

**ARMSTRONG ECONOMICS**  
**FORECASTING THE WORLD**  
 阿姆斯特朗

Financial-Capital-Equity-Commodity & Political Trends  
 History is a Catalogue of Solutions

会長 マーティン・A・アームストロング

**The Rise & Fall  
 of the  
 Euro**

**COPYRIGHT AUGUST 21<sup>ST</sup>, 2011**

*This document may be freely distributed as a public service*  
**ArmstrongEconomics.COM & MartinArmstrong.ORG**



*Please register for Special Updates and  
Please send comments and suggestions to*

## **ArmstrongEconomics.COM**

*Copyright Martin A. Armstrong All Rights Reserved*

*This document may be freely distributed as a public service but remains the  
copyrighted property of Martin A. Armstrong and his family and may be cited as  
reference but not reprinted in whole or in part without exclusive written permission*

### ***ArmstrongEconomics.COM & MartinArmstrong.ORG***

*This Report may be forwarded as you like without charge to individuals or governments around the world. It is  
provided as a **Public Service** at this time without cost because of the critical facts that we now faced economically.  
The contents and designs of the systems are in fact copyrighted.*

### **ACKNOWLEDGEMENTS**

I would like to thank all the former employees, associates, sources, and contacts for their ongoing support and efforts to contribute to the writings I have been able to continue through their great efforts. I would also like to thank those who have looked after not just myself, but my family, and shown them support and kindness.

The purpose of this report is to broaden the understanding that is so vital to our personal survival. It has been my distinct privilege to have witnessed history from a front row seat. Being both a trader and a corporate-governmental advisor around the world, such an experience opened my eyes to see everything through the looking glass of currency and individual interests of my global clients. I came to see that the required analysis in the REAL WORLD was substantially different than THEORY and that above all else, the advice around the world had to be tailored based upon the CURRENCY based in which the client operated. Everyone acted in their own self-interest, measured in their domestic currency as the standard unit of account for this dictated not just their earnings for shareholders, but to what extend their government taxes them..

There are many who go out of their way to try to personally attack myself in order to discredit the findings. This proverbial strategy is of course a logical fallacy known as *Ad hominem*, a term that comes from Latin meaning "*toward the man*" because they are incapable of addressing the substance. Those who engage in such attacks cannot address the real issued that confront us because the conclusions reached are against their personal self-interest. Lacling a viable response, they digress to *Ad hominem* attacks to protect their self-interests revealing in truth their personal corruption and agendas they try desperately to conceal. These are the people who only think of themselves anf to hell with society or their

own posterity. Incapable of debating the substance of any issue, they defend their moral debasement rooted in their own self-interest by revealing their lack of character.

I have stood in the shadow of history in the making, and it was **Milton Friedman** who was the first to propose a floating exchange rate system in 1953 that became reality by 1971 as an emergency step in trade negotiations. **Milton** saw this as the ultimate freedom of capital to vote regarding the political fortune of every nation. It has been government that set out to sterilize the actions of the **Free Markets** trying to have their cake and eat it to. While the floating exchange rate system allowed capital the freedom to move, politicians have chosen to try to manipulate the consequences of their actions rather than restrain their power.



**Milton Friedman**  
(1912–2006)

Thus, capital can leave in economic times of crisis or people can hoard their wealth refusing to invest or lend money. But the wage earner is incapable of either hoarding his/her labor or exporting it alone overseas. Capital is not to blame as government engages in their own *Ad hominem* attacks always pointing the finger at the “rich” and engaging in class warfare attempting to always blame other people for their failure of coherent government policies. We can prosecute and hunt down capital that has migrated and erect a wall to prevent its migration. But to follow such paths will only destroy what little is left of our once proud free society. The hatred of the “rich” employed by government today to shift personal blame is no different than the Roman Emperor Nero who blamed the Christians for setting fire to Rome instigating centuries of Christian persecution to cover up his own acts. Marxism today accomplishes the same goal for even stripping the “rich” (defined as HOUSHOLD income of \$250,000 or more) of all property and wealth, would not solve the Sovereign Debt Crisis and would result in the same dark age of Communism.

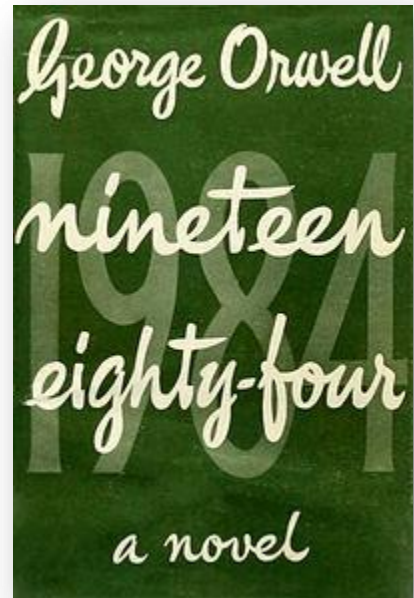
It was **Milton** who encouraged me to write and to bring the understanding I had gained from a unique global experience to the world. **Milton**, above all others, recognized currency for what it was – another commodity. This accumulative experience I have gained may be unique for I was chosen by events and molded into who I became by my clients on every continent. This has been a long journey of learning for I have seen things that domestic analysts do not even consider. Thus, I am indebted to **Milton** far more than most would ever realize. For it was **Milton** who encouraged me to share what I had learned with the world in hopes that one day, it would reshape it much as **Milton** had tried to do himself.

We live in a **NEW DYNAMIC GLOBAL ECONOMY** where capital rushes around fleeing political changes and taxes just as it is attracted by prosperity and opportunity. Even during the Great Depression, Herbert Hoover wrote that money in the form of “**reserve deposits were constantly driven by fear hither and yon over the world. We were to see currencies demoralized and governments embarrassed as fear drove the gold from one country to another. In fact, there was a mass of gold and short-term credit which behaved like a loose cannon on the deck of the world in tempest-tossed era.**”

All the people who migrated to the United States in the 19th and 20th Centuries came for reasons of economic and religious freedom. Today, that **Temple Of Freedom** has been pillaged. The respect for the **Liberty** of individuals has been displaced by suspicion that everyone is a potential terrorist and the presumption of guilt has once again displaced the core rights of freedom rooted in the **Right to be Heard** and the **Presumption of Innocence**. It is said that **Due Process of Law** stems from God summoning Cain knowing he killed his brother, but still God gave him the **Due Process** right to be heard; “**Where**



*is your brother Abel?" "I don't know,"* he replied. *"Am I my brother's keeper?"* We have lost our core sense of civilization for we have lost this precious right of **Due Process of Law**. Civility has been renamed "**Liberalism**" and rejected as evil transformed into the presumption that government knows best displacing even God, as government claiming to be all knowing and caring, worships at the altar of self-interest in prayer to the image of Karl Marx whose theory supports their unlimited control of power. What was once fiction in George Orwell's 1984 now has become the rules upon which our society functions with corruption, manipulation and dishonesty hinging on the Presumption of Guilt. It is support by claims of protecting the "people" from terrorists and now every person must be searched and carry proof of who they are. We now demonize "illegal aliens" and enact laws claiming they do not pay their fair share and must be hunted down, when the original design of the United States was **NO DIRECT TAXATION**. Following Karl Marx, government rejected the wisdom of Ben Franklin, Thomas Jefferson, James Madison, and all Founders of America replacing their experience with tyranny with the wisdom of Karl Marx and the introduction of the **INCOME TAX** requiring government to know everything you do or earn. The monuments that adorn Washington, DC praising men as Jefferson and Lincoln are but hallow symbols of days long since passed.

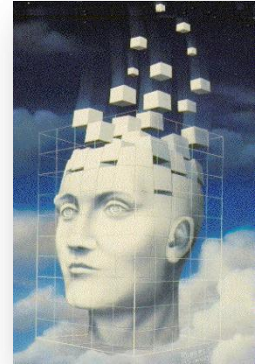


The contest between the eternal optimist and the pessimist/realist remains unending. Like the story of how both stood on the once lofty roof of the World Trade Center in New York and were suddenly blown off the roof by a gust of wind, the pessimist, immediately saw his fate and began to pray. The optimist, on the other hand, could be heard saying "*Well so far so good!*" as he passed the 4th floor.

Our once great societies constructed out of wilderness dominated by nature, sprung to life and were crowned with the golden roofs of a temple of Liberty. That temple is now overthrown, the gold and noble morals have been pillaged, the wheel of fortune has indeed accomplished her revolution, and the sacred ground upon which so many statesmen had espoused such noble goals of Liberty and Justice for All, is but once again disfigured with decay of politics and corruption as tyranny rises from the ashes. Capitol Hill, formerly the envy of nations, the citadel of Freedom on earth, the defender of human rights; illustrated by the stupendous footsteps of so many great minds encapsulated in Jefferson's words "***We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable rights, that among these are life, liberty and the pursuit of happiness.***" This breathtaking achievement of man's struggle to be free, the pinnacle of accomplishment, how is it fallen! This spectacular triumph of hope over experience, how is it possible to now crouch in the shadow of such greatness, gobbling over the spoils of the people like casting lots for what remains after death. How changed are the inspirations that moved a people to stand tall and assert ***Liberty and Justice for All?*** How disfigured the structural design of a nation obliterated by the theories of Karl Marx concealed by a mountain of rules and procedures incapable of improving upon the simple ***Ten Commandments***. Look upon what remains. A shapeless fragment or moral virtue colossal in size consuming the resources of the people until

all property is controlled by the state by regulation leaving title only in name to reside in the meager hands of the people. The great halls within which true representatives of the people once assembled to enact their laws and elect their magistrates, is now hopelessly insolvent, incapable of defending the people or the nation against the change in fortune and circumstance, leaving only monuments and edifices, that were founded with such great hope for eternity, awaiting their fate to lie prostrate, naked, and broken, like those of every civilization that has raised itself from the ground grasping at the chance for culture and progress only to found buried by the sands of time in ruin waiting only in silence to reveal to future generations what a stupendous relic of human folly lays here a victim of its self-inflicted injuries over the course of time and fortune.

