The Bell Tolls For Fiat

By Alasdair Macleod – Gold Money, July 2023

The importance of Russia's announcement that a new gold-backed trade currency is on the BRICS meeting agenda for August 22—24 in Johannesburg seems to have gone completely over everyone's heads, with mainstream media not even reporting it.

This is a mistake. **China and Russia know that if they are to succeed in removing the dollar from their sphere of influence, they have to come up with a better alternative. They also know they have to consolidate their trade partners into a formidable bloc, so plans are afoot to consolidate BRICS, the Shanghai Cooperation Organisation, and the Eurasian Economic Union along with those nations who wish to join in. It will be a super-group embracing most of Asia (including the Middle East), Africa, and Latin America.**

The groundwork for the new currency has been laid by Sergei Glazyev and is considerably more advanced than generally realised.

This article explains why Russia and China are now prepared to fully back Glazyev's expanded project. **For Russia, it is also now imperative to destabilise the dollar as a deliberate escalation of the financial war against America and NATO.**

China's priority is no longer to protect her export trade, but to ensure that her African and Latin American suppliers are not destabilised by higher dollar interest rates.

Introduction

"The BRICS's introduction of a gold-backed currency, which is supported by 41 countries with large and influential economies, will weaken the dollar and the euro and will benefit countries such as Iran, while Iranians in possession of gold will experience a wealth increase," Mousavi added [the head of the South Asia Department at Iran's Foreign Ministry]. **The Russian government confirmed a day earlier that Brazil, Russia, India, China, and South Africa would introduce a new trading currency backed by gold.**

Iran's MEHR News Agency[i]

The quote above encapsulates why a new gold-backed currency is desired: it will undermine fiat currencies which have been no friends to oil producers and benefit individuals who own gold making it popular on the streets. RT, the Russian government-financed English broadcasting service had confirmed on last Friday the intention to introduce a new gold-backed currency for BRICS members. The announcement was completely missed by mainstream media, partly because RT and other Russian news sources are censored in many countries in Europe including the UK, and any news out of Russia is disbelieved anyway.

Reactions from those who saw it, even among gold bugs, vary from the opinion that neither China nor Russia could make a gold backed currency stick, to it taking years in the planning and implementation so is irrelevant to today's markets. But there are good reasons to believe that this complacency will turn out to be wrong, and that events are likely to evolve considerably more rapidly than expected.

The problem for capital markets is that they are dominated by Keynesians, automatically programmed to believe gold is bad and fiat is good. As a stockbroker in London, when President Nixon suspended the Bretton Woods Agreement, I recall there was a similar level of confusion over those implications. **And now, 52 years after putting the world on a fiat dollar standard, the majority of the world has had enough of dollar hegemony, has found safety in numbers, and is going back onto a gold standard. Like all life, the pure fiat era is ephemeral after all, defined by its birth and death. Macroeconomics will have to be rewritten.**

The move away from fiat has been evolving for a considerable time, with de-dollarisation the ultimate objective of the Asian hegemons. Those tracking developments in gold bullion markets in recent decades have noted the drift of bullion from west to east, and the rise in gold mine output in China and more recently in Russia. **Central banks, predominantly in Asia, have been accumulating bullion reserves and adding to declared and undeclared state funds in record quantities. Ultimately, this activity can only be to use gold to secure currency values as the dollar dies or is done away with.**

A sudden turn of events occurred when the western alliance imposed sanctions against Russia following her attack on Ukraine. They set off a train of actions that has unified Asia and many of its supplier nations into a rebellion against American hegemony, stoked up by Putin and led by Saudi Arabia and the Gulf Cooperation Council. **And since the western alliance turned its back on fossil fuels, the low-cost producers throughout Asia have banded together representing nearly half global oil output, and a third of natural gas.** **As a cartel, OPEC is now just an appendix to the Asian mega-energy producers.**

The new cartel is dominated by President Putin, whose degree from Leningrad University was in energy economics and well qualified to be energy ringmaster. Not only has he demonstrated an understanding of the importance of controlling global energy supplies, but he also has a clear understanding of the importance of monetary gold.

Since the western alliance's sanctions, the signals coming out of Moscow have been clear: Sergei Glazyev, who is Putin's point-man for macroeconomic policy has been waving the gold flag since then in plain sight. As a board member of the Eurasian Economic Union Commission (EAEU) since 2019, he was tasked by Putin to design a trade settlement currency for the EAEU. The initial statement through a news agency in Bishkek in early March 2022 reported that it was to be based on the currencies of the member states and a basket of undefined commodities. **According to Glazyev, his brief was to create a Eurasian monetary and financial system to the exclusion of foreign currencies, particularly the dollar and euro.**

The intention was also to remove exchange controls for cross- border settlements within the Eurasian membership, replacing the dollar as the commonly used settlement medium between them. A week later, in an article for Goldmoney[ii] I concluded that as stated the new currency would not work, and the only logical solution was to do away with the currency basket proposal and use gold backing solely to represent commodities. That way, it would be easy for other nations in the Shanghai Cooperation Organisation (SCO) to join in, which was the ultimate objective from the outset.

In July 2022, Glazyev was behind a move to beef up the Moscow gold exchange, the official line being that having been sanctioned from the London market Russian miners needed a more effective local market. But working in conjunction with the Shanghai Gold Exchange this was an important signal about the way Galzyev's monetary thinking was developing. Confirmation came on 27 December last year, when he wrote an article for Vedomosti, a Moscow business paper, describing why the rouble needed to return to a gold standard. That article was co-written by his deputy on the EAEU committee designing the new trade currency and was a thinly veiled indication of the committee's view.

Therefore, you did not have to be particularly astute to discern the trail of clues presented to us. We could assume with justification that gold was intended to be the sheet-anchor for this new currency probably from the outset, but some political hoops had to be jumped through to convince the EAEU member states that it was the solution.

The impracticality of basing a new trade currency on anything else other than gold had been established. It now turns out that this project is almost certainly a Trojan horse for something far larger. It was obvious that other members of the Shanghai Cooperation Organisation should be able to join in, and now it turns out that the invitation is being extended to members of the BRICS club as well. But that's not all. The entire membership of the SCO, its dialog partners, and associate members will be attending the BRICS conference in Johannesburg on 22—24 August. I am assuming that the original list of 36 nations, which according to most recent reports has expanded to 41, includes the members of the EAEU who were not on the original list — at the time of writing this is yet to be confirmed.

