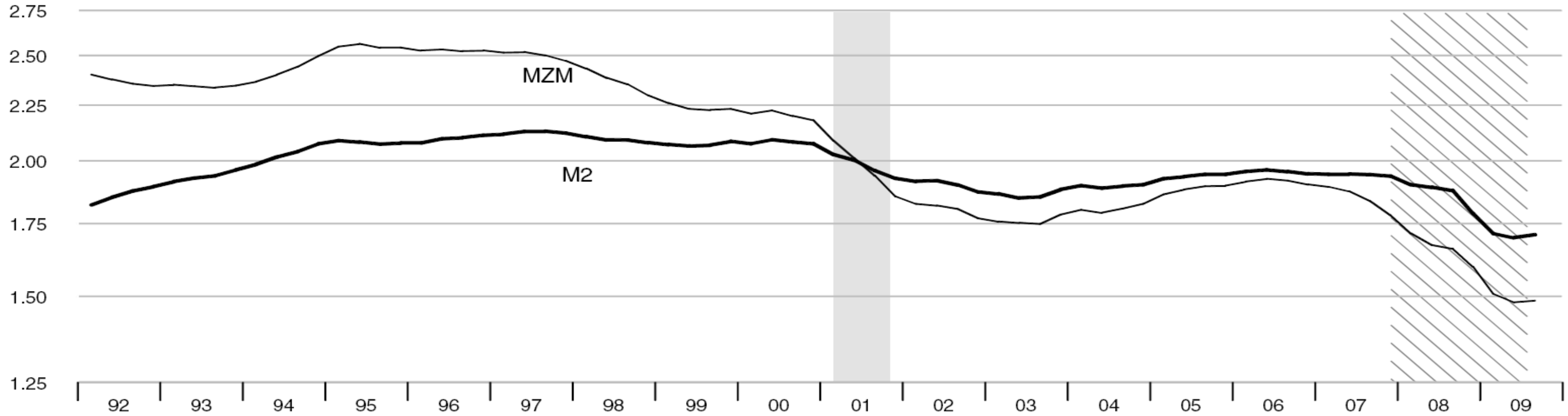
The Rise & Fall of the Dollar: 1800 - 2009
Created by Sean W. Malone
$2.00
$1.50
$1.00
$0.50
After the War of 1812, the next 35 years of relative peace saw a period of unprecedented growth in production and as a result, a currency which had more than doubled in purchasing power by 1850.
A return to lower taxes & the gold standard fueled futher economic growth and resulted in 40 years of improved purchasing power - returning all the pre-Civil War gains by 1900.
$2.04
In 1913, the third central bank of the United States is created. The Federal Reserve now has control over the US' monetary system.
Spanish-American War (1898)
M2 Money Stock (M2SL)
Source: Board of Governors of the Federal Reserve System
Shaded areas indicate US recessions.
2009 research.stlouisfed.org
From 1920-1923, the money supply remains somewhat static. However - leading up to the crash of 1929, the Fed pumps in $10 Billion new dollars fueling a boom economy. Note that due to the lack of a major war, and revolutionary growth in technology, purchasing power marginally increases.
WWI (1914-1918)
Civil War (1861-1865)
Money Supply from 1946-2009 has been increased 5,938% to $8,235,900,000,000. In that time, the US has seen 10 recessions, constant military action, massive expansion of government power, an explosion of the welfare state and the complete annihilation of the buying power of the US Dollar.
Now try to imagine what your life might be like if every dollar you had bought you 20 times as much stuff... This is the cost of inflation.
1929: The Federal Reserve created bubble collapses. The Federal Reserve responds by reducing the stock of money in the US slightly, in the meantime, FDR sets about the New Deal, destroying any hope of prosperity for nearly a decade. FDR critically wounds gold standard to fund WWII. By 1946, the Fed has increased M2 to $138.7 Billion, giving the Federal Government a way to fund all expenditures based primarily on debt & inflation.
$1.11
$1.22
War of 1812 (1812-1815)
WWII (1939-1945)
$0.93
$0.83
From 1861 to 1865, the United States' Civil War occurred. Both sides financed much of their efforts by printing new money. The North was also able to raise funds through higher taxation & borrowing. Consequently, in just 4 years, nearly 100% of the gains in standard of living & purchasing power had been wiped out - along with 650,000 lives.
Start with the value of the US Dollar in the year 1800. This chart tracks relative value of the dollar with $1 in 1800 as its baseline.
Between 1917 and 1920, the Fed added roughly $15 Billion to the money supply - a 75% increase, again for the purpose of financing war. Printing of money combined with immense destruction of wealth led directly to the lowest relative value of the dollar since 1800. (M2 - 1920: $34.8 Billion)
Note the slight increase in the dollar's value from 1800-1805 and the subsequent drop from 1811 when the 1st Bank of the US ended and the War of 1812 began. At the time, the currency was fixed to a gold standard, so most of the decline down to $0.93 was likely the result of war-time destruction of resources. Historians cite the lack of a central bank as a reason that the US had difficulty financing the war. Wars are expensive and best to avoid.
Korean War (1950-1953)
Vietnam War (1960-1975)
President Richard Nixon finally officially ends the gold standard in 1971.
Persian Gulf War (1990-1991)
Iraq/Afghanistan Wars (2001-?)
$0.08
1800 1805 1810 1812 1815 1820 1825 1830 1835 1840 1845 1850 1855 1860 1865 1870 1875 1880 1885 1920 1929 1930 1935 1940 1945 1950 1955 1960 1965 1970 1971 1975 1980 1985 1990 1995 2000 2005 2008
1913
FEDERAL
RESERVE