The experience of mankind can truly be understood only from exploring the past to understand our future. History is boring to most and that is probably the reason we repeat the same mistakes over and over. Like a Shakespearian play acted over the centuries, the story remains the same, only the characters change. History is accurately a *Catalogue of Solutions*. It has been the discoveries enabled by a global *Artificial Intelligence Computer Model* that has brought to light the fallacies and myths that seem to lead us to the same course of conduct leading to the same results each and every time. By teaching the computer the method of analysis rather than hard-wiring inflexible rules governing relations between markets and economies, an exploration of the world around us became possible.



---

Disclaimer: Futures, Options, and Currency trading all have large potential rewards, but also large potential risk. You must be aware of the risks and be willing to accept them in order to invest in these complex markets. Don't trade with money you can't afford to lose and NEVER trade anything blindly. You must strive to understand the markets and to act upon your conviction when well researched. This is neither a solicitation nor an offer to Buy/Sell futures, options, or currencies. No representation is being made that any account will or is likely to achieve profits or losses. Indeed, events can materialize rapidly and thus past performance of any trading system or methodology is not necessarily indicative of future results particularly when you understand we are going through an economic evolution process and that includes the rise and fall of various governments globally on an economic basis.

CFTC Rule 4.41 – Any simulated or hypothetical performance results have certain inherent limitations. While prices may appear within a given trading range, there is no guarantee that there will be enough liquidity (volume) to ensure that such trades could be actually executed. Hypothetical results thus can differ greatly from actual performance records, and do not represent actual trading since such trades have not actually been executed, these results may have under-or over-compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated or hypothetical trading programs in general are also subject to the fact that they are designed with the benefit of hindsight and back testing. Such representations in theory could be altered by Acts of God or Sovereign Debt Defaults.

It should not be assumed that the methods, techniques, or indicators presented in this publication will be profitable or that they will not result in losses since this cannot be a full representation of all considerations and the evolution of economic and market development. Past results of any individual or trading strategy published are not indicative of future returns since all things cannot be considered for discussion purposes. In addition, the indicators, strategies, columns, articles and discussions (collectively, the "Information") are provided for informational and educational purposes only and should not be construed as investment advice or a solicitation for money to manage since money management is not conducted. Therefore, by no means is this publication to be construed as a solicitation of any order to buy or sell. Accordingly, you should not rely solely on the Information in making any investment. Rather, you should use the Information only as a starting point for doing additional independent research in order to allow you to form your own opinion regarding investments. You should always check with your licensed financial advisor and tax advisor to determine the suitability of any such investment.

Copyright 2011 Martin A. Armstrong All Rights Reserved. Protected by copyright laws of the United States and international treaties. This report may be forwarded to their parties free of charge and to politicians but any citation must provide reference to its websites at [ArmstrongEconomics.COM](http://ArmstrongEconomics.COM) and [MartinArmstrong.ORG](http://MartinArmstrong.ORG).

# THE RISE & FALL OF THE



# EURO



**COPYRIGHT AUGUST 21<sup>ST</sup>, 2011**

**By: Martin A. Armstrong  
former Chairman of Princeton Economics International, Ltd.**

*Copyright all rights reserved throughout the world*



**HE Rise and Fall of the Euro** is a sad story. However, it is a lesson that we should **NEVER** forget. The greatest danger is allowing politicians to make decisions in areas that they are not qualified to decide. During the 1980s, a major Australian public company inquired with **Princeton Economics** what would it cost for our firm to run its treasury operations assuming the hedging risks. They felt that our quote was too high so they hired a young trader in his late 20s who bought himself a flashing Porsche and proceeded to get into a car accident breaking his leg. He never bothered to even check the positions he had open. The firm lost about \$80 million in one week. The scandal resulted in proposed legislation that board members had to seek the expertise of someone like **Princeton Economics** or they were personally liable for decisions regarding financial subjects they knew nothing about. Likewise, in Germany, I was called in to a major public corporation because the company had been making hedging decisions at the board level and since the market swung back and forth and the board was incapable of trading, they passed resolutions that once the board decided to hedge, they would let the hedge go to maturity. That resulted in a loss of about \$1 billion caused by them reading the newspapers and selling the pound short because Britain would not join the upcoming Euro.

It is an old proverb that a lawyer, who acts as his own counsel, has a fool for a client. What the corporate world had to learn the hard way that they should not make decisions regarding hedging without expertise, it is now time that the politicians learn the **SAME** lesson. Would you go to a lawyer or a dentist to repair your car? Yet we elect people because they look good and smile nice. There are **NO** qualifications required and that is the downfall of representative forms of government (republics).

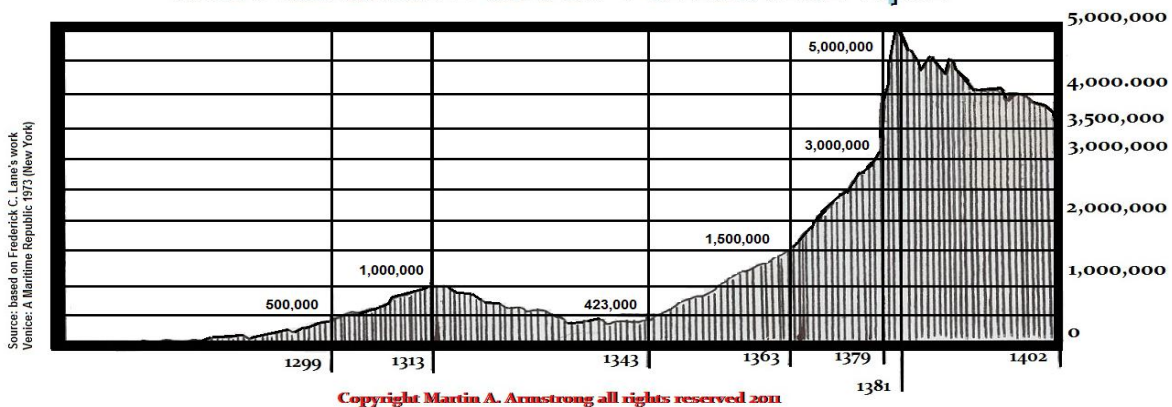


Venice Banco de Giro

In a real democracy, the people go down directly and propose laws. We pretend we have a democracy, but we have a Roman Republic instead with an elite political class. Therein is our downfall for the same reasons the Roman Republic collapsed. A political elite class is always too disconnected from the people and becomes a mere tool of special interest that leads inevitably to an oligarchy.

The reality of **Public Debt** has been a saga omitted from the history books. Nobody wants to talk about **Public Debt** and how nobody has ever paid off that debt always ending in default with a single exception of Romania in 1980. The earliest **Public Debt** post-Dark Age was that of Venice, which engaged in forced loans to the state dating back to 1187 when they began to prepare for the destruction Zara (*Zadar*). As illustrated below, the National Debt of Venice when charted shows the same exponential spike high that covered a period of about 51.6 years before it destroyed the Venetian Empire. Note in this chart, there is **ALWAYS** the **Phase Transition Spike** at the tail-end no matter what market or economy we look at. It is the sudden advance often doubling or tripling in value in the shortest amount of time.

### The National Debt of Venice 1262-1402



Even Florence adopted this practice of compelling people to buy notes\lend money to the state known as **FORCED LOANS**. This compulsory obligation to buy the state debt contributed to the fall of also Florence. The sovereign defaults eventually wiped out the Medici as well. So the track record of lending to government is anything **BUT** one of trust, quality, and good for the people. In every case, politicians have proven they are simply incapable of doing the right thing and they always seek to borrow today from the future revenues they expect to extract from the people tomorrow.

So the problem of Europe is by no means unique. When nobody teaches the perpetual **Sovereign Debt Crisis** that destroys Empires, Nations, and City States burying them all in a common grave (*see upcoming book*) it is no wonder that we are totally insane as a species for we constantly repeat the same mistakes



over and over and actually expect a different result. We are a unique species capable of learning from others by example, but too stupid to capitalize on that advantage. The excuse changes as to why borrowing is necessary from the invasion of a competitor as *Venice v Zara*, to conquer the world, defend against invasion, or the Marxist concept of borrowing from your children's future earnings to make your life better today because government claims to care. The end result is always the same – bankruptcy.

Creating the immediate solution to save the world must start with Europe and the flawed concept of creating a **Single Currency** in a half-bake pie that was very much like trying to be just a little bit pregnant. Consolidating the debt of Europe into a **Single National Debt** is just the first necessary step. It does **NOT** mean you throw all the future debt into one pot. **Nor** does it mean you create a national debt on a par level with a **single interest rate**. It **MEANS** you discount the debt of the weak and it must be **ALL** accumulated past debt, **NOT** going forward! Future state debt would become local debt distinguished from federal debt as is the case in the USA, but it would NOT be acceptable as RESERVE quality debt and thus would float according to market value. The consolidation of past debt would also be at market value and **NOT** at some fictitious par value because some politician thinks that is fair.

The problem in Europe is the states are effectively issuing **EUROS** altering the money supply because Debt is used for **RESERVES** the same as if it were printed currency that pays interest. In reality, the system has the same net effect as if every state in the USA had the right to print dollars. The banks hold a portfolio of member state bonds, and **ALL** are equal to **RESERVES**. Can you imagine what would happen if US banks could use state and muni debt as **RESERVES** at the Fed instead of Treasuries? This would constructively allow local debt to augment the national money supply if it is **RESERVE** quality. What is acceptable for **RESERVES** is critical because it then contributes to the REAL money supply. This would be a **HUGE** difference to the stability of the economy. Europe is living in the shadow of a debt volcano that is on the verge of erupting. The failure to have consolidated the debt is far more dangerous than most seem to understand.

The **Sovereign Debt Crisis** in Europe thus threatens to destroy the European banking system wiping out **CAPITAL FORMATION** the similar to the economic destruction of 1931 when Europe mostly defaulted on its bonds sold to the average American. That default wiped out **SAVINGS** and that amounted to the destruction of the core base **CAPITAL FORMATION**. Once that was destroyed, there went the US backing system and the Great Depression was born. Money supply collapsed and the Federal Reserve failed to grasp the seriousness of events clinging to this same concept that it needed to maintain the **CONFIDENCE** of capital and thus it chose austerity rather than monetization causing the economy to contract. That same austerity concept is alive and well today.

