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POLITICAL AND MONETARY REFORM

Financial history and libraries are never as dull as they may seem. In my experience a couple of decades ago, it was like prospecting for gold, but within the relative comfort of dusty library stacks. The discoveries ranged from Eureka! to the vignettes of life.

During the 1600s, the Northern Hemisphere suffered an unusually cold climate that has been described as the "Little Ice Age". Naturally, this increased the use of fireplaces. A broadsheet published in 1625 in Newcastle promoted the benefits of burning coal to warm a household, in particular the warmth and glow from the bedroom fireplace "*heightened the joys of intimacy*".

Be that as it may, another vignette was on the political side when two bitter opponents encountered each other in a London street. On an exchange of mannered insults, one said, "*You sir, will either die of the pox or on the gallows.*". The response was "*And that, sir, depends upon whether I embrace your mistress or your principals.*".

To be serious, there is much to be learned from a thorough review of the actual history of the financial markets rather than as filtered through orthodox theories.

The highlight of today is the struggle between those compelled to bring us yet more intrusive government and those who've had enough. Over the past 2000 years, this intense struggle has occurred before and freedom eventually won.

Previous such immense conflicts and reforms were not only features of the period but, I would suggest, the political highlights of the past 2,000 years.

The most straightforward way to convey the observations is by asking and answering a few key questions.

One is – **When did the senior economy suffer a great and chronic inflation?** Over the past 2,000 years, there have only been three. Each lasted for almost one hundred years and the increase in the basic cost of living was horrendous and, in its most rampant phases, destructive to the social fabric.

As calculated by Emperor Diocletian's administration, prices in Rome soared by a factor of 40 times through the Third Century.

The next great inflation brewed up and ran through the 1500s and, after some 400 years of a relatively quiet price history, the third great inflation began very early in the Twentieth Century when the U.K. was the senior economy, with the world's financial centre in London.

It is interesting that in 1900 England enjoyed, even celebrated, classical liberalism with its high regard for limited government and economic as well as political freedom. This has been the characteristic of the world's financial capital as it was voluntarily moved from Rome to Northern Italy to Antwerp and eventually New York.

But the passing of the baton of freedom and prosperity has had the three major setbacks and their inceptions have been unpredictable. Even with full knowledge of the two previous dislocating inflations, a researcher in London in 1900 would have been unable to predict that by 1980 England would be governed by radical trade unions and that the cost of living would have soared by a factor of 40 times.

However, with the three distinctive centuries of inflation being so consistent in character and duration, it is possible to consider that the third one is unwinding, which brings us to the next big question.

What periods suffered the greatest experiments in authoritarian government? This one jumps out at you. Rome, which had been a republic, did not relinquish in peace the prerogatives of power assumed during a couple of great wars. This, combined with unrelenting taxation and currency depreciation during the Third Century AD, culminated in a murderous police state.

Another question – **Beyond rampant inflation and political bullying, what else was common to the three monstrous centuries?** It's been the lust for unearned money.

With its vast empire of conquest and tribute, Rome had accumulated the greatest amount of wealth in history. Then, once limitations upon government ambition were corrupted, even this great treasure became inadequate to fund bureaucratic ambition. Thus the resort to confiscatory taxation and horrendous debasement of the currency. These two evils are the big sign that bureaucracy has become more important than the common wealth.

Over the centuries, there has been inquiry about collapsing empires and why Rome failed. Some have thought it was destroyed by the "barbarians". But in the Third Century, the term meant stranger or Christian. The latter, with its fundamental concept of free will and teachings of morality, was found intolerant to the establishment. This, combined with the Northerners' legal system that protected the individual from the state (Rome's was top

down) eventually collapsed the out of control police state. In this condition, Rome, as with the Soviet Union, was an uneconomic model that, without a steady flow of tribute, failed.

Actually, the difference between Rome at its most corrupt and the Romans in the northern provinces was more like today's differences between Texas and Massachusetts. Rome essentially succumbed to its own unaffordability and to unseemly outsiders with "new" ideas about smaller government.