That being the case, the BRICS currency project is not a cold start and not something to be planned for a distant future. The groundwork has already been prepared by Glazyev and the structure can be rapidly assembled once the necessary resolution is adopted. It is even possible that the necessary institution(s) exist waiting to be deployed.

<u>It is also beginning to look like there will be another proposal on the Johannesburg agenda, to merge the SCO, the EAEU and BRICS into a supersized trading block. In terms of both combined population and GDP on a purchasing power parity basis, it is already in excess of half the world, dwarfing the western alliance which kowtows to America.</u>

The US Treasury would almost certainly have known about the BRIC proposals when the agenda was first circulated, which probably explains why at short notice Janet Yellen, US Treasury Secretary flew to Beijing. From her department's point of view, if the new currency proposal was to be adopted its financing of the budget deficit would be adversely affected, not to mention the threat to the dollar's hegemony. The principal card up her sleeve was to threaten greater sanctions against China's exports, not just to America, but to her allies as well, but we don't know if it was actually discussed in these terms.

The Chinese view

For too long and too often China has been threatened over access to markets by the Americans. We can be sure that ahead of the BRICS currency proposal the Chinese have gamed this possible threat being acted upon and come up with their own conclusions about its economic consequences. Russia's experience, which harmed the sanctioning countries considerably more than the sanctioned, will have been fed into these calculations. One suspects that other than signalling to the Chinese and Russians that there is an increasing level of alarm in Washington, Yellen's mission will have achieved little. And an important factor for the Chinese attitude is their experience of the US's attempts to destabilise Hong Kong, which led to it being taken directly under Beijing's control. **<u>It is therefore important to understand China's analysis of America's objectives and methods in order to define her own position.</u>**

<u>In April 2015, Qiao Liang, the People's Liberation Army Major-General in charge of intelligence strategy</u> gave a speech at a book study forum of the Chinese Communist Party's Central Committee.[iii] Qiao commenced by stating the obvious, that the U.S. enforces the dollar as the global currency to preserve its hegemony over the world. **<u>And he concluded that the U.S. would try everything, including war, to maintain the dollar's dominance in global trading. But what he then went on to say is extremely relevant to the current situation. He described US's actions with respect to foreign national debts</u>. ********

Qiao made the case that both the Latin American crisis in 1978—1982, and the Asian crisis in 1996—1998 were engineered by America. By reducing dollar interest rates to below their natural level they would weaken the dollar and encourage an investment boom in the targeted jurisdictions, funded by dollar credit. They then increased interest rates and strengthened the dollar to create a financial crisis. These events did, indeed, happen, but perhaps driven by the cycle of bank credit, as much as by foreign policy.

The relevance of Qiao's analysis is that today, the same conditions appear to be targeted not against China, which does not borrow dollars, but at the

dollar indebted nations around the world with which China trades — the BRICS nations. Informed by Qiao's analysis, it must appear to China that America's persistent strategy is to continue to raise interest rates even after the inflation dragon is slain, and by bankrupting them the US will attempt to bring the nations seeking to join BRICS back under her control.

That being the case, China will have weighed up the consequences for her export trade against the likely sanctions America and her allies could threaten and decided that the **real threat is against the emerging economies in Africa, Latin America, and elsewhere which have received substantial Chinese investment.** **In financial terms, it is therefore imperative that this threat be addressed in a pre-emptive attack on the dollar, which can only be achieved by exposing the dollar's weakness as a fiat currency. At least since the Lehman crisis, China and more recently Russia have had the power to do this.**

Furthermore, the New Development Bank, which is headquartered in Shanghai, will be able to provide credit either in yuan or the new BRICS currency at lower interest rates to offset the undoubted strains imposed on BRICS members as a result of rising US interest rates. **Therefore, China is fully prepared to counter what General Qiao Liang described as the American strategy of "harvesting" assets in foreign countries.**

It is important to understand what China believes and motivates her, not whether Qiao is right or wrong. But given that his view is inculcated in the Chinese government, **China is ready with Russia to mount an attack on America's fiat currency by returning to a gold standard for trade, and ultimately for their own currencies.**

The Russian view

It should be clear that the current plans for a trade currency originated in Russia, and not China. Indeed, until now China will have been reluctant to destabilise the currencies of the western alliance, because of her export interests. **But not only has the relationship with America deteriorated over Taiwan, not only is it clear (in China's view) that America plans to bankrupt the BRICS members and all those seeking to migrate away from the dollar's hegemony by raising interest rates, but it is now also clear that neither Russia nor America can back down over Ukraine**.

Consequently, unless China and Russia together take the initiative, shortly Russia will be directly at war with America and her NATO allies and China will almost certainly be dragged into the conflict over Taiwan. **World War 3 must be forestalled.**

It is clear that NATO, under the thumb of America, is determined to defeat Russia, remove Putin, and gain control of its massive natural resources. The proxy war being fought in the Ukraine appears to be failing with Zelensky's summer offensive having ground to a halt. And following the Wagner debacle, Russia is now in a strong position to counterattack. This has led to President

Biden being prepared to send the Ukrainians cluster bombs, increasing the urgency for a Russian counter-offensive.

Furthermore, with Ukraine's summer offensive failing, NATO's theatre of operational strategy is moving to Poland and the Baltics (Biden was in Vilnius this week for a NATO summit), with Poland particularly becoming a client state of America through NATO. The build-up of military personnel and missiles in Poland will become increasingly obvious in the coming weeks and is already anticipated by Moscow. We await Putin's reaction, but he is unlikely to just sit on his hands and let NATO build its forces in Poland and the Baltics.

Compromise is out of the question, because it is plain to Putin that America cannot back down. Imagine the consequences for Biden, who started his presidency with the withdrawal from Afghanistan if he ends it with a withdrawal from Eastern Europe. Furthermore, the neo-cons are firmly in charge of policy, determined to defeat Putin, add Russian territory to their sphere of influence, and leave China isolated.

Putin's terms for peace would be unacceptable to America because he insists on protecting Russia's borders, which means that all missiles and American bases be removed from Eastern and Central Europe. For Moscow, this raises the question as to whether Russia should simply secure its current position or take Ukraine, which can then be set up as a buffer state. A Russian attack is bound to drive up energy, cereal, and fertiliser prices, worsening price inflation in western alliance countries and causing division with America and Britain, but to the benefit of Russia's finances which are coming under pressure. Additionally, a successful attack on their currencies' credibility would undermine the alliance's military capability, so the dollar should be attacked financially as well.