Therefore, this issue is not simple and is actually far more complex than most realize. The first step in defusing this debt volcano requires the **CONSOLIDATION** of member state debt even though there are political hurdles that must be overcome (detailed below) and such **CONSOLIDATION** must **NOT** be at the same par level but rather on a **discounted** basis according to **free market** prices. If Europe does **NOT** do this, the banks will be forced to sell the weaker bonds to protect themselves and then what - the ECB buys all the bad toxic debt? This is as if the mortgage debt had been acceptable at the Fed for **RESERVES**. Instead of Lehman and Bear Stearns going down, the entire banking system would have collapsed since the central bank would have owned all the mortgage time bombs.

This is not the permanent solution. That comes with **STRUCTURAL REFORM**. We can solve the immediate crisis. But politicians have to stop the bullshit before it is too late. History is a catalogue of solutions. But a funny this is necessary – you first have to read it!





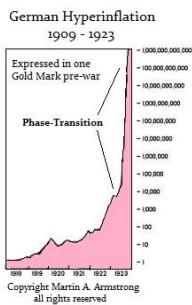
## EURO – DESTINED TO FAIL?

When we look at the structure of the Euro, it becomes clear that the design was flawed from the outset because of a failure to understand what **MONEY** really is. The driving force was trying to beat the USA and to regain former glories. Europe had talked itself into the idea that its economy if joined together would be “bigger” than America. Europe just never got over the fact that it lost its **Financial Capital of the World Status** to America in 1913 and has been obsessed with getting that back ever since. Living in a world of past glory, Europe committed economic suicide by engaging in two world wars and becoming effectively serial defaulters ensuring that it would be unable to rise from the ashes. Preoccupied with Marxism, Europe moved down the same path of debt as before. The only difference was the reason.

We are all shaped by our personal experience. Nations also collectively are governed by their past experience. I was in Tokyo when the first Gulf War took place. The outside world was criticizing Japan for not sending troops. But its constitution, written by the USA, had restricted Japan on a military basis so that its troops could not be more than 200 miles from Japan. There was an effort to change the constitution to allow Japan to participate with the world. The city streets were full of protestors. From their experience, it had been a military usurpation of Japan that led it into World War II. The people did not trust the military and were protesting against that change. From their perspective (*misunderstood in the West*), they feared a rise in the military if they were released from the chains that bound them. It was not that their sons were better than everyone else. They were fighting to keep their government restrained. We are shaped by our past no matter what anyone says. And as for war, they are the power plays of politicians who think they are playing a board game with the lives of their people. It is not the people who make war, but politicians. A mother still mourns her son’s death. The politician speaks insincere words of gratitude as to how he gave his life for his country. All those who died

in Vietnam accomplished what? Vietnam embraced western culture and put up casinos and won the war. What are those who die in Afghanistan today giving up their lives for? Is this just another chess board game? For every son and father they kill, they create a cycle of hate where others merely rise. Oh this is the fight against “**terrorism**” that is a word so broad that no doubt the British called Thomas Jefferson a terrorist when they and sent troops to his house to hang him. Wars have always been power plays. They are used to stir the feelings of patriotism, but in the end leave a hallow shell of destruction. Such was the result of World War I and II. Both were presented as the “**war to end all wars**” - so much for slogans. War has done nothing but destroys economies, create debt crisis and always end in the economic collapse of the nation.

To understand the Euro, we must understand the economic experience of Germany during the twentieth-century. It is **THIS** history that defines the thinking process and that history has been told from many different perspectives - military, political and moral extremes. However, Germany's twentieth-century **ECONOMIC** history is rarely discussed other than vague references to the hyperinflation of the 1920s. Ignored generally, has been a story from the debt perspective. Fighting World War I required colossal borrowing and the loss of that war burdened Germany with enormous additional obligations in the form of **REPARATIONS** imposed upon it by the victors largely out of resentment. Even John Maynard Keynes had warned that the **Reparation Payments** imposed would saddle German with such obligations; it would reduce its people to essentially economic slaves. This was important because it is the politicians that stir up war and the people are never fully united. Even today, the sentiment among Americans is that the war in Afghanistan is enough already.



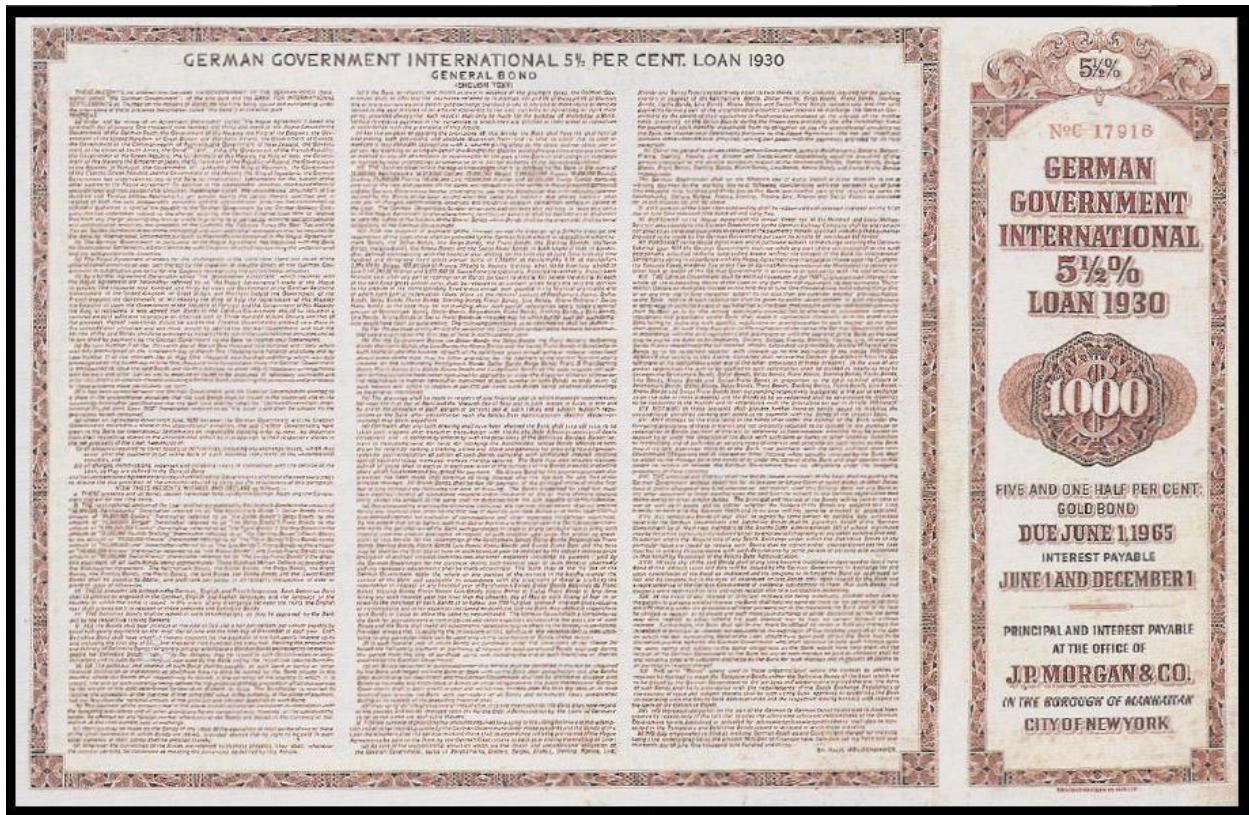
German  
Weimar Government

Date:	German Marks needed to buy one ounce of gold
Jan 1919	170.00
Sept 1919	499.00
Jan 1920	1,340.00
Sept 1920	1,201.00
Jan 1921	1,349.00
Sept 1921	2,175.00
Jan 1922	3,976.00
Sept 1922	30,381.00
Jan 1923	372,477.00
Sept 1923	269,439,000.00
Oct 2, 1923	6,631,749,000.00
Oct 9, 1923	24,868,950,000.00
Oct 16, 1923	84,969,072,000.00
Oct 23, 1923	1,160,552,002,000.00
Oct 30, 1923	1,347,070,000,000.00
Nov 5, 1923	8,700,000,000,000.00
Nov 30, 1923	87,000,000,000,000.00

## Hyperinflation

Resurrecting the German economy after World War I and allowing her people to share in the prosperity again during the 1920s, led politicians to think they could print their way to prosperity which indeed necessitated yet another new round of borrowings. The rise of the Nazi regime in 1933 repudiated most of that debt, but in fact, any other government would have done the same being left with little choice. After the Second World War, the victorious Allies had learned from the disaster caused by the **REPARATION** demands and how that had so oppressed the German people opening the door for

someone like Hitler who grabbed power without a majority. This time, the Allies lent the German people even more vast amounts of money to sustain them and to help them rebuild their economy.



Nevertheless, in the decades that have gone-by since World War II, the German people have been sorting out their past reestablishing themselves as part of the global community. This effort has been so successful that they have risen to become the economic anchor of Europe once again taking the position of the largest economy. Clearly, it was a vital first step in that process to acknowledge their financial debts that were formalized in the **London Debt Agreement** that had to address the massive German external debt. Part of this debt was for the postwar assistance to reestablish the German economy, yet still much of it also reflected the interwar debt that had been the object of default or suspension. Technically, Germany in 1945 still owed gigantic sums dating back to the early 1920s **Reparations**. The United States, United Kingdom, and France, actually purchased in 1949 the three Western occupation zones together creating the Federal Republic of (West) Germany. The three powers now demanded that Germany work out a settlement with all of its foreign creditors as one condition for restoration of its full sovereignty. This led to the **London Debt Agreement** of 1953. Germany has always been an export nation in trade and this was a vital element to reach an accommodation with their foreign creditors to facilitate renewed trade creating employment for the German people.

The defaults of the 1930s also greatly complicated trade relations and made additional private lending virtually impossible going forward. The outstanding creditors demanded through their politicians that German exports should be blocked until Germany paid all its creditors. This of course made no economic sense and only a very few creditors were willing to be practical and extend fresh credit to a country on



the economic ropes. The German people were being punished for the sins of government. Trying to restart the economy was deeply tied to normalizing economic relations with the rest of the world. At the time, Chancellor Adenauer accepted responsibility on the part of Germany and agreed to most of the external debt issues. Germany consented to undertake to repay all **Public Debt** issued in Germany between the two world wars, which was a tall order. This included the obligations of the central government as well as the various states, and the local municipalities. It is doubtful that anyone could make such an agreement today given the tremendous debt levels. This actually included both **public** debts owed both to other governments and all the **private** persons and entities that had purchased earlier German debt issues. Furthermore, Germany agreed that the new Federal Republic recognized debts owed by German **private** debtors provided those debtors lived in the Federal Republic. On this score, the German government accepted not the obligation to repay private debts, but rather to establish legal mechanisms that would ensure repayment. These debts had to be included in the overall restructuring plan. This is where **private** interests lobbied their politicians for a piece of the action. Germany had little choice but to agree if it ever hoped to rebuild its economy.