St Louis Fed Money Multiplier January 2010



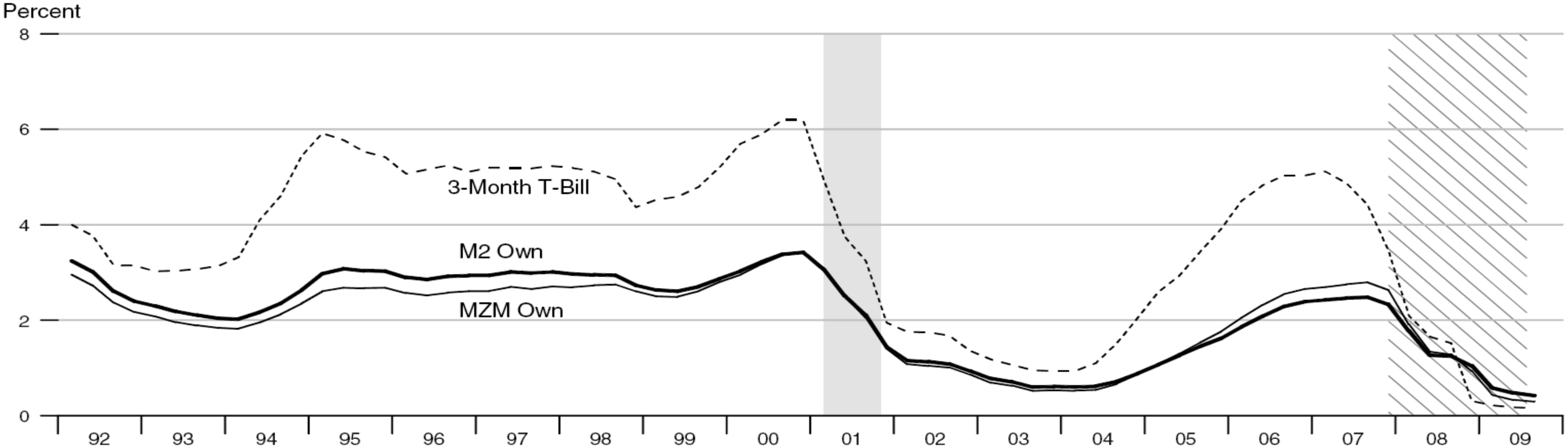
Velocity

Nominal GDP/MZM, Nominal GDP/M2 (Ratio Scale)