No one can be sure whether destroying the dollar would avert a nuclear war, but there is little doubt that so long as America can finance its aggression that events are drifting in that direction. From Putin's viewpoint, undermining the dollar must now be a priority, perhaps combining it with taking Kiev now that Zelensky's summer thrust has failed.

An advantage of a financial war is that it need not be declared, therefore there is no official victor, and no need for a post-war reconciliation.

Designing a gold-backed trade currency

A new trade currency has the advantage that it will not ever be used as a means of funding government deficits. And given that its role is limited to cross-border trade settlement and dealing in physical commodities it has to be institutionally acceptable and does not have to appeal to public confidence. Much of the credit will be self-extinguishing. It is additional to national currencies, leaving individual nations to manage their own currency policies, which is why such a currency can enjoy widespread support. It is not to be used as a medium for capital investment.

As the groundwork appears to have been already established by Sergei Glazyev, it could be ready to use as soon as it is approved in August. **Besides a strict and simple set of rules, all it needs are two things: the establishment of an issuing entity, and physical gold. The first can be done in a flash, if it is not already established, and the gold will be allocated from the reserves of participating central banks.** This is almost certainly why central banks of many of the putative membership of BRICS have been adding bullion to their reserves. They must be extremely thankful for actors in the western financial establishment who trade paper gold in ignorance of this outcome.

The bulleted list that follows is a brief outline of how a new trade settlement currency based on gold can be quickly established to replace the fiat dollar in all transactions between member nations, updated from an earlier Goldmoney article on this topic.[iv] It will be interesting to see how its elements compare with Glazyev's proposition.

It is designed to be politically acceptable to all involved, as well as a long-term practical solution to facilitate the Russian Chinese axis's ambitions for an Asian industrial revolution, encompassing Africa and Latin America, free from interference by America and her allies. The essential elements are as follows:

- The announcement of the creation of a **New Issuing Central Bank (NICB**, not to be confused with the existing New Central Bank in Shanghai, whole purpose is to fund investment in the BRICS members) and a new gold-based currency on the lines below is the first step.
- The NICB is **established with the sole function of issuing a new digital currency backed by physical gold.** It will be designed to be a fully trusted gold substitute, independent of existing fiat currency values.
- **The new currency will only be redeemable for gold** between the NICB and participating central banks. They will be free also to add to their NICB currency reserves by submitting additional gold to the NICB at any time.
- The NICB's eligible participants will be the central banks of participating nations, broadly limited to member nations, associates, and dialog partners of the EAEU, SCO, and BRICS, and additionally nations applying for membership of any of these organisations on an approved list.
- The **NICB's currency is issued to approved national central banks against their provision of a minimum 40% gold backing for it**. For example, currency representing one million gold grammes secures an allocation of 2,500,000 currency units denominated in gold grammes. The gold does not have to be delivered to a central storage point but can be earmarked[v] from within a central bank's gold reserves, **on condition that it is securely stored in vaults on a list approved by the NICB. This list is likely to exclude gold stored at central banks of the western alliance and must not be leased or swapped.**
- A participating central bank records the new currency units allocated to it as an asset on its balance sheet, balanced by an increase in its liabilities

as equity. A participating central bank's balance sheet is thereby strengthened.

- A participating central bank can offer credit and take in deposits tied to the new currency's value, to and from the commercial banks in its national network. **Note that the new currency is available exclusively to participating central banks, upon which they can base their own credit dealings with commercial banks.**
- Commercial banks trading in member nations and elsewhere will be free to create and deal in credit denominated in the NICB's new currency. **They will have no credit relationship with the NICB, but their regulating central bank will.**
- Commercial banks whose central bank does not have access to the NICB currency can clear through wholesale credit markets and will be always free to acquire physical gold in the markets, should they wish to back credit created in the new currency with gold itself.
- **All taxes and restrictions on gold ownership must be fully rescinded by participating nations, recognising its historic and legal status as money**.
- An efficient central clearing system for commercial banks dealing in credit based on the new currency will be established.
- **Asian commodity exchanges in the expanded BRICS will price all products in the new NICB currency as well as in dollars**. Intra-BRIC imports and exports will similarly be priced. This will ensure that physical markets and their derivatives are insulated from a fiat currency collapse, a likely consequence of gold's return to its true monetary status.

The purpose of the new currency is to provide the basis for trade finance and other cross border financial settlements on a sound money basis. The expansion of credit based upon it will grow strictly in line with economic activity and therefore will not be inflationary, undermining its purchasing power. Last week, in an article for Goldmoney I explained why when tied convincingly to gold, commercial bank credit grows on a non-inflationary basis when distortions from the lending cycle are removed. This is the key to understanding why a new trade currency constructed on these lines will endure.[vi]

It is also likely to lead to participating nations placing a greater emphasis on their own currencies' stability while providing a safe haven from the consequences for the dollar following its introduction. Once the new currency is established, it will be in Russia's interests to put the rouble back on its own gold standard, and China may follow with the renminbi.

All empirical evidence informs us that when gold becomes the means by which credit is valued, credit's own value becomes tied to that of gold and is not dependent on stability in the quantity of credit. Operating as a gold substitute imparts pricing certainty to trade and investment and leads to stable, low interest rates giving the necessary conditions for maximising economic development in emerging economies.

Constructed on the lines above, it should be simple and quick to establish. It must be free from attack by members of the western alliance trying to preserve their own fiat currency systems. And the 40% gold backing rhymes with the basic requirement for a metallic monetary standard set by Sir Isaac Newton, when he was Master of the Royal Mint.

For participating central banks, the replacement of gold in their reserves for allocations of the new currency would represent a significant increase in their balance sheet equity. As confidence in the scheme builds, it could be argued that only minimal gold reserves need to be retained by participating central banks, with the balance swapped for the new currency. For example, the Reserve Bank of India officially possesses 787.4 tonnes of gold. Converted into the new gold currency, its value in reserves is uplifted to 1,968.5 tonnes equivalent, added to its equity capital.

The impact on gold

Throughout history, money has been gold, and the rest credit. When you detach credit from gold, there are consequences. Pricing goods and services in credit diverges from pricing them in gold. It is really that simple.