Lastly, Germany was also now forced to agree to accept full responsibility for debt incurred by the Austrian government as well during the period of **Anschluss** with Germany. Additionally, the new Federal Republic of Germany had to agree to accept responsibility for repayment of advances under **GARIOA** and the **Marshall Plan**. What made the burden greater was that Germany had been divided into four occupation zones with the fourth player being Russia taking what became known as East Germany, which of course refused to contribute anything to the **London Agreement**. This meant that the Allies expected the West Germans to pay also the debt now of the East. Creditors demanded repayment and ignored that perhaps the debt that they had purchased may have been municipal debt located in the new Eastern Bloc. It didn't matter. Many of the private entities had been destroyed in the war as was the case of municipalities. This mattered not to creditors who sought to extract from Germany everything they could regardless of the facts. For example, the Russia state had actually been dissolved according to the demands Allied forces and part of the territory was given to Poland.

The demand for blood money from Germany was tempered and controlled by a clause in the agreement not to repeat the mistakes of the reparation past. On this score, the agreement was crafted on the premise that Germany's actual payments could never endanger the short-term welfare of the German people or the long-term ability to rebuild a shattered economy and society. The Allies for once learned a lesson that there were two aspects that had to be respected, one economic and one political. They at least listened for once that any repayment had to be tied to the economy's ability to produce export surpluses. In this light, the Allies respected that with the Russians taking half of Germany posing a threat to the political well-being of the West, pressing the claims of private creditors against Germany would risk driving her into poverty where she could be taken by the Soviet Union. Consequently, national security began to override the economic oligarchy demands. By 1968 Germany ran a total trade surplus of 18.4 billion marks. The fixed payments under the **London Agreement** had become less and less important in the total scheme of events. Most of the agreement had actually been satisfied by the early 1970s. The last annual payment due under the original agreement was made, as planned, in 1983. **Article 25** provided for a separate rights issue in the event that Germany should be reunified. That was



Clause was triggered in 1990 kicking in the final stage of this financial responsibility, as the German government repaid debts that had been postponed at the London negotiations. From an economic standpoint, Germany met its obligations on honorable terms and the Allies behind closed doors realized that the **Reparation Payments** imposed upon Germany after World War I not only fostered its hyperinflation of the 1920s, but that set the stage for Adolf Hitler in 1933 who gained control with less than a majority. But for the **Reparation Payments** imposing terrible economic oppression upon the people, laid the foundation for World War II.

It is against this backdrop that we can now place the **European Sovereign Debt Crisis** in context. It is easy to see that Germany is reluctant to now consolidate debt and it fears at the end of the day that will have to take on the burden of now bailing out all of Europe. We must look at a problem from everyone's perspective and those who will reject anything that takes the German perspective should keep in mind that such attitudes are what made it possible for Adolf Hitler to rise. We should never oppress any nation, as we are currently doing to Greece, and ignore the consequences of our actions.



## THE SOLUTION

---

If we are to address a **REALISTIC** solution, unfortunately it must take into consideration both the **political viability** as well as the **economic practicality** of the consequences. Germany has to realize that being in the Euro but trying to dodge responsibility for all members, is just not going to save the day. Either Germany is in, or it should leave the Euro. It can't be a little bit pregnant.

That said we must view this from a **political viability** and an **economic practicality** perspective. Germany must realize that forcing austerity upon Greece, Spain, and Italy where unemployment is pervasive among the youth averaging 30-50% depending upon the region, is asking for trouble in the future. We cannot allow such a disenfranchisement to continue. **Socialism has been predicated on one generation paying for the other.** That is collapsing. We are risking what could be a generational war. Not only are youth starting to rise in Europe, it is beginning in the US and in Japan they are asking the same questions – ***Where is my future?*** Germany must look at the problem also through the eyes of everyone else. If it is honest, there is a risk of social unrest created by the refusal to reform that is precisely how Hitler came to power.

## REVALUATION OF THE DEBT INTO EURO

I have written before that when the debts of the member states were revalued into Euro and the Euro rose by 50% in general, instead of the national debts of the weaker states declining in international terms, they **rose in REAL VALUE**. If an American investor had purchased such debt for \$100,000.00, upon selling that debt and reconverting it back to dollars, he took home a new **REAL PROFIT** of about 50% on the currency alone. This in return extracted real international value from the weaker economies such as Greece. The actual debt burden essentially increased as foreign investors profited from the currency revaluation. This reversed the secret process of how governments reduce the debt burdens. Even the US benefits from the depreciation of debt so that the \$1 trillion in 1980 that represented the costs of WWI, WWII, Korea, Vietnam, and the New Deal, is now less than the annual budget. In substance and effect, the debt with time is structurally paid back with cheaper dollars and the bondholders really have not figured this out.

In terms of **REAL VALUE**, the debt burdens have actually risen rather than declined measuring in dollars. We remain trapped by our misconception of what is **MONEY** and how to measure it. We have confused **MONEY** (*medium of exchange*) with tangible wealth or **VALUE**. Everything has an inherent international value. Gold confuses many because it trades in dollar only because the US dollar remains the **RESERVE** currency. But internationally, gold has an inherent value just as oil that is conceptually translated into the local currency (**MONEY**) of the observer. No matter what we look at, gold, oil, wheat, labor, or debt, there is an inherent **international VALUE** by which everything actually trades globally. This is nebula of **International Value** is kind-of like the new Cloud Computing. It is tangible in the mind of each nation, yet lacks a solid mass in the form of a global currency per se. Still, it collectively combines into an **International Value** of exchange that is purely conceptual in a collective virtual world of finance. Those who grasp this concept then engage in the more complex world of **International Arbitrage**. In truth, this murky field of **International Value** was the origin of our global economy. It gave rise to mercantilism where people traveled among nations searching for a product of a value in one country that could be transported and sold in another at a higher value (*profit*). Banking thus began with merchants as did foreign exchange. This is truly the source of what we conceptualize to be **MONEY** and it is how **International Trade** even flows. Without difference in **VALUE**, trade would cease. It is essential to understand for this even supports David Ricardo's observations of **Comparative Advantage** among nations.

The revaluation of national debts into the Euro naturally created a tremendous deflationary pressure that is even now contributing greatly to the rising unemployment among the youth in many parts of Europe. This further undermines social programs that relied upon taxes that the youth would pay to fulfill the payments on promises made to the baby-boomers. This is all connected and unless we confront this vast nebula of **International Value**, we risk driving the economy over a cliff.

The ordinary depreciation of a currency is **NOT** directly tied to the CPI (*inflation index*). There is also a major component of confidence in that economy and its ability to pay those debts.

Therefore, the depreciation of a debt will typically exceed the measly inflation rate that is traditionally misunderstood in any event and **EXCLUDES** taxation. The cost of government has been rising faster than the CPI rate, but the cost of government is generally excluded and regarded as your obligation to society rather than your cost of living within it.

It is true that the weaker economies within Europe benefited by a lower interest rates at first upon joining the euro. However, whatever gains this contributed have long been wiped out by the rising rates of interest and the diminished capacity to borrow euro in this crisis period. If anything, they are seen as tainted dragging the whole of Europe down rather than as a separate nation state. Consolidating the **FEDERAL** debt into a single **Eurobond**, would have the effect of reducing the risk and thus lowering the rates that are now saddling the weaker economies provided in incorporates existing debt **ONLY**.

Consequently, there is much more to this concept than this mere consolidation of debt alone. It was essentially **NECESSARY** as a component of creating a **Single Currency** to consolidate the debt. There would be a single European interest rate **ONLY** possible on a **single debt**. Overlooked, is the distinct difference between creating a unified currency (euro) and individual sovereignty. Creating a single currency did **NOT** require agreements on spending with each state that in reality sacrificed individual sovereignty. A Monetary Union need only consolidate the debts from inception, as was the case in the United States. It did **NOT** necessitate the central government interfering with the local state budgets as long as they remained local going there forward retaining the sovereignty and culture of each member state. This was a fundamental misconception that seems to still be lost in the debate. Interest rates would then vary on a state by state basis and there would have been **NO** demands upon other member states to bailout any other state. Likewise, the effect of local state management would not create a contagion that spread cross-borders manifesting in the current crisis. Local issues of debt in each member state would be dealt with by the **Free Markets** providing the check and balance through interest rates. The **FAILURE** to understand **MONEY**, mislead Europe into assuming political controls over independent member states creating a bigger bureaucracy than was needed to have simply consolidated the debts and established a limited Monetary Union. In the United States there would be a single interest rates federally, **NOT** locally. The differential among the states in interest rates still reflects a **Virtual Currency** that cannot be deposed even by a monetary union and single currency be it the euro or the dollar because it is a byproduct of **International Value** inherent in all things giving rise to arbitrage.

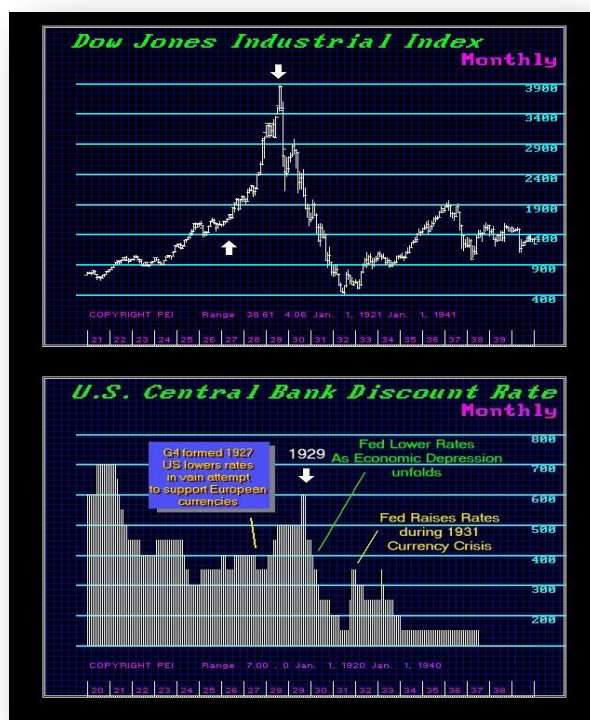
Only under this consolidated structure is there **ANY** hope of a standardized fiscal policy federally separating the budgets of the local member states. It is the Federal level of debt in each member state that is undermining the euro and mixing monetary policy objectives with **Independent Sovereignty Rights** that is threatening the diverse culture of Europe and will lead to disputes and resentment. Going forward, the member states must be separated from the federal structure and restored to their independent cultural status. Cultural sovereignty should never be sacrificed for federal monetary policy. In the USA, each state is free to pursue its own cultural differences within the confines of human rights without affecting national monetary policy.

