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Book Review:

The death of money: The coming collapse of the international monetary system.

By James Rickards

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Reviewed by Richard W. Rahn
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How are you going to protect yourself when the international monetary system collapses? In his new book "The Death of Money" James Rickards argues that it is a near certainty that the existing monetary system will collapse. There is nothing particularly original about that insight – many economists, including yours truly, have been making that argument for the past several years. What Rickards has done, however, is produced the best book to date of why the existing order cannot continue, along with likely scenarios of how it will end.

The existing monetary system is built on the global supremacy of the dollar as the de facto world currency. The essence of Rickards' argument is that because of the mismanagement of the dollar by the Fed and recent administrations, most notably and importantly the Obama administration, the dollar will lose its international standing. By collapse of the dollar, he means the loss of confidence in the purchasing power of the dollar by both central banks and the people who use it.

This loss of confidence is most likely to lead to inflation, such as occurred in the 1970s, and the destruction of capital formation. Or it could result in major deflation, which occurred in the 1930s in the U.S. and many other parts of the world, and what Japan is experiencing today.

At first glance, one might find such a two-handed answer unsatisfying – which reminds of the old Harry Truman's joke that what he really wanted was a one-armed economist – but Rickards well explains why each scenario can occur, largely depending on the actions of the Fed.

A financial collapse does not mean the end of trade, finance or banking. What it does mean is that all of these activities will be much more difficult and expensive. Real incomes will fall, savers and pensioners will suffer, but most nations, major banks, and multilateral institutions will survive and muddle through until finance ministers and others put together a new set of rules. But, as Rickards notes: "If social unrest emerges before the financial elites restore the system, nations are prepared with militarized police, armies, drones, surveillance, and executive orders to suppress discontent." The

new financial system "will not be based on dollars because China, Russia, oil-producing countries, and other emerging nations will collectively insist to the end of U.S. monetary hegemony and the creation of a new monetary standard."

Unlike many other authors of the financial-doom-and-gloom books now on the market, Rickards takes a very measured approach based on history and empirical evidence. Even if one does not accept his conclusions, his monetary history, including the history of the gold standard, and his chapters on China, Germany, the BRICS (Brazil, Russia, India, China and South Africa), and other emerging markets are well worth the read in themselves. Rickards was trained both as lawyer and economist, is a portfolio manager, and has been an international financial advisor to U.S. intelligence agencies and the Department of Defense. His previous book "Currency Wars" was a national best seller.

Rickards is no ideologue, but has, through education and experience, developed a Hayekian view of the world, with its skepticism of the ability of those in government to plan. "In plain English, the central planner has no option but to drink his own Kool-Aid. This is the great dilemma for the Federal Reserve and all central banks that seek to direct their economies out of the new depression. The more these institutions intervene in markets, the less they know about real economic conditions, and the greater they need to intervene."

As a historian of modern economic history, Rickards shines in both the clarity of his writing and his attention to real facts. I found almost no errors in the book. Those who pay at least some attention to economic affairs may be familiar with the recent successes and failures of the BRICS, but probably know little about the BELLs, consisting of Bulgaria, Estonia, Latvia, and Lithuania, and the GIIPS (Greece, Ireland, Italy, Portugal, and Spain). Rickards argues that the BELLs have pursued more free-market and fiscally responsible policies than the GIIPS, giving a case study in what works and what doesn't. "The findings show that economic prudence works and Keynesian-style stimulus fails. The results are not surprising, given Keynesianism's dismal track record over the decades and the lack of empirical support for its claims."

As a result of the mismanagement of the dollar and the increasing financial imperialism by the U.S. government, other countries are looking at ways to escape from the shackles of the dollar. The U.S. has increasingly acted as a financial imperialist under the excuse that it must regulate all foreign institutions that might deal in dollars or have relationships with U.S. citizens in order to combat "money laundering," terrorist finance, and tax evasion. China, Russia, and the Persian Gulf states have created groups of countries who have common economic, military, foreign policy, as well as monetary interests.

"When a country or group of countries peg to the U.S. dollar, those countries effectively outsource their monetary policy to the Federal Reserve." Directly or indirectly, many countries are, in essence, forced to peg their currency to the dollar, which leads to the justified fear that the U.S. may "export" inflation to them and undermine their own economic well-being. As Rickards notes: "It remains to be seen whether the international monetary system collapses of its own weight or is overthrown by emerging-market losers in response to this crime of the century being perpetrated by the U.S., U.K., and Japanese central banks."

What is true for individuals and businesses is also true for governments, and that is debt will be ruinous if it is growing and merely used to finance existing debts. Debt can be productive if it is used in investments with positive returns. Unfortunately, the U.S. and many other countries are malinvesting and with ever increasing debt-to-GDP ratios.

The result is the Fed and other major central banks are trying to walk a tightrope of creating just the right amount of inflation in order to solve a fiscal problem (too much government spending) through monetary policy. Success is unlikely.

Rickards, although a critic of the IMF, argues that it has become, despite its many failures, and will become even more so, the central banker of the world as it increasingly serves as the global lender of last resort. He notes: “In the 1980s and 1990s, the IMF was like a doctor who made house calls, dispensing bad medicine in the form of incompetent advice to emerging economies.”

He goes on to argue that: “The next global liquidity crisis will shake the stability of the international monetary system to its core; it may also be the catalyst for the realization of the IMF’s vision” (i.e., a reconstituted SDR as the global currency). After spending some time making a persuasive case for gold, Rickards states “The United States and the IMF should lead the world to the gold-backed SDR, which would satisfy Chinese and Russian interests while leaving the United States and Europe with the leading reserve positions.”

The book ends with a couple of chapters detailing the inside games that key individuals have played in their revolving door between the Fed, the Treasury, the big banks, notably Goldman Sachs and Citibank, in order to increase their own power and wealth – and how this has led to the situation where there is no benign way out. He correctly argues that the big insolvent banks should have been put into receivership rather than allowed to grow even bigger – which will only add to the financial calamity we all will face. And he also correctly explains how the financial regulators only made and continue to make the situation worse rather than better.

Which leads to the conclusion: “Monetization of debt leaves the Fed with a Hobson’s choice. If the United States tips into deflation, the debt-to-GDP ratio will worsen because there is insufficient nominal growth. If the United States tips into inflation, the debt-to-GDP ratio will worsen due to higher interest rates on U.S. debt. – There appears to be no way out of the sovereign debt crisis for the United States; the paths are all blocked.”

Of course, there is one way out, which Rickards ignores, and that is for Congress and the administration to radically cut government spending and regulations now – but I expect the reason he ignored it was it does not look politically possible. So for now, all one can do (Rickard’s list) is put some assets in gold, some in land, some in fine art, some in alternative funds, and some in cash. Good luck!

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http://www.compasscayman.com/cfr/2014/08/08/The-death-of-money-/

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