It is widely assumed that fluctuations in prices have nothing to do with the medium of exchange, and for individual transactions it is certainly true that both buyer and seller will share this view. But over time, with official policies aiming for a 2% fall in purchasing power for the dollar and other major currencies it is not true that price fluctuations are entirely due to changes in the demand/supply balance for commodities and other manufacturing inputs. In fact, since the end of Bretton Woods, measured in real money which is gold, the loss of purchasing power has been considerably in excess of the 2% annual target. The chart below puts it directly in a gold versus fiat context.

Since the suspension of Bretton Woods, the dollar has lost 98% of its value relative to gold. The other major fiat currencies have been similarly impoverishing for their users and savers, and only now is the final act in their destruction looming due to the introduction of a new BRICS gold-backed currency.

Through the medium of gold, participating central banks will exchange their reserve dollars for the new NICB currency. Immediately, this rejection of the dollar by a large number of central banks will devalue it further, followed by foreign non-government entities seeking to reduce their exposure. Initially, this will be seen as a run on the dollar into gold, similar to that which followed the suspension of Bretton Woods on 15 August 1971. The market was similarly nonplussed then as it appears to be today, with the London morning fix on Monday 17 August at $43, slightly down on the previous week**. It wasn't until 19 November that the morning fix exceeded $43 again for the first time. It took two whole months for the implications to sink in. But when they did, the price rose to $197.50 on 27 December 1974.**

The lesson for us in this Keynesian world is that two months of static prices following the suspension of Bretton Woods is proof that gold was poorly understood in financial markets, and still is today. Derivative markets, particularly the London forward market and Comex futures for the last forty years have lost sight of gold being money and assumed it is a trading counter which plays on irrational fears of instability of the modern currency system. But with the return of gold as the anchor for credit values for the Asian hegemons and their sphere of influence, those fears will suddenly become rational.

The wider consequences of a BRICS currency gold standard

We can assume that the consequences of Asian trade settlements backed with gold will have been carefully considered by the Asian superpowers, particularly by the Russians who have faced weaponised dollars.

Besides bringing stability to export values there are other advantages to reintroducing gold into currency systems. Interest rate stability at lower rates is an obvious benefit. Currently, the Bank of Russia's key interest rate is 7.5% and price inflation has collapsed to 2.3% (April). The yield on Russia's 10-year OFZ bond is still 11.3%. If the rouble becomes a credible gold substitute, price inflation, interest rates, and bond yields can be expected to decline and maintain levels that reflect gold's long-term stability, particularly in more normal times when the Russian government runs decent budget surpluses. And assuming that credit expansion by Russia's commercial banks is not cyclically excessive, there is no reason to expect otherwise than that financial stability for the currency and the Russian economy would continue in the long-term. Coupled with low taxes (Russia's income tax is a flat 13%) this stability can be expected to foster genuine economic progress and the accumulation of personal wealth for the Russian people. It would be a far better outcome than the current situation and it would secure Putin's legacy.

However, a move towards gold backing for their currencies by the Asian hegemons can be expected to undermine the purchasing power of western fiat currencies. International capital will abandon ephemeral fiat currencies for real values in commodities, with nations rebuilding stockpiles of energy, metals, and other raw materials instead of accumulating fiat paper. Precious metals, specifically gold, will be sought and its price can be expected to reflect the demise of fiat currencies.

The consequences for wholesale and consumer prices in the western nations would rapidly become obvious, with central banks forced to revise their expectations for price inflation sharply higher. Bond yields can be expected to rise further, undermining all financial and property values. **As this negative outlook clarifies, measured against gold fiat currencies will likely enter a substantial relative decline.**

The consequences of the emergence of gold backing for currencies in Asia on the currencies and economies of the western alliance are bound to differ in their detail for the currencies in the western alliance. The reliance on inward foreign investment has protected the dollar from continual trade deficits and played a key role in funding US Government debt since the end of Bretton Woods. It has allowed the US Government to run budget deficits more or less continually. The ending of the fifty-two years of a fiat regime changes all that. **The US Government will face significant funding hurdles against foreign liquidation of Treasuries. Bond yields and funding costs for the government are bound to rise significantly.**

The consequences for the EU and the eurozone would be both politically and economically divisive. If it were not for political constraints, Germany would naturally drift towards cooperation with the sound money regimes emerging to her east, particularly as the finances of the Mediterranean club deteriorate. With rising bond yields, the entire euro system comprised of the ECB and its national central banks would need to be recapitalised, being already deeply in negative equity.

The eurozone's global systemically important banks (G-SIBs) are extremely highly leveraged and unlikely to survive the combination of falling asset values and bad debts that would be the certain consequences of the euro's declining purchasing power. Having been assembled at the behest of a political committee and now managed by a political cabal, the euro is at risk of losing all market credibility.

The consequences for the UK pound will also be significant. In a similar debt trap to that of the US Government, the British have the further disadvantage of an economy suffering under increasing taxes. Furthermore, with London being the international financial centre, the **UK will be at the epicentre of a fiat currency crisis. For the size of her economy, the UK has little in the way of gold reserves, hampering any future escape from the fiat currency trap. The major governments aligned both economically and intellectually with the fiat dollar will be left at a comparative disadvantage by a BRICS gold-backed currency, possibly followed by Russia and China adopting gold**

standards. Interest rates, which are escaping from central bank control, will rise due to two factors: there is the credit crunch from the turn of the bank credit cycle, and the deteriorating outlook for fiat currency purchasing powers. It is the worst of both worlds. Furthermore, economists in governments and central banks would be reluctant to abandon their embedded economic and monetary policies. And will be slow to react.

The only salvation will be for western governments to jettison Keynesian macroeconomics entirely and revert to classical economic theories. The false assumptions that have built up over the fiat currency era will have to be overturned. Crises of this sort nearly always emanate in the foreign exchanges because it is foreign holders of currencies who are the first to recognise a currency's weakness. Usually, it involves a specific currency. But this time, it will affect all the major currencies in the western alliance.

References

[i] Official Iranian news release. See https://en.mehrnews.com/news/203015/BRICS-currency-to-benefit-Iran-undermine-US-dollar-euro

[ii] See https://www.goldmoney.com/research/designing-a-new-currency-is-impractical

[iii] See http://chinascope.org/archives/6458

[iv] See https://www.goldmoney.com/research/cbd-cs-the-good-the-bad-the-ugly under the sub-heading, *The Good.*

[v] Earmarking is the technical term whereby one central bank acts as custodian for another central bank's bullion.