The next daunting dilemma becomes the servicing of this new federalized debt. Ideally, once the debt is consolidated, the interest on that new Eurobond debt would be monetized to the extent that this would account for a portion of the vitally needed expansion in money supply to keep pace with population and economic growth. This would not become a wholesale printing of money that would frighten Germany, but must be confined to these two elements of population and economic growth. The member states would now be separated from creating money be it in the form of printing currency (*the least worry today*) but the far more important creation of euro debt that becomes in reality **RESERVE** currency used by banks and financial institutions.

This would help to relieve the immediate debt burden and crisis on the member states so that they can turn to reform to further economic growth and job creation. It would be possible to apply a Roman system of taxation at the EU level where member states would contribute a small amount on a national basis toward the expense of the EU and the debt servicing should that exceed the natural growth in population and economic expansion. The percentage contribution would also be on a pro-rata share basis upon which the debt was originally consolidated. This will help to eliminate the fears that Germany will be forced to bail out the other states. That must be avoided at all costs. This contribution from each member state as a percent of its GDP would go to the central federal level to cover operating expenses and the reduction of the new national debt. A resolution must prohibit the creation of **NEW** debt to merely service the old. As long as the debt is being reduced on a collective basis, capital normally investing in sovereign debt would become more beneficial by investing privately that would further economic growth. The less competition for capital from government the greater the economic growth will blossom within the new economy.

## MONETIZATION & ZERO INFLATION

Zero inflation is merely a utopian dream and it is impossible to achieve during economic periods of growth because the economy is divided into sectors that do not all grow at the same pace. Moreover, contrary to market myth that the stock market declines with rising interest rates, periods of economic growth are marked by a corresponding trend of rising interest rates that reflects the rising demand for money. Correlate any stock market to interest rates and you will see that market rise with periods of **RISING INTEREST RATES** and decline with lower interest rates. The collapse in interest rates did not help the Nikkei go back to new highs. You might as well create the perfect world in which no one dies while you're at it.





Inflation will rise due to changes in weather that will affect food prices and disruptions in oil supply just to offer a couple of examples. Inflation naturally takes place as a side-effect of economic growth because there is also a disparity among the sectors within an economy. There is no such thing as a steady and even growth rate in any economy across the board in each sector. Capital will always concentrate within one sector creating a domestic boom and bust and then it will move to the next sector. The object is not to smooth the business cycle, but live within its boundaries and that means the best we can hope for is to reduce volatility. So zero inflation is a utopian dream that is impractical and does not exist at any point in the economic historical record absent a deflationary economic collapse. Such concepts have led many economists astray. It is human nature that lies at the core of economic activity and to try to eliminate that business cycle is making the same mistake of Karl Marx and you must relinquish human nature and become a drone to live in such a world of perfect union that cannot be sustained without human individual freedom. The monetization to service the debt must be capped at a minimum matched to the demographics. The supply of money **MUST** expand with population and economic growth or the net effect will be a reversal of economic fortune.

The federal debt is in this manner eliminated from the concept of creating sticks and carrots to influence national policies in all member states, which historically just does not work in any event and threatens resentment. There is no enforcement mechanism to compel compliance without federal troops to invade an unruly member state. Hence, federal spending is thus controlled and to the extent that deficit spending takes place, it must be capped by the demographics. The key is to absolutely prohibit borrowing to cover perpetual deficits. The accumulative interest multiplies the debt and reduces economic growth. Therefore, borrowing **SHALL** not be authorized except in times of war but rather steadily monetized within strict limitations (*the claims of "fiat" currency will be addressed below but if money supply does not expand with the economy, deflation occurs because money becomes scarcer than assets*). There is no empirical evidence that borrowing is less inflationary than monetization because you merely create more bonds and then more again to cover the interest. In theory bonds are not **MONEY**, but in reality, they are simple a derivative currency that pays interest and add to the overall money supply in the form of **RESERVES** acceptable within the financial system. To prevent runaway inflation and fears of hyperinflation, money supply growth shall be capped at 5% annually. If asset inflation takes place due to speculation, this will bring it back in line by causing money supply to grow less than the economic expansion providing a breaking mechanism that is **DIRECT** rather than **INDIRECT** by central banks raising interest rates in HOPES of reducing that same demand. The supply of money is to be curtailed **DIRECTLY** and can be augmented by restraints upon borrowing rather than increasing interest rates without any guide as to what level will affect the bubble.

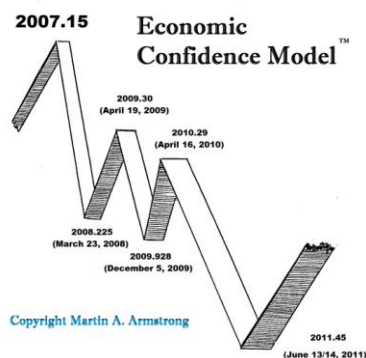
The size of the member state governments must be pruned and thus tax burdens reduced to create jobs. In other words, live within the means of government, and focus on tax reduction to create local jobs in the private sector. Taxation must be reduced from 40%+ of GDP to 25% within 5 years and 10% within 15 years. About 70% of employment on average is created at the small business level, not by the giants. The tax structure must be reduced and the VAT should

be transformed into a point of sales tax. This will eliminate the high cost in collecting such a VAT tax, eliminate the pretended refunds subject to fraud, and this should apply to real estate as well that can be incorporated in a mortgage for the individual. Every effort should be made to eliminate **DIRECT** taxation that requires a vast bureaucracy to keep track of people to gain revenue and shift to an **INDIRECT** form of taxation that is non-refundable. In this manner, so called illegal aliens still pay taxes toward the cost of society.

The GDP of Europe stands at US\$16.2 trillion (*including French possessions*) compared to US\$14.6 trillion, but the terrible level of taxation still hurts the long-term growth. Taxation in Europe is running at about 41.2% of GDP compared to 28.3% in the USA. There should be no direct taxation at the EU level either. By consolidating the debts and shifting the tax collection process to **INDIRECT**, this will help to reduce the tax burden among member states by reducing the size of government. If this is not accomplished, there will be long-term social unrest for unemployment is simply way above Great Depression levels among the youth and government will still need to contract under market forces currently.

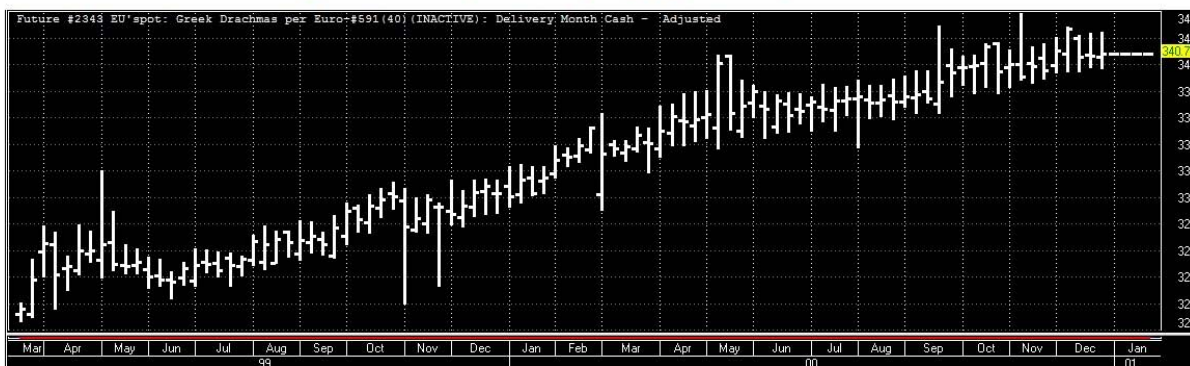
## SINGLE CURRENCY & SINGLE DEBT

There is simply no precedent for such an economic system of a **Single Currency** creating in theory a **Monetary Union** absent a **Single Fiscal Debt Union**. This type of fast and loose economic structure is from another planet. There is no enforcement mechanism whatsoever to compel member states to curtail their budgets yet the bonds they issue are of the equivalent of a federal nature. This is as if a federal government allows foreign states to print its **MONEY** at will. In the USA, state and local debt is **NOT** federal and cannot serve as **RESERVE** status increasing the money supply. No does the threat of one state threaten the federal debt. Hence, without serious reform, there can be no credible solution. Creating bailout funds do not solve the problem and only kicks the can down the road. This is why there must be **FIRST** a consolidation of **ALL** member state national debts. There is no mechanism to enforce fiscal policy at the member state level. Consolidating the debt will restrict bank **RESERVES** to only federal debt and this will also stabilize the banking system.



The local debt levels within each member state would float according to the **free market**. In this manner we create a check and balance of the **free market** interest rates that will remain as the club to help keep politicians on the right path. The entire **Greek Debt Crisis** began as we approached the  $\pi$  (**Pi**) Turning Point on the **Economic Confidence Model** 2010.29 (April 16<sup>th</sup>, 2010). Had it **NOT** been for the **free market** there would be **NO** check and balance. This is why there should be stated up front by resolution that there shall be **NO** bailout of local debt.

## Greek Drachmas per Euro (Weekly 1999-2000)



At all times, local debt **MUST** carry the risks and rewards of investment. If you invest in stocks and they fell 50%, does government come running in and create a bailout fund to restore the value at par by guaranteeing all losses to investors? As absurd as this appears, it is precisely what takes place in the debt markets pushing the cost to taxpayers that ultimately destroys the future of the next generation. The **free market** was correct from the outset for pictured here is the Greek Drachma per Euro on a weekly basis for 1999 and 2000. This shows how the Drachma fell from nearly 320 to 340.75 to the Euro in anticipation of future problems.