The second extraordinary accumulation of wealth started in 1500 with the transfer of gold and particularly silver from the new to the old world. Much of this was coined and the increase in circulation was associated with some rise in prices that was exacerbated by deliberate and frequent currency depreciation. During the 16th Century, Spain became the dominant power and, despite controlling most of the greatest windfall in history, the treasure was insufficient to fund state ambition. Despite this and confiscatory taxation, Spain defaulted to its creditors three times.

This drained Spain's vitality and the collapse of Europe's greatest power in the 1500s was similar to that of Rome's some 1,200 years earlier.

Throughout the 16th Century, it was difficult to distinguish between the secular and divine world or, in other words, church and state had become a monopolistic power. Proponents of political correctness then supported the divine right of kings and, by extension, of bureaucrats. Today it's the insidious theocracy of 20th Century liberalism that needs reformation.

Responding to insatiable demand for money, alchemists thrived. At the time, the biggest commercial bank in history circulated a market letter and in 1558 a series of them scorned both alchemists and the fact that it was mainly governments that were gullible enough to fund the chicanery.

Following the early 1600s, the cost of living became relatively steady. Moreover, the political culture, with a number of setbacks, changed from a police state to an eventually free society. Each region accomplished this in its own way and, generally, this change is described as the Protestant Reformation.

This implies that it was a religious event and it was in the sense that an authoritarian combination of church and state was reformed from the most massively corrupt form of government since that of Imperial Rome.

However, the change was essentially prompted by the productive sector of society realizing that there was way too much money going into the state and too much imposition of authority coming out. At its most destructive were the horrendous official policies of hatred as evidenced by the St. Bartholomew's Day Massacre of up to 30,000 Huguenots, who were the Protestant and productive part of France's economy. At the time, the Spanish Ambassador reported: "*As I write, they are killing them all ... sparing not even children. Blessed be God.*".

The atrocity of 9/11 in New York was anticipated by the "Spanish Fury" that in three days in 1576 slaughtered some 7,000 non-combatants in Antwerp, which was the world's financial capital. The hatred of authoritarians for the freedom of religion and expression that has been the feature of the financial centre (no matter where it is) and a long run of price inflation provoked unbelievable violence upon innocents.

It's worth stopping for a moment to consider what was so offensive. When a Parisian traveled to Antwerp, he wrote, with some amazement, that when he arrived his serfs became free, the streets were safe, anyone could publicly criticize the administration and, what's more, when you left you could take all your money with you. Another observed that when a businessman became successful, he supported charities and the arts, served on committees, and took up golf.

For some perverse reason, authoritarians in any century hate such productive behaviour.

In Rome's case, any religion or cult, such as astrology, with any means of forecasting or advising was employed by the state. Generally, this was known as the "Genius" of the emperor and the approved list ran to many pages and the only merit was that the movement, one way or another, supported the top-down form of government. Only one religion was not approved and the establishment's intolerance included the death penalty for its adherents.

With the population of the city approaching one million and including some 400,000 on welfare, political stability was precarious. Slaughter of Christians relieved authoritarian hatreds and diverted the attentions of a frequently demanding mob. (On a mundane level, this included politicians promising "free" bath oil, with another topping this with scented oil.)

Of course, the decline of formidable authority was opposed by those on top and welcomed by those below. Romans from the northern provinces, while detested by the establishment, were admired by the lower and middle classes as "innovative". Their fashions spread as those in the city took to bleaching their hair and those who could afford it had real blond wigs made. The emperor made it illegal but, as with the also prohibited fashion of wearing long trousers, the public eventually did as it pleased. Recall that Russians in the 1970s were paying \$100 US for black market Levis.

On the demographics, all regions endured severe cooling of the climate from 250 AD to the 500s, as well as a number of lethal plagues. The Mediterranean region suffered significant depopulation. With exceptional vitality, northerners thrived.

Without going into detail, there seems to be enough evidence to suggest that the description "Dark Ages" could be more appropriately considered as a

"silent age" of political reform, agrarian expansion, and innovation. Rome, as a police state, was the real Dark Age.