[vi] See https://www.goldmoney.com/research/the-real-determinants-of-currency-value

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Why The Dollar Is Finished

By Alasdair Macleod – GoldMoney, Jul 20, 2023

Last week in my Goldmoney Insight, I analysed the rationale for a new gold backed trade settlement currency on the agenda of the BRICS summit in Johannesburg on 22—24 August.

This article is about the consequences for the dollar-based fiat currency regime.

There is strong evidence that planning for this new trade settlement currency has been in the works for some time and has been properly considered. That being so, we are witnessing the initial step away from fiat to gold backed currencies. Without the burden of expensive welfare commitments, all the attendees in Johannesburg can back or tie their currency values to gold with less difficulty than our welfare-dependent nations. And it is now in their commercial interests to do so.

We have been brainwashed with Keynesian misconceptions and the state theory of money for so long that our statist establishments and market participants **fail to see the logic of sound money, and the threat it presents to our own currencies and economies. But there is a precedent for this foolishness from John Law, the proto-Keynesian who bankrupted France in 1720.** I explain the similarities. That experience, and why it led to the destruction of Law's livre currency illustrates our own dilemma and its likely outcome.

It's not just a comparison between fiat currency and gold. **America's financial position is dire, more so than is generally realised. The euro is additionally threatened with extinction because of flaws in the euro system, and the UK is already in a deeper credit crisis than most commentators understand.**

Introduction

On 7 July, news leaked out and was then confirmed by Russian state media that the BRICS meeting in Johannesburg would have a proposal on the agenda for a new gold-backed currency to be used exclusively for trade settlement and commodity pricing. It appears that this is still beyond the comprehension of the mainstream media who have failed to even report on it. But like the fall of the Berlin Wall in the twentieth, it will probably turn out to be the most important monetary and geopolitical development this century.

The very few of us who have followed this story from the outset know that the Russian confirmation is the culmination of a trail of clues dating back to the time of the western alliance's sanctions on Russian trade. With very few exceptions, among those who don't understand the whys and wherefores that lead us to this event are the press, economists of all schools, and the western financial community.

Driving this is a war between the hegemons, with America on one side and Russia in partnership with China on the other. Until Russia was sanctioned, the Asian hegemons appeared to have a policy of sitting on their hands and letting the Americans tie themselves in knots. This has been evident in military strategy — Syria, Afghanistan, and other pyrrhic victories or failures. But it has also been true in the hidden financial war. And it is the financial war which could determine the military outcome, because if the dollar is destroyed, so will be America's military capability and NATO will fall apart.

That much should be obvious to independent observers. **Therefore, an important question to be answered is under what circumstances would the Asian hegemons drop their generally passive strategy and take the initiative?** As well as Russia's Special Military Operation last year, there is evidence that the time has now arrived. Russia's trade surplus has now fallen sharply, and the SMO in Ukraine is a drain on otherwise healthy government finances. Because of these factors, President Putin needs to act soon to bring his SMO to a conclusion, or alternatively act to drive global commodity prices higher, which is the same thing as undermining the purchasing power of the dollar.

China sees this and faces an additional problem from the escalation of US hostilities over Taiwan. If Ukraine continues to worsen with neither party being able to backdown, China could be dragged into the conflict, given the common enemy. Furthermore, with much of Africa and Latin America migrating away from America's sphere of influence and towards Asia, rising dollar interest rates are creating a crisis for those of them owing dollars. **China almost certainly believes that in bankrupting these emerging economies by raising interest rates, America is attempting to stop them from joining BRICS, and seeks to take over many of their assets and infrastructure which China has helped create.**

This threat is now greater to China's long-term economic strategy than threats to her export trade with America and Europe. **This is why China is now prepared to back the Russian plan for a new gold-backed trade currency, which is bound to rapidly undermine the fiat dollar, as all central banks in the Asian hegemons' sphere of influence sell off their dollar reserves to acquire physical gold. For a long time, I have described activating gold as being the financial equivalent of a nuclear war — this is about to be tested.**

A lesson for us from Cantillon

One of the earliest writers on economics was an Irishman, Richard Cantillon, who went into partnership with his cousin, also named Richard in Paris in 1714, finally assuming control of the bank. It was during this period that John Law befriended the Duc d'Orléans, the Prince Regent for the infant King Louis XV who succeeded Louis XIV in 1715. John Law was a proto-Keynesian, with similar policies for the state expansion of credit as the means by which a government could stimulate an economy, thereby increasing tax revenue. With the royal finances facing bankruptcy due to Louis XIV's profligacy, the Regent grasped at Law's scheme like a drowning man thrown a lifebelt.

There were four essential elements to Law's scheme, which resonate with the monetary regime today:

- The establishment of a bank with the principal function of issuing banknotes to replace gold and silver coins as the medium of exchange. This would evolve his commercial bank into a prototype central bank, appointed by the government to have a monopoly on the note issue. Gold and silver coins were to be driven out of circulation entirely.
- The establishment of a trading entity (later known as the Mississippi venture) as part of a debt management scheme for the benefit of royal finances. The bank and the venture were to be the only tradable financial assets. This equates with all bond and stock market asset values being inflated currently, for the general enhancement and perpetuity of tax revenues.
- To use his position as controller general of finances to boost the values of both his Royal Bank and the Mississippi venture by expanding the quantity of banknotes and bank credit.
- To merge the new central bank with France's import and export monopoly embodied in the Mississippi venture to secure income from trade tariffs and duties, significantly enhanced by the wealth created through the expansion of credit.

The similarity of Law's financial policies with those of today are remarkable. The state's monetary monopoly over its economy managed by a central bank replicates Law's design for his fiat currency. **The manipulation of today's fiat currencies has ensured a wealth transfer from savers to the state for the benefit of government finances. The Fed and other central banks believe that a healthy stock market (a bubble?) is essential to maintaining consumer confidence in spending, and therefore sustaining tax revenues. The expansion of central bank balance sheets creates a wealth illusion in bond and stock markets, leading to irrational valuations.**

While profiting hugely as a banker by lending credit to wealthy speculators, Cantillon was sceptical of Law's scheme from the outset. And he was not above the sharp practice of taking in stock as collateral against loans and immediately selling it without informing the borrower. This was to result in legal actions in London's Court of Chancellery after the bubble burst, all of which found in his favour on technicalities.