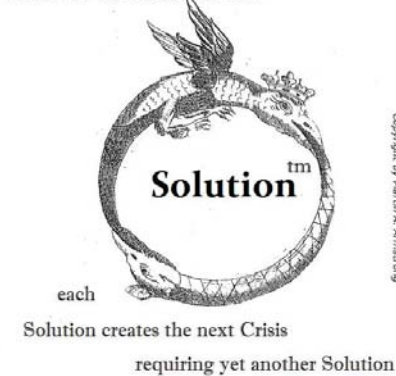
Therefore, we **MUST** eliminate any idea that member states can spend as they like knowing that they will have to be bailed-out in an attempt to defeat the **free market**. By **OUTLAWING** any such bailouts requiring **TAXPAYER** approval at a general election in advance placing that decision in the hand of the people instead of an elite political class, the system will have a much greater chance of survival. Debt should remain at all times **BUYER BEWARE** in the **public** sector as it is in the **private**. At least privately we have the rights to seize property where in the public sector there is no collateral. Additionally, this member state debt (including municipal) **SHALL NEVER** be acceptable as bank **RESERVES**. Whenever government borrows, it is competing against the private sector that is the only **REAL** creator of national wealth. Government employees are "**public servants**" because they contribute nothing to economic growth of a nation, but are an expense that must be restrained wisely. Therefore, only Euro federal bonds would be good **RESERVE** collateral. A secondary market would emerge to allow the trade in such local bonds and this can be strictly controlled much more closely than the **REPO** market was in the United States.

The current structure cannot be maintained and presents a serious threat to the **WORLD ECONOMY** in a similar manner as did World Wars I and II. The system simply becomes too complex by maintaining independent issues of sovereign debt that fashions a daunting task when attempting to allocate the funds from state issues or rolling the debt across the different countries. This leads us down a path of regulatory insanity requiring incentives and direct hard-wired intervention mechanisms in hope of keeping each country in its proper place based upon misguided concepts of what would be sound economic policies. This introduces complexity that further invites corruption to neutralize the inherent **checks and balances** within the system.

Unfortunately, politics within a representative system of government (Republic) always devolves into a political budgetary system that attempts to prevent **free market checks and balances** that are contrary to lobbying or oligarchic special interests. This also attributes to the political process a level of **economic knowledge** and **expertise** for which there is **NO** historical empirical track record. This type of system is by no means transparent and will hopelessly collapse every time. The danger is always in creating a more complex and larger system there emerged the unavoidable tendency to result in self-destruction. Communism collapsed **because** central planning cannot possibly function being deaf, dumb, and blind to what is actually taking place in the rank and file of the general economy. Human nature cannot be replaced by regulation. Passing a law that **thou shalt not kill** does not eradicate murder.

Government control is **NEVER** the solution, for it historically merely creates the next crisis with each new solution, which I call the **Paradox of Solution**. With each step government takes to

### The Paradox of



solve the current crisis, it simply creates the inevitable circle of political change that leads nowhere. So how can an even **'bigger system'** solve a problem of the euro by creating more complex federal budgetary allocation mechanisms? The **free market**, much hated by those on the left that try to create the perfect Marxist world and those on the right who seek ultimate dictatorial powers unable to sleep at night worrying someone is doing something they disapprove of, ironically is the precise check and balance inherent within a collective society that is vital to the our survival. This has been reflected in the variable interest rates appearing in the diversity of the euro member state bond markets.



## THE EURO DID NOT REALLY REPLACE CURRENCY

The unsophisticated in global economics bought the idea that they were creating a **Single Currency**. This hogwash helped to sell the Euro to the public claiming the costs of converting currency and the currency risk inherent in European trade would all be magically swept away with this new Euro. In reality, what they did not understand is this concept of **International Value** that creates a **Virtual Currency** they could not prevent.



During the early '80s before **Salomon Brothers** and **Goldman Sachs** were getting their feet wet merging with the commodity world (**Phibro & J. Aron** respectively), to some I was just the most expensive advisor in the world as the **Wall Street Journal** highlighted in 1983. Outsiders truly didn't grasp the real complexity of the global economy for this was a new field born only in 1971 with the fall of the fixed exchange rate system. I gained a reputation of a sort of financial Houdini. I was the guy you called when you had a problem that nobody knew how to solve it. One project was for an Islamic bank that management was a former Bundesbank director and the board was unsophisticated religious types who had made the decision they should open a branch in Turkey for religious reasons and management saw that they had to put up \$10 million that would be converted to Turkish lira pending approval that would take about one year. The Turkish lira was steadily declining and they would lose half that value in one year. To top things off, the Turkish lira was **NOT** tradable. There were no market options or futures contracts only spot conversion prices without a forward market. I was called in to solve the problem of hedging something that could **NOT** be traded.



The **Wall Street Journal** couldn't believe people were paying me \$2,000 an hour. They told me they were doing a piece on the consulting industry and asked me: **Who was my competition?** I told them I had no idea I wasn't sure if I had any. What I was doing was far beyond advising buy or sell commodities. It was too difficult to even explain. They asked if they could speak to a few clients. I asked clients if they would speak to the WSJ and they agreed to speak anonymously for I still assume it was about the infant industry. The journalist called me back and said my God, people said you were cheap and if you charged \$10,000 they would pay it. I myself did not perhaps appreciate the scope of what I was doing. But it was certainly cutting edge.

In effect, as a trader, I just knew instinctively how to use markets to synthetically achieve goals. To solve the impossible trade of the Turkish lira, I correlated the cash spot lira prices to markets I could trade and created a synthetic group of tradable markets that would mirror or simulate the Turkish lira. In this manner, I was creating tradable instruments out of thin-air as clients began to say. The WSJ didn't quite get it and portrayed me as just the highest paid commodity advisor in the world. In reality, I was solving problems using commodities, but synthetically really creating hedging strategies that were otherwise unavailable lacking the market structure.

This is why I warned Europe what would happen. I may have been the first to create synthetic products (*making something out of nothing at all as people use to say*), but that by no means was something which I had a patented monopoly. Others began to get into the field over the next 5 years largely after **Salomon** and **Goldman** began to acquire commodity trading expertise merging that talent with Wall Street. I merely had the trader talent and instinct enabling me to **SEE** a pattern of opportunity in the financial field before the New York boys got up and running. I was told that some saw what I was doing as something to emulate, but by no means was I the **ONLY** person capable of doing this new type of business once traders from the commodity world were exposed as I was to the global markets, the field rapidly expanded. S&P500 futures began trading in 1985. The US 30 year bond futures in 1978.

Hopefully you can see that it is possible to synthetically still create a currency. In the case of the euro, it is child's play and far less complicated than what I had to create to trade the Turkish lira. The path of evolution the markets were taking in the early '80s was predicated upon the concept of **TIME** had arrived at Wall Street from the commodity side of futures, forwards, swaps, arbitrage and hedging product. It is difficult to describe this evolution process to people not in the field for they just see complex trading that is beyond comprehension. By leaving the **UNCONSOLIDATED** debt structure intact among the diversity of the member states, the politicians created a **Virtual Currency** for each member state. I realize even politicians are mumbling what the hell is he talking about? Brain surgery appears complex, dangerous, and technical to a person outside the medical field. So hang in there. We are all just a product of our environment. What I am striving to articulate is the **NECESSITY** of understanding this **Virtual Global Financial System** and why politicians should be barred from trying to manipulate this complex **International Value** network for they truly know **NOT** what they are doing.

The euro **DID NOT ELIMINATE** by any means the member state **REAL** currency movement as believed most assumed it would accomplish from the outset. The **free market** will always respond to any such change. In this manner, it was logical that the **bond market** of each member state would simply become the **tradable virtual constructive currency derivative** that in effect provides the **SAME** impact as the old currency would have accomplished. A currency rises and falls based upon **CONFIDENCE** in the political government underling that instrument. Creating the euro, **BUT** leaving each nation with its sovereign debt converted to euro, left intact the **SAME** underlying element of separate and distinct political risk. To someone like me, I see the **inherent currency** component that remains and thus I can create a hedge against the political risk by now **SHORTING** the euro bonds of that member state creating the same identical Virtual Currency performance had the drachma, lira, peso, or even the German mark still traded.

To some I am still making something out of nothing at all. But they just fail to understand the true nature of what it is they **THINK** is even **MONEY**. Too many people are stuck in the mud yelling and screaming about currency **MUST** be backed or else it is a "**fiat**" currency. They are blind to what a currency even is and are living in a time warp of misconception going back to the Stone Age. They assume **Money** has to be tangible and do not understand that there is **NOTHING** that is tangible and we have been living under a floating exchange rate system since 1971. They are confused by this idea that **MONEY** must somehow be **TANGIBLE** and can only articulate the reason being inflation. Yet there was inflation under a gold standard and the flood of gold to come from the California, Alaska, and Australian



Cowrie Shells



Qin Dynasty, Shih Huang-ti (246-210 BC)  
Ban Liang (1/2 Liang)

discoveries not to mention South Africa, were all followed by waves of massive inflation simply because you increased the supply of gold. If every central bank dumped all their gold reserves, the price would collapse. Gold would then rise thereafter because there would be no longer a threat of such sales. So I fail to understand this

**TANGIBLE** nonsense when you cannot point to any period in history where such utopia existed where **MONEY** never rises or falls in **VALUE** regardless of what it is regarded to be.