Of course, more is known about the second reformation that arose in the late 1500s which, with the printing press, was by no means silent. There was a growing demand for reasoned argument against excesses, no matter how "good" or bloody the persuasions of authoritarian clergy were.

With the Tiananmen uprising in 1991, the political masters in Beijing loathed that they did not have control of the information going in to the protesters via voice telephone and fax. When the crunch came in the 1600s, even Archbishops in England complained that the private sector was publishing books and pamphlets outside establishment control. Recently, Canada has allowed broadcast of Al Jazeera TV news while refusing Fox Cable.

Due to impartial observation rather than personal theories, alchemy became chemistry and astrology became astronomy. Both enhanced the commonwealth while diminishing the use of superstition as a tool of state propaganda (well, at least until astrology was seriously employed by the National Socialists in 1930s' Germany and Roosevelt reinvented Rome's "New Deal"). Regrettably, in the 20th Century alchemy moved from the periodic table to the printing press.

The second century of inflation ended as a massive speculation in tangible assets blew out in 1609 and a severe credit crunch was followed by nine years of stagnation. Compared with the preceding boom era, relatively high unemployment bothered the administration and the Crown was enticed to a direct adventure in business by the eventually infamous "Alderman Cockane".

With the sluggish economy, the promoter persuaded the British Crown to finance the duplication in England of cloth-finishing facilities. As business conditions began to deteriorate with the contraction that began in 1618, the King became apprehensive – particularly as successful merchants described the scheme as *"a Sepulcher – attractive without, Dead bones within"*.

Then in November of that fateful year, which was seasonally appropriate for financial calamity, the Archbishop recorded that the King told the advisor, *"in could bloud before ye Council Table yet if he had abused him by wrong information his 4 quarters should pay for it"*. As this meant "hanged, drawn and quartered", the Archbishop continued with *"ye poore Alderman stood infinitely amazed"*.

Other than providing poignant accountability for policymakers, the anecdote occurred during a prototype of the "New Financial Era". And with the end of the "old" era of inflation, politics took a turn away from authoritarianism and back towards the sovereignty of the individual. In England, there was no currency depreciation until the

financial panic induced in 1797 by the horrors of the French Revolution. The Bank of England defaulted from 1797 to 1819.

The end of absolutist kings was ensured by the "Glorious Revolution" of 1688. This was run by Protestant businessmen in London and, in today's world, it is appropriate to regard Christian denominations without the usual capital letters – protestant, non-conformist, dissident, to name a few.

The establishment's bullying combination of high church and big state, which endlessly involved itself in intrusive regulation and granting holidays including all-day parties called "Church Ales" was slowly but inevitably diminished until around 1900. Productivity soared.

Most impartial readers of financial history would agree that to date there has been only one financial history. From 1300 to 1500, England's price index showed little net increase, but within this there was a recurring pattern. A decade of sharply rising prices would mark the end of a long expansion. A rapid drop in prices was followed by nine years of stagnation, which was ended by a massive credit collapse that bankrupted both countries and bankers.

This then marked the beginning of a contraction in the order of 20 years. Then the pattern repeated, typically with two being accomplished per century.

As with the 20th Century, the 16th recorded the basic pattern, but the long periods of natural contraction were overwhelmed by massive currency depreciation and transfer of wealth to a relentlessly ambitious state.

One new thing in financial history was the voluntary development of the stock market in the late 1600s. The first tech mania erupted in the 1670s, which was in Turn Pike roads with an outstanding increase in productivity. The next steps to modern finance were the advent of independent research with Houghton's market letter in 1692 and the Bank of England in 1694. The latter, when its notes were convertible, provided the innovation of a sound and efficient paper currency. The abandonment of this benefit permanently in 1931 returned the monetary corruption that has always been the temptation and hazard since coinage was developed more than 2,500 years ago.

This evening's audience is well informed about the 20th Century, but Elizabeth's question in the introductory flyer should be specifically addressed. ***"What have almost a hundred years of interest rate and foreign exchange manipulations accomplished?"***

In the Western world, it enabled one of the greatest examples of state theft in 2000 years as well as one of the greatest losses of individual freedom. Moreover, this did not materially change the basic patterns of financial history.