In 1720, Cantillon decided the collapse of Law's scheme was coming. He sold all the remaining shares under his control amounting to 1,742 shares, 573 of which were collateral taken in that year at prices between 8,200 livres prior to 12 March to as low as 4,550 livres in September for a total value of 8,229,786 livres.[i]

Besides clearing out all remaining shares under his control, his choice of action was to short Law's livres on the foreign exchanges in London and Amsterdam in preference to Mississippi stock in the market. As events proved, Cantillion was right, because between the peak of the bubble in February 1720 and the final quarter of that year, Law's merged Mississippi venture lost two-thirds of its value, while the livres became worthless in London and Amsterdam.

From his *Essai sur la Nature du Commerce en General* published posthumously in 1755, it was clear that Cantillion understood the inconsistencies in Law's actions. In late-February 1720, Law promised to not expand the money supply, but from early March he was forced to do so to support share prices by buying them in the market. In May over the Whitsuntide holiday, with the agreement of the Prince Regent it was decreed that there would be a phased reduction in shares and banknotes to stabilise the shares and the currency, but that failed in both respects. These actions rhyme strongly with the inconsistency of central bank policies today — fighting inflation while still relying on currency debasement to fund fiscal deficits. Furthermore, central banks are raising interest rates in an attempt to control price inflation, without realising that it is the valuation users place on a fiat currency which ultimately sets its value, not monetary policy.

Today, bank credit has stopped growing and is already contracting in a number of major currencies, being driven by a combination of high commercial bank balance sheet leverage and growing concerns over bad and doubtful debts which taken together threaten to bankrupt entire banking systems. Furthermore, like Law's Banque Royale which did not survive the 1720 crisis, today's central banks are already technically bankrupt on a mark-to-market valuation basis due to their acquisition of government bonds at inflated prices through quantitative easing.

The one shoe to drop is the switch from raising interest rates intended to stop the general level of consumer prices rising above official 2% targets, to rescuing the entire system through a renewed credit expansion. **But as the John Law experience in**

February 1720 showed, while a switch from supporting currency values to credit expansion to rescue a failing system is inevitable, equally it does not succeed.

The dollar and related currencies are being challenged

So far, few have minded that the dollar is a naked fiat currency. But the proposed BRICS trade settlement currency clothed in gold is bound to expose that nakedness for all markets to see. **Not only will we then witness the ending of the fiat dollar regime, but we will see a forerunner of its replacement. In common with the punters at the top of the Mississippi bubble in February 1720, today there are very few commentators who, like Cantillon, detect these dangers ahead.**

For fiat currencies it is a problem with two aspects. A properly designed new BRICS trade settlement currency will lead to problems for fiat currencies on a comparative basis. And led by the dollar, the fiat currencies' credibility is being undermined from within as well. As this becomes increasingly apparent, like John Law's livre the dollar can be expected to sink towards oblivion valued in real money, which is the gold being adopted as an anchor for the new BRICS currency.

The first problem the US authorities will face is the falling off of foreign demand for dollars and dollar debt, likely to be followed by outright sales. Of the major foreign holders of US Treasury debt amounting to $7,581bn in April, the largest liquidation in recent years was by China, as the chart below shows.

But at a pinch, by recycling dollars through financial centres to compensate, such as Cayman Islands, Luxembourg, London and Dublin, non-buying from China and the BRICS tribe can probably be offset. China and others could even be dealt with by the US Treasury refusing to accept transfers of bond ownership, but at a risk that it would seriously backfire.

The wider problem is liquidation of the dollar itself. In April, foreigners owned short-term securities, including bank deposits, CDs, and T-bills totalling $7,198bn, and long-term securities totalling $24,865bn for a combined total of $32,063bn.[ii] This is considerably more than the US's entire GDP and does not include Eurodollars, which is dollar denominated credit created between foreign banks abroad not reflected in correspondent banking balances. Worse still, US resident citizens, businesses, and investors hold short-term assets and deposits in foreign currencies to the equivalent of $689bn (US Treasury TIC figures for March), being the only foreign currency available to absorb net dollar liquidation by foreign holders of dollars. And virtually all long-term investments are in ADR form, which means that liquidating these investments does not raise foreign exchange transactions (and therefore demand for dollars) unless they are bought by foreigners.

The crisis phase of Triffin's dilemma[iii] is rapidly approaching, and there is very limited non-dollar liquidity on the foreign exchanges to avert it. Already, the

dollar has breached an important chart support line on its trade-weighted index, as the next chart shows.

As a measure of foreign confidence in the dollar, the TWI has suddenly deteriorated in the wake of the Russian confirmation that a new gold-backed trade currency is on the BRICS summit agenda. **And if it is not just deteriorating dollar sentiment, it will be rising interest rates and a securities bear market which will accelerate a dollar liquidation.**

It is universally assumed in global financial markets that consumer price inflation will subside and that central banks will be able to reduce interest rates. But only this week, Russia refused to renew permission for grain shipments from Odessa, giving further impetus to global food price inflation. **Falling inflation is the condition for the maintenance of financial asset values, and therefore for foreigners to retain dollar portfolio assets: but rising grain prices and the current renewed strength in oil prices indicate that the inflation dragon is still breathing its fire.**

A further error in the hope that interest rates will soon decline is to not realise the consequences of commercial banks restricting credit expansion. In doing so they are sure to drive up the interest cost of credit — it used to be called a credit crunch. **This contraction of bank credit, which is only just beginning to be apparent in US banking statistics, will not only threaten bankruptcy for many businesses thereby driving the economy into a slump, but it will increase the government's funding requirements due to tax shortfalls and increasing welfare liabilities.**

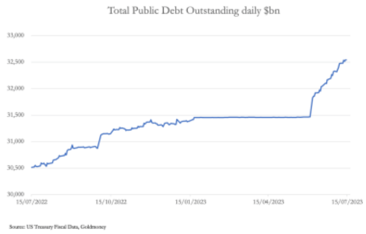
Meanwhile, to the confusion of neo-Keynesian expectations consumer price inflation will continue to be a problem, even accelerating again after the current pause. **The error here stems partly from discarding Say's law, and not realising that a general glut of products arising from falling consumption cannot happen. A further error is to not understand that the fiat dollar will continue to lose value measured in goods, just as John Law's livre did after May 1720 despite belated attempts to contract the bank note issue. Like spots are to measles, inflation of prices is the visible symptom of all dying fiat currencies.**

