The Golden Revolution, Revisited: 
Introduction to Part I

This Insight is the second in the serial publication of the new, Revisited edition of my book, The Golden Revolution (John Wiley and Sons, 2012). (The first instalment can be found here.) The book is being published by Goldmoney and will also appear as a special series of Goldmoney Insights over the coming months. In this instalment I introduce Part I of the new book.

Part I: The Monetary Sources of Economic Inequality

“On Thursday [Sept 15, 2008] at roughly 11am the Federal Reserve noticed a tremendous draw-down of money market accounts in the US to the tune of $550 billion dollars being drawn out in a matter of an hour or two. The Treasury opened up its window to help and pumped $105bn into the system but quickly realized they could not stem the tide. We were having an electronic run on the banks… They decided to announce a guarantee of $250,000 per account so there wouldn’t be further panic. Had they not done that their estimation was that by 2pm that afternoon $5.5 trillion would have been withdrawn from the US, would have collapsed the entire economy of the US and within 24 hours the world economy.”

US REP PAUL KANJORSKI, C-SPAN INTERVIEW, 2009
In November 2008, following the collapse of the investment bank Lehman Brothers, there was an unprecedented run on US money-market funds. Frightened that these funds would “break the buck”—fall below par value—due to their extensive holdings of Lehman’s and other financial institutions’ commercial paper and other debt, investors rushed to liquidate and move their holdings into FDIC-insured bank deposits or even safer US Treasury securities. The result was a near-collapse of the so-called shadow banking system and, were that to have occurred, many believe a general run on the conventional commercial banking system would have followed in short order.

Amid such uncertainty, for the first time since the 1930s, the American public was forced to contemplate what, exactly, money was. After all, although it contained the name, and you could write checks on it, was a money-market mutual fund account really “money”? Or was it merely masquerading as money, concealing previously overlooked credit and counterparty risks? Was an uninsured deposit at a bank potentially at risk of failure “money”? Were multiple large commercial banks to have failed and FDIC funds thus to have been depleted, were even guaranteed deposits “money”? Finally, although few may have asked themselves these next two questions, were the banking system to collapse entirely, would even the US Treasury have been able to continue making payments to holders of Treasury securities? Could the dollar itself have collapsed, rendering even physical cash worthless? To paraphrase the now legendary Star Wars character, Jedi Knight Obi Wan Kenobi, it was as if millions cried out in terror, “What is money!?!” and then were suddenly silent, because they didn’t have an answer.

For a period spanning from the 1940s to November 2008, most of the US public took the concept of “money” more or less for granted. It was the paper dollars you used to make purchases, or at least it was the basis for purchases, say by writing a check or by using a credit card, and if you had a lot of dollars, well, then, you were wealthy. Indeed, many considered “money” and “wealth” to be the same thing.

In those dark days of November 2008, however, they were anything but the same. The monetary officials at the Federal Reserve didn’t exactly help to clarify matters either. They rolled out several emergency lending and liquidity facilities with acronym names such as TALF to inject liquidity into the financial system and eventually TARP to provide banks with wholesale, taxpayer-funded relief from their bad assets. The monetary result of these and other bail-out programs was to create a huge, unprecedented amount of “excess reserves” in the banking system. This liquidity, these excess reserves, are defined as “money” by the Federal Reserve and are thus
included in the official US money supply data. But are they really fungible “money” that could, for example, be used to make purchases (as with a medium of exchange)? That someone would consider as a source of “wealth”? No, to call the purely electronic, zero-velocity excess reserves “money” only obfuscates the matter of what money really is even further.

A frightened and increasingly confused public was thus receiving an unexpected and unwelcome crash course in learning what money was, or was not, and were taking matters into their own hands by moving their money from forms that were discovered to be relatively unsafe (e.g. money market funds) to those thought to be relatively safer (e.g. guaranteed bank deposits, Treasury securities, physical cash). In doing so, their actions were making a bad financial liquidity situation worse, as this caused a sharp contraction in the broad money supply that stands behind the commercial lending activities undertaken by shadow- and nonshadow financial intermediaries alike, thereby forcing asset liquidations and escalating the systemic risk so feared by the Federal Reserve.

If public perceptions of safety matter so crucially as to what can be properly understood as “money,” and if sudden changes in those perceptions can have a huge impact on the broad money supply, does this help us to answer the question, “What is money?”

DEFINING MONEY

Let’s start with some definitions. Money is generally defined as that which serves as one or more of the following:

1. A medium of exchange
2. A store of wealth
3. A unit of account

In a modern economy, money serves in all three roles and we don’t normally consciously consider which of these three our money is carrying out at any one particular point in time. However, it is worth considering that there is a hierarchy in the above roles, that is, that people will most probably resist or refuse to use a medium of exchange that does not function as a reliable store of value. After all, why accept that which is expected to depreciate rapidly in value? (This is one reason why economists generally agree that high rates of inflation are economically destructive, in that they inject a large amount of risk into ordinary, day-to-day transactions, making rational, efficient economic calculation all but impossible.) If a given money is not considered
sufficiently safe, as per the discussion above, then it will struggle to meet a strict definition of money. It becomes unclear just what money is when it can vaporize in a bank account or be arbitrarily devalued or defaulted on by the issuing government or other authority. November 2008 illustrates the point, as does 1931–33, when US banks were failing by the hundreds as depositors rushed to withdraw not only their banknotes, but physical gold as well. (Most recently, the Indian government summarily and arbitrarily declared high-value banknotes invalid, igniting monetary chaos.)