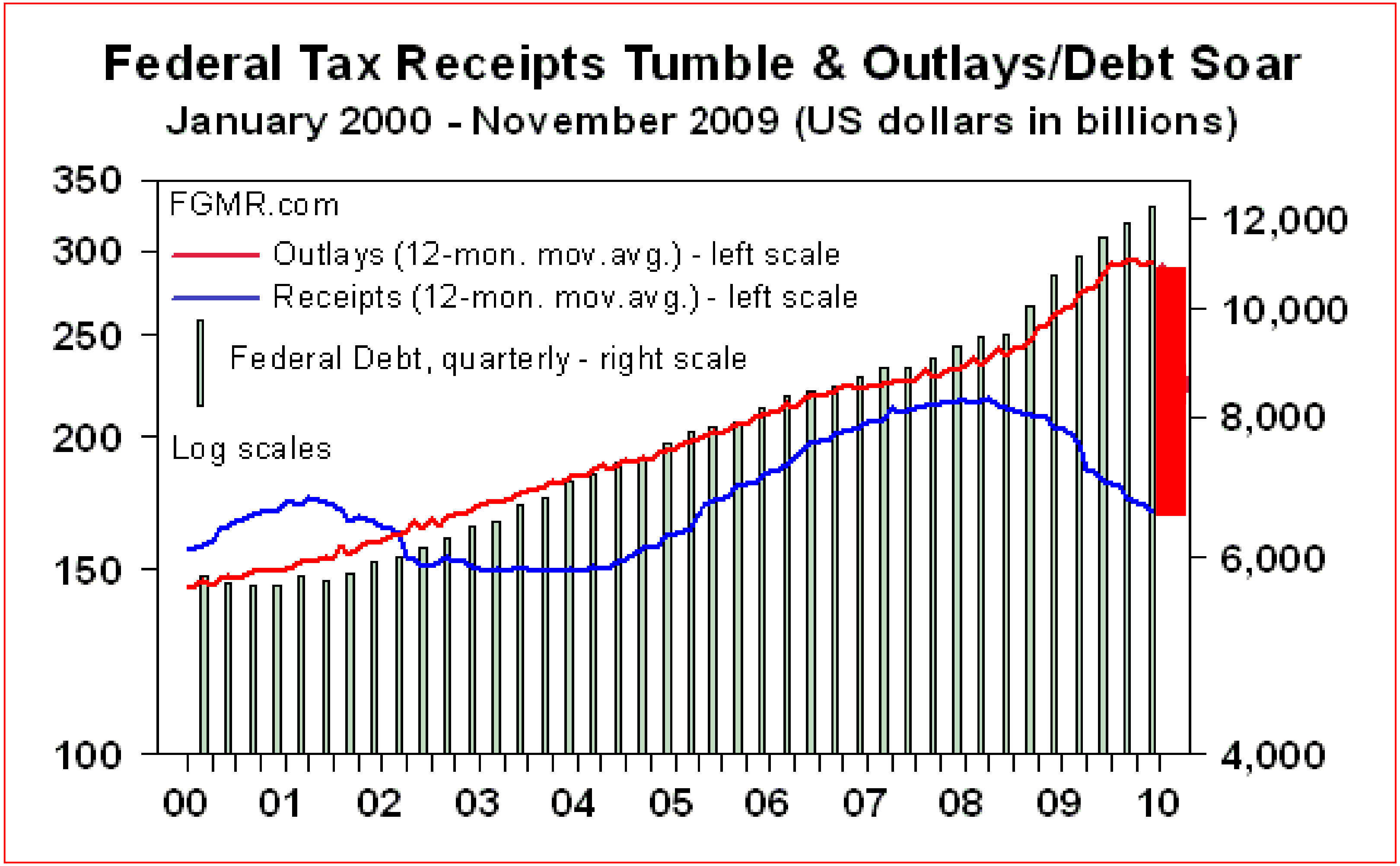


Interest Rates

Percent



THE DOLLAR
BE AFRAID; BE VERY AFRAID of the DOLLAR



Trade Weighted Value of the Dollar 1990- 1999

Year Over Year Change

RED IS YOY DECLINE

	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Average
1990	93.07	92.28	93.78	94.92	94.24	93.02	91.53	89.01	88.25	86.27	84.44	85.50	90.53
1991	84.88	83.75	85.83	90.36	90.11	91.23	92.88	91.50	90.58	88.23	87.46	86.67	88.62
1992	84.14	86.36	88.3	89.70	88.81	87.30	84.68	84.02	81.67	84.28	88.92	90.55	86.56
1993	92.14	92.21	90.99	88.94	87.56	87.25	89.61	89.59	89.87	89.52	90.99	91.84	90.04
1994	92.50	91.04	90.58	90.74	89.06	89.83	87.34	87.43	87.00	85.96	84.24	86.95	88.56
1995	87.47	86.85	85.23	81.30	79.98	81.07	80.42	80.97	84.36	84.13	84.57	85.15	83.46
1996	85.23	87.47	86.69	86.73	87.29	87.61	87.65	86.42	86.99	87.93	87.25	87.86	87.09
1997	88.70	91.70	93.09	93.09	94.95	92.89	92.65	95.77	96.03	94.63	94.18	96.87	93.71
1998	98.35	98.17	97.24	99.25	98.05	99.92	100.61	102.40	100.65	98.00	94.35	96.46	98.62
1999	93.86	95.46	98.17	98.10	97.71	98.87	99.50	97.43	96.36	94.47	95.06	96.52	96.79

Range 80.42 to 102.40

Federal Reserve Bank, St Louis

Trade Weighted Dollar 2000- 2010

2000	95.24	98.10	98.33	98.37	101.66	101.68	99.70	102.03	102.11	104.37	105.80	105.90	101.11
2001	102.48	103.04	105.19	110.03	107.54	109.41	110.67	108.76	107.76	107.00	108.04	109.02	107.41
2002	110.04	112.44	112.16	111.20	108.01	105.16	101.88	103.21	101.73	103.61	102.50	103.16	106.26
2003	100.71	98.01	96.91	96.54	94.13	91.34	91.44	93.88	94.57	89.59	90.06	87.42	93.72
2004	84.64	85.77	86.06	84.91	88.83	87.67	86.87	87.60	86.61	85.15	82.62	79.45	85.51
2005	79.71	81.72	81.19	82.00	82.51	84.81	86.17	84.93	83.09	84.91	85.33	86.63	83.58
2006	84.94	84.24	84.67	85.22	81.43	80.40	81.16	81.51	80.96	81.60	81.64	80.09	82.32
2007	81.09	82.29	81.47	80.56	79.14	78.74	78.04	77.47	77.36	74.37	72.66	73.02	78.02
2008	72.85	72.21	70.91	70.92	71.31	70.78	70.92	71.72	75.69	76.20	82.04	83.27	74.07