**ALL MONEY IS REALLY A SIMPLE DERIVATIVE** of the core system that remains **BARTER** at all times underlying everything. The **BARTER** system is simply you want a haircut and you grow potatoes. As long as the barber accepts the potatoes all is good. What happens when he doesn't want the potato and needs a carrot? You have to find a guy with a carrot who wants a potato. This is where **MONEY** comes in and becomes a universal virtual object that allows commerce (**BARTER**) to take place because the barber **KNOWS** if he accepts the object he can exchange it for the carrot with a third party. The idea that **MONEY** must be **TANGIBLE** is antiquated nonsense. That does **NOT** reduce the **VALUE** of gold. China's monetary system was **ALWAYS** based on a fiat system absent **TANGIBLE** value that was purely a Western concept. Eventually, a bronze coin known as "cash" emerged and its value historically was always whatever the emperor said it was without a tie to any **TANGIBLE** value of metal. Inflation occurred and the **Free Market** devalued the coins based upon supply and demand. Yet there were times when it **rose** in value and **declined** even though it was just a fiat currency absent **TANGIBLE VALUE**. We couldn't buy Manhattan from the Indians with gold. They did not use this as a medium of exchange. The Romans began with cattle and bronze where the first was food and the second could be cast into weapons or a plough. Either way, this was a **TANGIBLE** value. Fiat currency still rises and falls in value just as any **TANGIBLE** monetary currency. You work every week to get that fiat currency so you can pay your bills with it because others accept it in exchange. People are **CONFUSING** Value with a medium of exchange. All things have a practical **International Value** but that does not qualify it as a universally accepted medium of exchange. **MONEY** evolved from something of recognized **value** and on a practical basis, that was often bronze that provided the tools to farm as well as weapons both in ancient China and Rome. Gold is a **VIRTUAL** hedge against government instability both economically and in times of war. That by no means **NECESSITATES** the argument you should buy gold because the currency in use is fiat. China's system was fiat for the most part of 2500 years. Do not confuse the fact that gold is of value and a hedge against political-economic instability independent of whatever the money in use might be. This adds to the confusion about **MONEY**.

Roman & Chinese Ancient Bronze Coinage



If you cannot grasp this vital understanding of what **Money** truly is and its **PURE** function as a medium of exchange **NOT** a store of wealth, then it is going to be very hard to grasp the global monetary system. You are going to live in a world that is not real. Once you distance yourself from that bias, you will see the world for what it truly is and appreciate its function. The movie Matrix is based on a fictional world created by machines that have constructed an elaborate delusion. Once the character understands the real fictional world in which he resides, he sees the elaborate computer code behind the illusion. This is very much the world in which we live today. The scary part is our politicians assume they can control the world but still cannot see the elaborate interconnectivity in the code upon which it is constructed. **MONEY** is simply like a language providing the link between two people to exchange products (ideas). It is **INTANGIBLE** meaning it is **NEVER** fixed, but is subject to the **free market** forces that cause it to rise and fall in value **REGARDLESS** of what it might be at any point in time. **Money** thus **ALWAYS** fluctuates in value according to supply and demand because **MONEY** is **NEVER A STORE OF WEALTH**. It is whatever a society agrees universally shall serve as the medium of exchange. This is why it has been cattle, seashells, beads, gold, silver and bronze just to mention a few. We live in a delusion when we fail to comprehend the true nature of **MONEY**. This is why the euro is collapsing because of a faulty assumption that **MONEY** is some fixed **VALUE** and **STORE OF WEALTH**. There is a failure to realize that creating the euro did **NOT** replace the inherent function of MONEY as a simple derivative of CONFIDENCE! Leaving behind the national debts in each member state left in place the same element that causes foreign exchange (**MONEY**) to fluctuate.



Because money is **INTANGIBLE** or a fiat system where it is to some extent created by government (*putting aside the private creation by leverage*), the added component that is different from a **TANGIBLE** product serving as the medium of exchange such as gold, remains the faith or **CONFIDENCE** in the government state. In a **TANGIBLE** world, the value of gold rose and fell depending upon changes in supply. The **INTANGIBLE** world depends upon the core base supply provided by government. Thus, the **TANGIBLE** monetary system of gold is more random impacted by discovery that cannot be timed, and the **INTANGIBLE** monetary system fluctuates as a matter of public **CONFIDENCE** in the state as it did under a precious metals system influenced by debasement.

Hopefully now you can see that in an **INTANGIBLE** monetary system **MONEY** is simply a derivative component of **CONFIDENCE** as is the case in a **TANGLE** system when **debasement is introduced**. Now perhaps you can see that the **EURO** did **NOT** create a **Single Currency (MONEY)** as it was believed to be the case. That **CONFIDENCE** remained attached to each individual state **BECAUSE** the debt was **NOT** consolidated.

The cost of transferring **VALUE** between two countries that was the foreign exchange fees was only transferred to the interest rate reflected in the bond markets and absorbed by the entire economy. Hence, the bonds issued in euro facilitated commerce and cross-trading, but the **CONFIDENCE** remained a tradable element transferred to the bond market reflected in the fluctuation of interest rates in each member state. Consequently, we still have a **VIRTUAL CURRENCY** driven by the same elements. Instead of the currency depreciating devaluing the bondholder, not the interest rates rise forcing the member state to pay the bondholder for his **RISK**.





**UNCONSOLIDATED** Debt has a component derivative of the replaced currency when **ISSUED** on a state by state basis. **ONLY** a consolidated debt would defeat this inherent derivative transformation. If debt is consolidated and new borrowings going forward are **LOCAL** debt and **NOT** that of a sovereign Europe as a whole **NOT** suitable for reserve purposes, then the consolidated euro bonds would gravitate toward the lowest interest rate rather than the highest of the group and a far greater stability would unfold economically over the entire system. The **UNCONSOLIDATED DEBT** exposes Europe to collapse by the fact it is simply a **VIRTUAL CURRENCY** that can be divided and conquered. Moreover, local issues if denied regulatory **RESERVE** status will not serve as a **VIRTUAL CURRENCY** affect continental policy and stability.

For you see, it is gibberish to pretend printing is more inflationary than borrowing. This is another myth arising from the **FAILURE** to understand the nature of **MONEY** that it is simply a commodity that fluctuates according to supply and demand and **NOT** a mythical **STORE OF VALUE**. If bonds are issued and serve as **RESERVES** within the banking system, then they add to the **MONEY SUPPLY** and are again just a derivative form of **MONEY**. The **ONLY** way to prevent bonds from becoming a derivative of **MONEY** is to prevent their use as **RESERVES**. Issuing bonds that serve as **RESERVES** simply constructively creates interest bearing currency precisely as currency began in the United States paying interest rates printed on the reverse side of the note in order to provide an incentive to use this as the medium of exchange. We have thus come full circle.

I have mentioned the approach of Hamilton in the USA where he consolidated the debts of the states into a US federal national debt. We can see by the table provided that once again the **free market** determined the exchange rate to swap the state currency into the new US dollar. It was not done on a theory of “*fairness*” so that everyone was equal, but on a basis of practicality

Continental Currency	\$40 for \$1	April 1780
N.Y. & Conn	\$40 for \$1	April 1780
South Carolina	\$52.50 for \$1	May 1780
Mass., N,H. & R.I	\$100 for \$1	June 1781
New Jersey	\$150 for \$1	May 1781
Penn. & Delaware	\$225 for \$1	May 1781
Maryland.	\$280 for \$1	June 1781
North Carolina	\$800 for \$1	Dec 1782
Virginia	\$1000 for \$1	Jan 1782
Georgia	\$1000 for \$1	Feb 1785

according to supply and demand filtered through **CONFIDENCE**. What has happened post-Hamilton is that the state debts are local, subject to the laws of supply, demand, and **CONFIDENCE**, but they do not serve as a **RESERVE** currency and that is essential. Had each state’s new debt issue been acceptable as a **RESERVE** currency and good collateral even at an exchange, then the states would have a constructive ability to create money on a derivative basis. It matters not how much they issue on a national basis from a **PUBLIC** money supply perspective for they will not add to the national money supply. It is true that private banking increases the money supply through increasing the **VELOCITY** of money, but this contributes to the **VOLATILITY** and the same private increase in money supply would take place under a gold standard. You deposit \$100 and the bank lends me \$94. They have doubled the money supply effectively because we both believe we have about \$100 dollars or close thereto in our accounts, yet in reality there is only \$100 of the **PUBLIC** money supply. If it is gold or paper the same leverage is created and thus the monetary basis becomes irrelevant in the total scheme of the economy be it **TANGIBLE** or **INTANGIBLE**. *That argument is confined only to the PUBLIC money supply, not the TOTAL money supply.*

The argument for a gold standard is about as practical as the euro. The gold standard would not eliminate the **VELOCITY** of money and hence would not affect the “*real*” money supply nor would it prevent inflation. The euro was incapable of providing a true **Single Currency** because it **DID NOT CONSOLIDATE THE DEBT** and thus constructively transformed the national debts of the member states into simply a synthetic **VIRTUAL CURRENCY** that will still rise and fall because of the inherent political **RISK** factor (**CONFIDENCE**). While a direct currency allowed for the depreciation of the national debt transferring the political risk to the bondholder through



the currency, the euro **REVERSED** the process transferring the risk that use to be currency from the bondholder to the state in the form of interest rate risk. The bondholder has “*price*” risk on any resale of a bond before maturity insofar as the price will decline as interest rates move higher. However, because debt is now a derivate of political risk, greater volatility will appear in the interest rate transferred from the old currency.



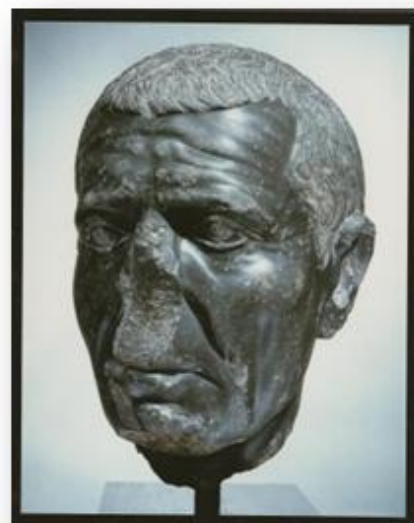
## PRACTICAL ECONOMICS<sup>tm</sup>

There are three primary issues when it comes to trying to apply **PRACTICAL ECONOMICS**. It matters not the **PROPER** type of political-economic system that would solve the problem, it must also be saleable (**PRACTICAL**). Polls shows over one-third of Germans already believe the Euro will not exist by 2021. Is the reform worth the pain? What do we face?