As with any of the past three centuries, the highlight pattern prevailed and recurred twice. The peak of the last business cycle of the "old" era of inflation was set in January, 1920. The end of the "new" era of financial speculation blew out in September, 1929 – 116 months later, obviously within the usual nine years from inflation peak to the initial financial contraction.

I don't know if anyone here was watching CNBC in early 2000 when Larry Kudlow's Friday review typically included "*You just have to buy the stock market because there is no inflation.*" The rationale that the Fed had reformed and inflation was no threat was also part of John Moody's long-term rave about the "new" financial era in **The Atlantic Monthly** of August, 1928.

The comparisons are fascinating and, for consistency, we'll stay with the NBER determination of the business cycle.

The last business cycle with the "old" era of inflation peaked in July, 1990 and, with fateful duration, the mania blew out in March, 2000 – 116 months later, obviously unchanged by massive intervention.

It is worth stressing that key points covered are observations of financial history and these are worth reviewing.

- The basic pattern with nine years between the end of inflation and the collapse of a financial mania has recurred twice within each century.
- The intervening contraction that would have returned basic prices to pre-boom levels was, as with the 1500s, masked by an extraordinary currency depreciation.
- Along with confiscatory taxation and regulatory intrusion, this relentlessly transferred savings to the bureaucracy to the detriment of the commonwealth.
- All countries suffered an extraordinary loss of individual freedom as, each in its own way, participated in the third great experiment in authoritarian government.
- By the Twentieth Century, the accumulation of capital and savings was not due to tribute or windfall, but to hard work and innovation that freedom fosters. As with the early examples, the wealth became irresistible to the bureaucracy and any charismatic theory that celebrated the "genius" of the state was employed to centralize the power.

These points, I think, answer the question about the effectiveness of 100 years of interest rate and currency manipulation.

The next step is to move from observation to opinion. History has spent most of the last 2,000 years resisting the devastating 100-year plagues of inflation and authoritarianism. While their inception has been seductive,

their ends have involved bitter political polarization, with the experience of Eastern Europe providing a general example.

It takes a relentless imposition of authority combined with the constant complacency of the subservient to keep the experiment going.

In the mid-1970s, I came across a paper written about dynastic collapses in ancient Egypt. In an era of increasingly hard times, the public became sceptical about the promises of the Pharaoh. With no improvement, the priesthood would replace the old Pharaoh with a new one who, with their incantations, would definitely restore prosperity.

Then as things got worse, the establishment had a problem. The police and palace guards were not of the governing classes and the guards sided with the people.

In the late 1980s, East Germans wanted to go "cross-border" shopping and the guards, who were not part of the nomenclatura, laid down their rifles and the shopping spree started. At that instant, the state lost the will to impose authority as the public lost the complacency of submission

Part of this change was, of course, the public giving the finger to statist propaganda. Although suffering some recent setback in Russia, the basic political reform is to diminish or eliminate authoritarian monopolies.

In the Western World, such monopolies have involved excessive regulation or supply management schemes such as dairy and egg marketing boards. Of course, the most blatant has been the monopoly of a nationalized currency "managed" by the central bank. Well, going the other way, the purpose of sound money has always been to "manage" the ambitions of the state.

In a developing age of privatization, it seems reasonable to look forward to the public figuring out the main impracticality of Western central planning and then demanding monetary reform with the restoration of a convertible currency.

There is little doubt that this would be resisted by the establishment and, if the old and notorious Vancouver Stock Exchange has a parable, it would be the definition of a promotion: ***"In the beginning, the promoter has the vision and the public has the money. At the end, the promoter has the money and the public has the vision."***

In 1900, all levels of government were taking only 10% of GDP and the public was sceptical about big government. In the last part of the 20th Century, the government take was approaching 50% and the public had visions of government as a wish machine.

The concept of big government and its absurd currency is close to being discovered as a rank promotion.