2009	79.14	82.61	85.64	83.23	81.23	75.6[illegible]	76.90	74.26	75.49	74.71	73.91	72.03	77.90
2010	74.29												

Range 70.78 to 112.44

NOTE: July 2008 was the beginning of an interim Short Covering

The Curse of the Paper Dollar

Lew Lehrman WSJ 1990

- Managed exchange rates are exploited to subsidize exports and tax imports.

  "… just another Smoot Hawley."

- Under floating exchange rates the US (and I might add the world) has suffered unprecedented financial instability for 60 years.

Currency Instability

- Four periods of wage and price controls 1971 -1974.
- The US dollar plunged in value.
- Then the energy crisis with double digit inflation of 15% (double that of the Civil War).
- International banking turmoil 1982 to 1990.

Deflationary and Inflationary Collapses

The deflationary collapse of the 1930s,

the inflationary collapse of the Bretton Woods system in 1971, and

the recent financial crisis (is it inflation / deflation or eventually both?)   - all consequences of reserve currency shortsightedness.

Result: The gold price soared from $35 in 1971 to $200 by the end of 1974, and $1,100 / ounce in December 2009

The Longer Term Sequence of Increasing Economic and Monetary Pathology In the 20th century

1. The collapse of the post-World War I monetary system. the **stock-market boom of the 1920s, and the subsequent crash and price deflation, as the result of massive official accumulation--and subsequent liquidation--of foreign-exchange reserves**

2. The 1960s **breakdown of the dollar-based Bretton Woods system an** agreement that made the gold-convertible U.S. dollar the official reserve currency of the world monetary regime; it also fixed exchange rates within narrow limits.

3. The **U.S. abandonment of gold convertibility in 1971 eliminated fixed exchange rates. The dollar's reserve-currency role expanded sharply**; without gold backing, it became a question **of confidence** in the dollar and the US economy.

