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**Sound and Unsound Public Policies
Addressed to the Crisis of Modern
Financial Systems**

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Sound and Unsound Public Policies Addressed to the Crisis of Modern Financial Systems

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Abstract

Current crisis is only a temporary form of a deeper systemic crisis generated by some mistakes produced by monetary authorities in combination with governments. Apparently this crisis is the result of capitalism or private market failure, but this crisis is generated by problems induced in the global economic system by fiat money production and problematic public policies used to neutralize its chaotic effect (fiscal policies, monetary policies). If we want to solve the current crisis we should understand properly the real nature of these crisis and their causes. Only an appropriate understanding of this situation could produce sound policies and solutions to it. This paper includes an analysis of modern international financial system providing a good sight on the weaknesses of it, from the perspective of quantitative theory of money. Starting from this analysis, the paper discusses different sound and unsound solutions applied or proposed to be used to cure this problem that became more and more disruptive.

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Introduction

The current crisis activated the debates around the role of money and monetary policy for the stability of international financial system. The main modern theoretical approaches seem to failed in explaining the crisis and in finding an appropriate cure for it: [1] (neo)Keynesian economics (Keynes, Hicks, Phillips, Samuleson, Baumol, Tobin, Williamson, Mundell, Lerner, Krugman, Stiglitz, McKinnon) agreed on money production by a central banks together with commercial banks (using fractional reserve system) considering prices (goods and services and wages but not the capita) to be sticky (due to contractual limitations, due to the limits of negotiations) and the use of fiscal policies to be effective in neutralizing the effect of monetary policies; [2] (neo)Monetarism (Fisher, Brunner, Cagan, Meltzer, Friedman, Minsky, Phelps, Weintraub) worked with money production by central banks and with fractional reserve system too but considered prices do not be so sticky and the fiscal policies do not be so effective in reducing the inflationary effect. They hardly searched for an optimal monetary policy recommending not an “excessive” increase in the volume of money or proposing the limited open market operations for central banks (criticizing the use of repurchase agreements, the issue of financial instruments made by central banks in order to control the broad money).

Mainstream approaches in terms of money and monetary policy followed mainly these two directions. But in economic theory, a limited and marginalized group of theoreticians continued to argue against the violation of quantitative theory of money and against the presumed neutrality of money production (Menger, Heilperin, Mises, Rothbard, Hayek, Salerno, Hulsman, Baggus and de Soto). Austrian Economics continues the classical economics in terms of money (the title of neo-classical economists attributed to (neo)Keynesian being inappropriate in this case). The main arguments against fiat money production (so called “modern money”) are: [1] the monetary inflation is the only inflation relevant for economic decision (any natural increase or decrease of prices having positive influence in the allocation of resources and this evolution transmits an useful information not only for providers of the goods and services regarding the market conditions, but for consumers too, regarding the changes in their preferences); [2] the money production from nothing violates the Law of Say that demonstrated that there is no economic good that could be produced from nothing (J. B. Say, 1803 stated that for being able to buy and to consume something you should be able to produce something valuable for the economy); [3] the fiat money production violates the law of diminishing marginal utility of any good including money expanded by monetary authorities (any new quantity of money produced and introduced in the economy will have a lower marginal utility and the utility of money is measured through its purchasing power; for this reason Mises, 1912 claimed that the neutrality of money is an impossible concept); [4] the production of paper money has a very significant redistributing effect (discovered firstly by R. Cantillon, 1755 in 1755), the first people that will

obtain newly produced money will be richer than the last; [5] the production of money influences the level of prices in the economy (only with the production of money the generalized and continuous of prices is possible in the economy); [6] the production of paper money influence the structure of production in at least two ways: firstly, the patterns of consumption of the people that obtain firstly the newly produced money will influence the entrepreneurial decisions and secondly, the political entrepreneurs (those that are closer to the process of money production – central bankers, commercial bankers, institutional investors, life insurers, public companies, public servants and private companies working with the state and public funds) will try to gain more and more privileges that will suffocate the good economy and good capitalists (the Gresham's Law clearly stated that “bad money will drive out good money in case of a legal tender on money” that could be simply translated to “bad industries (those who produce, expand, clean, transport, secure money) will drive out good industries in case of a legal tender on money”) (Hullsmann, 2008); [7] the economic stability and the structure of production is dramatically altered by the influence of money production on the level of interest rates, this being the major source of entrepreneurial error in the so-called “market economies” (Salerno, 2010).

The mainstream theories (including both Keynesian and Monetarism economics) failed in explaining and curing the modern financial crisis because they operate with wrong concepts of money (confusion with capital is only one of the problem) and wrong understanding of the financial contracts used to withdraw savings from the population (demand deposit is interpreted by banks as a loan that gives the right to the banks to borrow money to different other users; time deposit is viewed as a demand deposit with the right of deponents to withdraw money any time they want etc.).

2. Evolution of international financial system

International financial system could be defined from two perspectives: (1) a set of rules and regulations accepted by all participants to the system that want to invest capital or to borrow capital to develop their projects and (2) a system of financial markets (money markets and capital markets), financial institutions (private, public, depositary, non-depositary) and financial instruments (direct and indirect investment instruments) used to ensure the transfer of the capital among investors and beneficiaries, with the lowest associated cost and risk.