The unit of account function, to complete the definition of money, is not strictly necessary, but rather a matter of convenience. In theory, we could all choose to translate our accounts into how many loaves of bread we could purchase; how many months of living expenses we have saved up; or how many years of retirement we can afford. Younger folks might measure their savings in terms of nights out on the town. The fact that people choose instead to maintain their accounts in the legal tender is that it is simply easier that way. There is the notable exception, however, that when an individual, small business, or corporation is preparing their taxes or engaging in other official transactions with a public agency, they are required to use the legal tender as the unit of account.

This traditional definition of money in terms of the roles it plays, which in turn requires a high perceived degree of safety, as shown above, overlooks entirely another way to understand money, however, one that is explored at length by the philosopher and information theorist George Gilder. Money’s role ultimately reduces, he explains, to that of a conduit for information. Prices are the essential information that allows a market-based economy to work. As he writes in his 2013 book, Knowledge and Power, “Capitalism is not primarily an incentive system but an information system.” The single most important form of information, he argues, is prices, and the numerator of all prices is, of course, units of money.

This insight has profound economic and social implications. For if information flows efficiently, an economy can function efficiently, thereby serving society. But if the information is somehow distorted or otherwise flawed, it implies an inefficient, substandard economy that can fail in various ways to serve the society as it should. At worst, if the flow of information basically stops due to a monetary crisis, the economy stops. This is being observed to some extent today in Venezuela and, in recent years past, in Zimbabwe, Argentina, much of Eastern Europe, and the former Soviet states. Post WWI there was a general monetary crisis that spread across most of the European

1  George Gilder, Knowledge and Power (Regnery: 2013).
continent, with similar consequences. (The Indian economy may also soon seize up entirely if the current monetary chaos caused by Prime Minister Modi’s sudden “demonetization” policies continues.)

In November 2008, the US public suddenly became aware that the money machine, long believed to more or less run itself with a little help from the Federal Reserve, could suddenly stop. In the scramble for safety, the public relearned a little about what money really is. It is a great irony that in a supposedly open, transparent, mature free-market economy an improvement in the public understanding of money became an immediate, grave threat to the very system that money was intended to serve: for it is money that should serve society, not the other way around.

THE ROLE OF MONEY IN SOCIETY

That money should serve society seems an obvious point, yet one that is far from clear amid sustained unconventional monetary policy and the associated zero or even negative interest rates that penalize prudent savers while encouraging imprudent speculators. The year 2008 may have lifted one veil on money. This book lifts the rest: not only what money is but how it is created and used in practice and to what extent it does, or does not, serve the economy and by extension society at large. I will show that the way in which the monetary system currently operates is the single most important source of rising economic inequality in both the US and around the world. Furthermore, I will demonstrate that the current system is one in which money can continue to function—and even then sub-optimally—only to the extent and as long as the public remains mostly ignorant as to what our modern money really is and how the financial system really works.

Such a confidence charade implies an unstable monetary system. Unstable systems are subject to large systemic risks, regime shifts, restructuring, and reformation. Applying game theory to the current, unstable global monetary equilibrium implies that some variation of a fundamental monetary crisis lies in our future, most probably our near future, and quite probably on a scale larger than that which hit in 2008. Fortunately, this is likely to catalyze a restructuring and reforming of the current, highly sub-optimal monetary order. When combined with relatively recent, historical strides in financial technology, this will pave the way toward a far superior monetary system, one in which money serves as a source of economic stability, confidence, and resilience, rather than the opposite. This future monetary system will also reverse the multi-decade trend toward economic inequality, increasing the earnings potential of labor-based incomes relative to those that are capital based.
What many claim is an inexorable trend toward inequality—perhaps one endemic to capitalism, or to associated technological advancement such as robotics—is in fact nothing more than a huge, historically unprecedented economic imbalance in disguise, financed by massive, misallocated debts atop a misunderstood, fragile, and now failing monetary system. Imbalances are by definition unsustainable in the long run, and the only way to resolve and rebalance this particular one is for financial assets (capital) to decline sharply in value relative to wages (labor).

In this section, I explain why this is so. In subsequent sections, we then explore how this change will come about, why gold will be at least partially remonetized in the process, and the general economic and financial implications thereof. In doing so, I will also demonstrate how new, nonbank payment technologies will play a key role in all of the above and remain central to the further evolution of money in future. Finally, I will conclude with some thoughts on the salutary social impact of a restoration of stable money, including higher rates of economic growth and the myriad benefits of greater economic balance within and between countries around the world.