4.The reserve-currency dollar has fostered the main pathologies that plague the world economy: speculative "hot money" flows that first inflated and then deflated stock, **bond, and real-estate prices**; sharp rise and fall of commodity prices; Congress's incorrigible fiscal irresponsibility; and the mushrooming U.S. deficit in international trade.

Today Washington Is Addicted to Reserve Currency Financing

- **Reliance on currency-reserve financing to expand government spending for current consumption.**
- ***It is much worse this time because Treasury bonds were joined in the mix by mortgage-backed securities issued by Fannie Mae and Freddie Mac and implicitly backed by the government***.
- “This funneled inflation (and then deflation) into residential real estate at the very time when Congress was forcing Fannie and Freddie to lower the quality of their mortgage loans to promote homeownership. "

An Eternal Truth

Stable Money emanates ONLY from an INDEPENDENT monetary standard

Keynesians Argued After 1971

- Devalue the exchange rate (move from fixed rates) and stimulate exports and employment. Let the Fed "fine tune."

- Monetarists argued that a Keynesian inflationary bias would exist.

Monetarist Fallacy: Impossibility of targeting both money supply and exchange rate. If demand for cash is stable free exchange rates should work.

Reserve Currency System: The Culprit

- Permits the reserve country to finance very large budget and trade deficits.

- The more permanent the facility, the bigger the deficits and the greater the subsequent devaluation.

How To Remedy:

Not an Impossibility

- Replace Forex reserves with an independent monetary asset – not one nation’s (or one organization’s) liability.

- Fix each country's currency to its gold or commodity value.

- Remove existing foreign exchange reserves form balance sheets – repay over decades

Advantages

- Stability- chaos of floating rates diminished.

- Relieve US of Reserve Currency burden – American manufacturing would revive.

- The world would experience a trade surplus equal to rise in official gold reserves – lower protectionism.

- Sustainable Global Currency structure, counter cyclical stimulus, anchored by gold's stability and not financed by government debt.

- Recap the Fed's balance sheet (NOW 50 TO 1 LOAN TO CAPITAL) by revaluing gold from officIal $42 to $800 -$1000.

Convertibility to Gold or Hard Assets

- Reform the international monetary system
- Make the world’s major currencies directly convertible to gold or other hard assets.
- This would restore immediate discipline to the US $.

Results

- Curb currency speculation.

- Diminish short term speculation. Channel savings to long term investments.

- Solve employment problem.

How Washington Can Avert the Next Crisis?

- 1. Adopt a global currency standard less centered on the dollar.

- 2. Reduce huge inflows of foreign capital.

These contributed to low interest rates, excess liquidity, loose monetary policy and irrational exuberance.

Which means overleveraging, under pricing of risk and an ultimate meltdown.

Today's Catch 22

- What If: Foreign investors refuse to finance the deficits?
- Devaluation – inflation – double dip

- But:

- It is equally damaging if foreigners finance large deficits for long times.

“The main culprit: the dollar's role as the world's main official reserve currency.”

“The Reserve-currency Curse."

The problem is that, unlike gold, official dollar reserves increase the money supply in one country without decreasing it in another.

WHICH MUST EVENTUALLY INDUCE

Either Inflation or Deflation Or Both

Go Forward To Gold: How To Lift The Reserve-Currency Curse
National Review, Dec 15, 2008

by Lewis E. Lehrman, John D. Mueller

“Though he almost certainly doesn't realize it yet, President Barack Obama will either set the dollar's reserve-currency status on the path to extinction or risk becoming the next victim.”

Congress Must Realize

- Large external deficits
- Existence and dominance of the reserve currency dollar
- Large capital inflows

- Are no longer in the best interest of the United States

The Key Difference Between a Gold Standard and a Reserve Currency system

- Foreign-exchange reserves, in the form of government bonds, are not only assets of the national authority that holds them, as gold was.

- **They are also (unlike gold) debts of the country that issues them**. When foreign monetary authorities acquire U.S. debt securities as reserves, U.S. monetary authorities are borrowing.

- The Global Currency regime is changing.
- What will the new regime look like?
- You must have a say - its your money!