- 1.) Social impact
- 2.) Capital Formation impact
- 3.) Political Impact

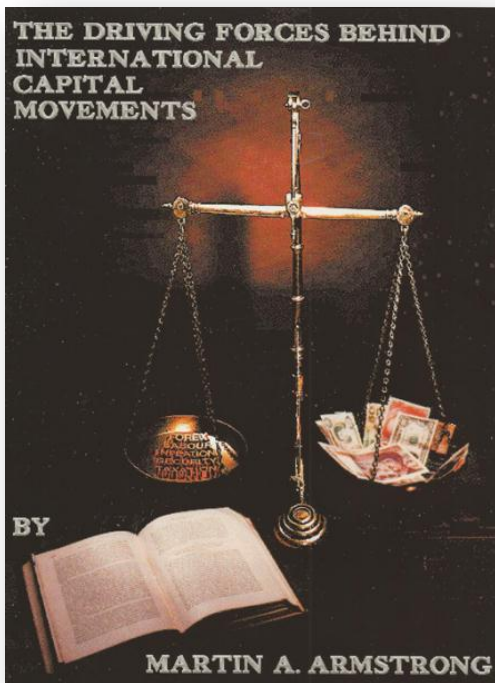
Europeans greatly distrust the new centralized government. The feasibility of moving toward a more integrated Europe is not an easy task especially after the economic mess that is surfacing. As economic turmoil increases, there will be louder cries to dissolve the union. Hence, it is vital that we **TRULY** understand the problem and that **ALL** stems from our misconception of what is **MONEY**. We cannot allow impractical ideas of what **MONEY** is to once again dominate the solution. The very reason for creating a single currency was to create a free trading Europe to improve employment and compete with the United States. However, much of this has not really materialized as unemployment moves higher. The forced austerity measures upon the weaker economies such as Greece are destroying the social fabric and the youth cannot find jobs in Greece and are being forced to migrate. Greece is losing its **BEST** talent and this will have an economic consequence upon the nation moving forward. All of this is taking place to save the **EURO** once again bringing us back to the misconception of **MONEY**.

I have written before of the solution adopted by **Julius Caesar** when he was faced with a debt crisis that also resulted in a collapse in price of real estate. As always, at that time, capital had indeed refused to even accept any such mere return of the property



Julius Caesar





that it had held the mortgage on. **Caesar** is one of the few politicians to glimpse this fallacy of **MONEY** being some sort of **TANGIBLE** constant. He realized that when capital lends 100,000 on a property and then there is a collapse in the **VALUE** of property (*real estate*), the creditor demands a return of the 100,000, but in reality, **MONEY** has risen in purchasing value and that 100,000 will now purchase two properties. Is that a profit to capital? Everything turns on your concept of **MONEY**. Does money remain constant and it was real estate that collapsed in **VALUE**, or did the supply of **MONEY** shrink causing it to rise in **VALUE**? For you see, **MONEY** fluctuates regardless of what is being used as the medium of exchange. So how do you decide who profits and who loses? **MONEY** is the medium of exchange and thus is merely a language allowing two objects to be transferred. When capital enters the equation

in the form of a bank, now **MONEY** becomes clearly a commodity and possesses a **VALUE** in and of itself aside from the medium of exchange component. I have written about these concepts in an early publication, *The Driving Forces Behind International Capital Movements* (1990) that became obvious to me in working with multinational corporations. Understanding that **MONEY** is simply a commodity opens the door to fundamentally understanding the construction of the world monetary system.

**Caesar's** solution was brilliant. He saw both sides through their eyes of self-interest. From capital's perspective he saw **MONEY** as a constant and thus they wanted what was given returned and did not regard its rise in purchasing power to be a profit. From the borrower's perspective he saw that the land **VALUE** declined when measured **ONLY** in **MONEY** (*not against other assets*) and thus regarded their dilemma as a loss. **Caesar** split the baby down the middle. He recognized the economic crisis affected commerce bringing everything to a halt, and the only means of restarting the economy was to resolve the debt crisis. The borrowers lobbied for **ALL** debts to be wiped away so that they retained the property. But **Caesar** saw this would unjustly destroy **CAPITAL FORMATION** and cause capital to suffer the entire loss. **Caesar** created a board of valuers who set the value of the property to what it had been at the time capital was confident to lend. He then took all interest paid by the borrower and applied it to the principal. On a **VALUE** basis, he backed everything out at a fixed point in time. Of course the moneylenders conspired and killed him, but the debt crisis was brilliantly solved.

In the US Mortgage Crisis, government **ONLY** concerned itself with the bankers, and not the borrowers. Lending money to the bankers **FAILED** to restart the economy because it was one-



sided. The solution would have been easy. Revalue all property, shave 25% off the mortgage price, use the funds to accomplish that end, which would have left the majority of people in their homes reducing the supply of real estate coming to market, and thus stabilize the two ends and the economy. The political solution was motivated **ONLY** by the bankers and this created the propaganda of “*too big to fail*” implying that they somehow were more important than the economy.

The solution in Europe is again a one-sided affair demanding austerity to save the bondholders at the price of undermining the social fabric within society. The approach is fundamentally flawed and will only lead to civil unrest, prolong any hope of an economic recovery, and dangerously flirt with a depression.

## THE POLITICAL IMPACT

Much of our inability to solve economic dilemmas emerges from the flaw of a Republican form of government insofar as the so called “representative” of the people usually becomes captured by the self-interests of one side or the other. This eventually leads the political system to become the enemy of the people whenever it is allowed to become a ruling political class that never leaves office indistinguishable from a dictator. This could be solved by reestablishing a real democratic system where by the people can go and make the laws as was the case in ancient Athens. But on the other hand, people are lazy and prefer a Republican system where they elect someone to go do that sort of stuff for them. Herein lays the danger. Without a limited one term of office, a **REPRESENTATIVE** becomes the ruling class and will see things only from his own self-interest – the survival of the political state status quo. So to those politicians, who like the career, they should just cross over to the government and stop pretending they are representing anyone for at heart they are truly a bureaucrat and **NOT** a **REPRESENTATIVE** of the **PEOPLE**. The elected people should be the **REAL** oversight to whom the legislative power is vested. To ensure they remain separate and distinct from government, their terms should be short one to two years maximum and **NEVER** again may they even be qualified to work for government in **ANY** capacity. In this way, it would look impressive that they contributed to their country like serving in the military. They will be separate and apart from the bureaucrats who must report to them. This, unfortunately, is a tall political reform and unlikely to take hold short of an economic meltdown.

It will be an extremely difficult PR (*propaganda*) challenge to lead the people in Europe towards more integration. Many are not happy with ONE Europe. This type of political reform would do the trick and provide greater **CONFIDENCE** that a central government will not be the enemy of the people eliminating the career politicians and leaving the sovereign dignity of individual culture. There must be political reform to win the support of the people for greater integration. The Roman Empire thrived because there was a **Single Currency** and a single set of laws that promoted integration. The concept of the euro did not reach reality because of politicians failing to **CONSOLIDATE** the debts transforming them into a **VIRTUAL CURRENCY**. They failed to truly understand honestly what is **MONEY** and that has doomed the system to fail.

## THE CONSEQUENCE OF FAILURE

Some pure **Free Market** believers will argue that the euro experiment is a dismal failure and it should be just left to collapse. Why bailout anyone and leave the weaker nations default on their debt, do the write downs accordingly, reduce the balance sheet of pension funds, and other banking and insurance companies. After such an economic apocalypse, then restart the system as it was from a sounder base. This is easier said than done. You are expecting the new layer of Euro politicians to simply give up their cushy jobs and go home. **NOT LIKELY!** They will fight to the bitter end to keep their power and status.

Additionally, this would be an economic mess and the holders of such debt are by no means exclusively European. This is why I have warned the **DEBT** had to have been **CONSOLIDATED** because **ALL** sovereign debt of the member states serves as **RESERVES**. This is a different status from localized municipal debt. The contagion may be incalculable. Much of this debt is also found in pension funds and now we default on private pension unsettling the future expectations even greater. The consequence of failure will have a ripple effect, but **ALL** government debt around the world is really junk. A failure in Europe will only cause capital to flee from everywhere. Herbert Hoover wrote in his memoirs (*MacMillan Co., 1952*) this comment on the economic crisis that hit in 1931 from the sovereign debt defaults.



Herbert Hoover  
(1874–1964)  
(President 1929-1933)

**"During this new stage of the depression, the refugee gold and the foreign government reserve deposits were constantly driven by fear hither and yon over the world. We were to see currencies demoralized and governments embarrassed as fear drove the gold from one country to another. In fact, there was a mass of gold and short-term credit which behaved like a loose cannon on the deck of the world in tempest-tossed era."**

We can see that not even a gold standard prevented sovereign debt defaults. It matters not what the currency base might be. The threat of sovereign debt defaults will destabilize the **ENTIRE** global economy and drive markets absurdly crazy to heights of volatility never before witnessed.



Here is a chart showing the British pound during this period and Britain went into a moratorium on debt payments rather than an outright default, yet the price actions of the pound was no tremendous almost as if Britain defaulted. Nevertheless, the socialistic agenda in Britain succeeded in creating a 72 year bear market from 1913 into 1985 marking the decline and fall of the British Empire. Yet we can see clearly the price swings during the 1930s Sovereign Default period has not been witnessed ever since. The consequence of failure could rip a hole directly within the fabric of the world economy that is not repairable for decades.

The propaganda of the bankers that they are *“too big to fail”* only encourages a sequel of bailouts. There will always be this same excuse to line their pockets at the expense of society. It is the only industry that constantly screws up and gets bailed-out every time. It is simply **NOT** true that they need to be bailed-out at taxpayer expense every time. There are plenty of smaller firms that would rise to occasion upon their demise. The only thing that is *“too big to fail”* is government and to save that we need real honest political reform combined with a restructuring of the monetary system. What is presented here is just **PART 1**. There is much more that needs to be done.



## IT'S A QUESTION OF TIME

From a timing perspective, the Bretton Woods System actually began with the operational start of the **IMF** on March 1<sup>st</sup>, 1947 (1947.164). The Euro began officially on January 1<sup>st</sup>, 1999 (1999.002). The birth of the Euro essentially completed the 51.6 year cycle between 1947 and 1999. The collapse of the Euro appears to be due no later than 17.2 years from its birth making the ideal target 2016.202 just 23.5 weeks ideally **AFTER** the peak on this current **Economic Confidence Model** wave 2015.75. The immediate start of that crisis however is **NOW** which is ideally due November 25<sup>th</sup>, 2011 (2011.902) (8.6+4.3 years from 1999.002). These are standard durations for such events – how long they normally take to unfold. The Euro **FAILED** to create a **Single Currency** and now the **Virtual Currency** will tear the system apart. Those who have called for a consolidated EuroBond have been merely looking at the prospect of individual default. The failure to have **CONSOLIDATED THE DEBT** left the system vulnerable to attack. This stems from the misconception of what **MONEY** is as a core function – the **Medium Of Exchange** not a **Store of Value**.

*(see warnings of 1997)*