The essential point is that markets are taking over control of interest rates from the central banks. This is an additional problem for the US authorities. Along with other group-thinking central bankers in the Bank for International Settlements network, **they will learn the hard way that interest rates are not the price of money, but the compensation foreigners require to maintain their holdings. And even that assumes that with the correct interest compensation foreigners will continue to be passive holders, rather than deploying credit for better purposes as they seem bound to do.**

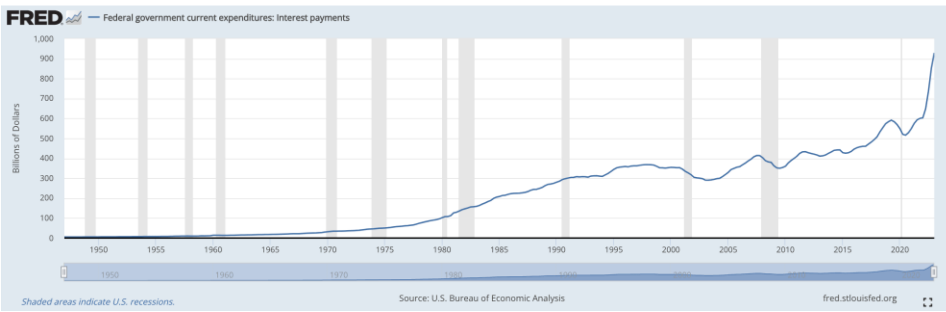
Now that a sound money alternative to maintaining reserve balances in dollars is emerging, if the dollar is not to suffer a major crisis at the minimum the Fed will have to go along with the markets and raise rates.

Another way of looking at this dilemma is that if the authorities attempt to support the dollar by activating swap lines, it will contract the quantity of dollar credit in circulation, worsening the credit crunch. But as John Law discovered in the months following May 1720, contracting credit in a fiat currency does not necessarily save it. The implications for the US Government's deficit and its funding costs are also dire.

US budget deficits and inflation



The chart above is of US Government debt outstanding daily for the last year, according to the US Treasury.[iv] Besides the period when negotiations to raise the debt ceiling put the outstanding debt level on hold, there are two notable features. The first is that in only a year, government debt has increased by $2,027bn (6.6%), and secondly the rate of increase is accelerating alarmingly. A large part of the problem is that the cost of funding US Government debt is soaring, as the next chart shows.



Congressional Budget Office forecasts are for budget deficits exceeding $1.5 trillion this and next fiscal year. But the interest rate assumption is an average of 2.7% for both years and beyond, which is clearly behind events and overly optimistic.

Put together the two charts above and you have the classic debt trap, whereby US finances are deteriorating beyond control. Furthermore, the US faces the prospect of a severe contraction of business activity due to the slowdown in bank lending and its effects on interest rates. Tax revenues will undershoot current Congressional Budget Office estimates and mandated welfare commitments will increase on the expenditure side. Consequently, government borrowing will accelerate even further and interest payments on it will as well.

Funding this accelerating deficit must be causing the US Treasury an enormous headache. Just as President Biden went to Saudi Arabia to persuade MBS to accelerate oil output unsuccessfully, Janet Yellen visited China's Vice Premier He Lifeng as this financial crisis is developing. Of course, none of this was mentioned in the press communiqués, but **you can bet your bottom dollar that Yellen wanted China to start buying Treasuries again, or at the very least to stop selling them. But the implications for the dollar are still dire, and it becomes something of an open question as to when foreign holders of the dollar will realise how serious America's finances have become.**

Even without a banking crisis, the Fed will be faced with a stark choice: does it try to save the dollar, or does it try to salvage government finances. Welcome to the John Law dilemma.

All fiat currencies are threatened

Gold backing for the new trade currency is bound to create problems for BRICS national currencies, which may or may not be fully appreciated by individual BRICS nations. The solution for them is to secure their own currency values, either by setting their own gold standards or linking them to the new trade currency in some sort of currency board arrangement**. While many of these nations have a history of currency mismanagement, theirs is essentially a confidence problem which can be resolved by turning their backs on the dollar-based fiat currency system.**

All these governments have finances that can be balanced with a little fiscal discipline, because they don't have the welfare burdens that the advanced economies have to contend with. The benefits to their economies of sound money and the low level of interest rates that comes with it are obvious, and social and economic progress can be expected to be as miraculous as those enjoyed in Britain under her nineteenth century gold standard.

But the introduction of a new trade currency backed by gold will undermine the major fiat currencies which have survived on Keynesian myths, which like those of the proto-Keynesian John Law are about to be terminally challenged. And the euro will have an additional problem arising from the ECB's committee-designed structure.

Like other central banks the ECB not only reduced interest rates, in its case to unnaturally negative levels, but it paid top euro for government bonds as part of its "asset purchase programmes" — currency-debasing QE to the rest of us.

Consequently, since the mark-to-market losses have wiped out its equity many times over, and also the equity of nearly all the national central banks which are the ECB's shareholders, the whole euro system is technically bust — a situation which will worsen if Eurozone bond yields continue to rise. Furthermore, there are substantial imbalances in the TARGET2 settlement system between the euro system's members which remain unresolved.

When a central bank has one shareholder such as its government, recapitalising it is relatively simple and can be done in a heartbeat. On its balance sheet the central bank creates a loan in favour of the shareholder, and instead of balancing the asset represented by the loan with a deposit liability, it enters the balancing item as equity. In many jurisdictions, this can be done and subsequently confirmed by the legislature.

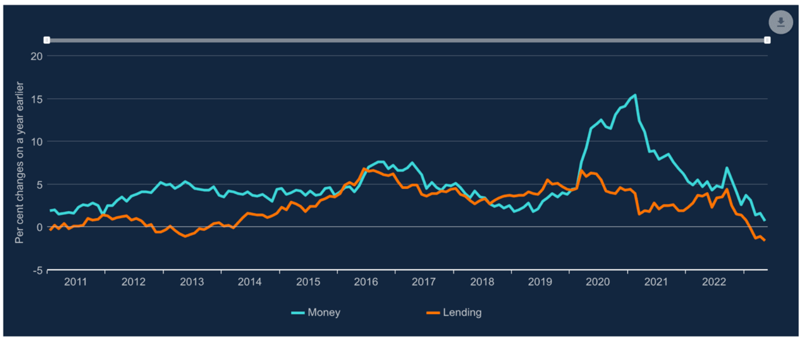
But the structure of the euro system requires multiple governments to agree to recapitalise their own central banks as well as the ECB. The recapitalisation of the entire system will be far from a *fait accompli* and almost certainly will become an embarrassingly public issue.

The ECB takes the view that it will hold the bonds on its balance sheet to maturity, so there is no need to mark to market and recapitalise the system. But that assumes monetary plain sailing for a considerable time and that interest rates will decline from current levels and stay down. Otherwise, the euro system will be called upon to rescue overleveraged commercial banks with mounting portfolio losses and bad debts.

But **we can now see that if the new BRICS gold backed trade currency replaces the dollar and euro for potentially more than half the world's trade measured by GDP on a PPP basis, it will lead to catastrophic falls in exchange rates for both the dollar and the euro valued in gold. Assuming that priced in gold commodities continue to be stable (which over time tends to be the case), then the implications for Eurozone states are that after the current dip inflation of prices will remain high and potentially rise even further due to the euro's loss of purchasing power. Similarly, bond yields will rise above current levels, commercial banks will be destabilised, and the euro system's hidden losses multiply.**

This is why the future of the euro system and the fiat euro itself is at stake. Not only will the euro be on the wrong side of the return-to-gold-backing story, but its structure is an additional, fatal weakness.

Sterling has similar problems to the dollar. London being the centre of financial activities outside the US has led to substantial quantities of sterling accumulating in foreign hands. For now, the increase in interest rates and bond yields has led to the currency recovering against a weakening dollar by 24% since last September. But the increase in rates is causing serious difficulties for residential property, which combined with price inflation is squeezing consumers badly. The UK economy faces the early stages of a nasty credit squeeze, which is clearly evident in the chart below from the Bank of England's website — the last data point being April.



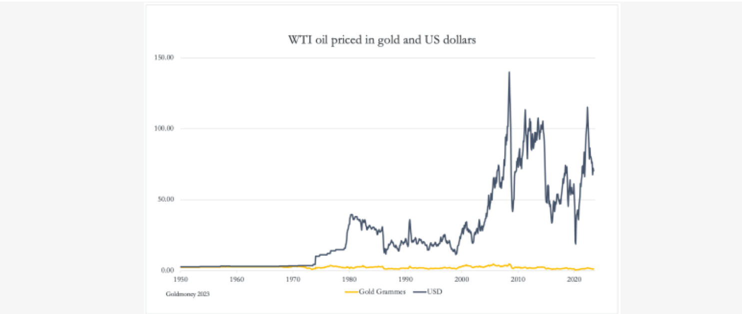
Interest rates cannot fall while lending is contracting because bank credit becomes increasingly scarce at a time of rising demand for liquidity. This is the consequence of rising input prices and slowing sales volumes. So far, consumers have absorbed much of the increase in prices by extending credit card debt, which increased by 9.5% in the year to April. But with mortgage and other costs now hitting consumers hard, sales volumes of goods and services are set to contract even further, in turn accelerating the reduction in business lending as banks turn increasingly cautious. For nearly all businesses, cash flow is slowing to a halt. And my company doctor friends and insolvency practitioners have never been so busy reconstructing companies with a view to avoiding bank debt write-offs.

Just as banks fuelled the boom, they are now fuelling the bust. This is a point which is poorly understood by market participants, who have come to believe

that it is the Bank of England which sets interest rates. It is a common error behind the state theory of money, which is now being challenged by events in Asia and much of the developing world.

The consequences for gold

Apart from monetary stability, the *raison d'être* for BRICS adopting a gold-backed trade currency lies in its relationship with commodities. This is illustrated in the chart below, which is of oil priced in dollars and gold.



Oil priced in gold has been considerably more stable than priced in dollars, a fact also reflected in any non-seasonal commodity you care to name. For energy and commodity producers, the volatility of the dollar as a pricing medium plays havoc with the values upon which extraction costs are predicated. Additionally, pricing in dollars has depressed the pricing of oil in gold, which is currently half what it was in 1950. This will have been noticed by Russia, Iran, and Saudi Arabia.

Price stability also benefits manufacturers, who in their business calculations can be more certain over long-term cost assumptions. They also benefit from low level interest rate stability that comes with a gold standard, particularly when compared with the current increasing interest rate volatility under the fiat currency regime. Russia is a case in point: the central bank's interest rate is 7.5%, and the 10-year government bond yields 11.5%, despite June's consumer price inflation at 2.76%. If the rouble went on a gold standard, and as confidence in the arrangement becomes established the overnight rate is likely over time to drop below 3% and bond yields should decline to not much more.

This argument is sure to have also persuaded the Chinese and other manufacturing nations in the BRICS community that tying production costs to gold is beneficial, exploding the myths about fiat currency flexibility, which have only led to the weaponization of the fiat dollar by the US government.

The benefits of gold-backed currencies are clear. The problems arising from adopting gold standards principally affect the standing of fiat currencies reluctant to embrace gold. China's exporters are bound to experience the purchasing power of dollars and euros declining, perhaps collapsing completely. This leads to higher prices for Chinese goods in all major fiat currencies. But **by sanctioning a new BRICS gold backed currency, the Chinese are now going along with the less visible benefits of valuing export goods in gold, and along with Russia she now has good reasons to put the renminbi onto a gold standard as well.**

In short, we are witnessing the end of the fiat currency era, which in pure form has existed since Bretton Woods was abandoned 52 years ago. Americans, Europeans, and the British will experience gold prices rising against their fiat

currencies, possibly at an accelerating rate when foreigners start dumping their currencies in favour of gold. But it won't be gold rising so much, as their fiat currencies failing, just like John Law's livre.

Notes

[i] See *Richard Cantillon, Entrepreneur and Economist* by Antoine Murphy (Clarendon Press, 1986)

[ii] Derived from US treasury TIC figures for April.

[iii] Triffin's dilemma was so named after Robert Triffin, who pointed out that a reserve currency required the nation providing it to run deficits to ensure an adequate supply of currency to provide foreign exchange reserves, but that ultimately these deficits would create a crisis for the nation. We could be approaching such a crisis.

[iv] https://fiscaldata.treasury.gov/datasets/debt-to-the-penny/debt-to-the-pen