The history of international financial systems revealed the following different stages that propagated problems until present:

[A]. Gold standard (until 1914): In this phase we can distinct between gold standard without central banks (until 1668) and a phase of gold standard with central banks (1668 – 1914). The gold standard operated without fractional reserves (not officially recognized and fully penalized by justice) and with fractional reserves (officially recognized by the monetary authorities). The creation of central banks is highly correlated with the idea of a last resort bank

for financing huge public projects (mainly wars). The history of central banks is full of examples regarding a direct connection between their creation and wartime: (1) Bank of Sweden provided important financial support for the Great Northern War (1700 – 1721); (2) Bank of England created in 1694 in the middle of Nine Years War (1688 – 1697) saved the British fleet after the Battle of Bévéziers (1690); (3) First Bank of United States financed the Independence War (1776-1783); this bank was replaced by Second Bank of United States that functioned until 1836. Between 1836 and 1862 United States functioned without central bank but Civil War imposed a Comptroller of the Currency that was transformed before First World War in 1913 into Federal Reserves; (4) Bank of France created in 1800 financed Napoleonic Wars; (5) Bank of Prussia created in 1765 to finance the implication in the Seven Years War; (6) Bank of Romania was created in 1880 to buy back the treasury certificates issued to finance the Independence War (1877-1878). Central banks offered a good alternative to taxation system for financing such national projects. This institution continued to offer this kind of support for this kind of activities (modern wars were financed mainly through the same source). On the other hand, the supporters of the creation of the central banks were not only the public servants or sovereign authorities but the commercial banks interested to increase the volume of credit expansion through fractional reserve system. With a central bank this activity finally became “legally” recognized and this institution represented a good guarantee for the stability of such financial systems (Figure 1A).

The fundamental features of this phase in the evolution of international monetary system are:

- The quantity of coins and notes (M_0) was fundamentally linked with the existing quantity of gold. Any increase in the existing money substitutes in a country was possible only with an increase of gold reserve produced by mining industry or by international trade.
- The currencies available in the system are very few;
- The exchange rate between them was fixed and determined by the rate against gold;
- The central banks existed in the last period and had a function concentrated in the administration of the system (central banks were less involved in the money production);
- The monetary systems operated with official fractional reserves mainly after the creation of central banks.

Gold was not randomly selected by market as a sound medium of exchange. The characteristics of this asset (good) imposed it as such (sound money): the divisibility, the impossibility to be artificially produced in huge quantities without relevant cost, stability in time, cognoscibility, homogeneity, portability, indestructibility (S. Jevons, 1875).

[B]. Gold bullion standard or gold-exchange standard (1925 - 1931): After the First World War the most developed countries (United Kingdom, France, Germany, United States) tried to establish the pre-war rate for their currencies

(a return to gold species standard). In fact, there was impossible to set a direct and exclusive link between all the currencies and gold, at least from the following reasons: (1) small countries that gained independence after the war did not have gold reserves to produce local money; (2) the most developed countries discovered the advantage of producing money from nothing and to allocate this resources in the favour of them. This phase of the international financial system included two different categories of countries: the most developed countries with enough gold reserves that imposed their currencies for international reserves of small countries and that promised to them to keep the quantity of money supplied on the market equal with the quantity of gold deposited in the central banks (after the war the major central banks started an aggressive policy to buy gold from the private hands) and small countries without gold that accepted to print their own local currency in accordance with their international reserves composed by gold and international currencies (Figure 1B). The possibility to increase de volume of local currency was to export more goods and services paid with international currency. The “aggressive” behaviour in terms of foreign trade became decisive for the wealth of nation. The monetary role of gold dramatically decreased and the importance of fractional reserves increased.

The fundamental features of this phase in the evolution of international monetary system are:

- The quantity of coins and notes (M_0) was determined partially by gold reserves and partially (mainly) by international currencies.
- The currencies available in the system significantly increased;
- The exchange rate between them started to be variable;
- The central banks existed in the last period and had a function concentrated in the administration of the system (central banks were less involved in the money production);
- The monetary systems operated with official fractional reserves mainly after the creation of central banks.

The main problems associated to this phase of the system are: the production of money increased and the link between local currency volume and gold became formal (for the developed countries) and the small countries started to speculate and to change their international reserves from a more inflationary currency into less inflationary one (massive quantities of international currencies were offered in a short period of time). The competition in production more money (in order to increase the “competitiveness” of your exports) between the most developed countries and the lack of monetary cooperation significantly increased the instability of the system and pushed global economy in the first major recession (Great Depression).

[C]. Gold – Dollar Standard (1945 – 1971): This phase was initiated by United States and United Kingdom since before the end of Second World War as a better solution to the previous phase. The decision was to link the dollar with gold by announcing a fixed exchange rate between them (USA concentrated around 70% from total gold reserves of the world). The other

currencies were pegged to gold into an almost fixed exchange rate regime established as a narrow band of +/-1% from an official established exchange rate against dollar. The fixed exchange rate against dollar was only formal because Bretton Woods agreement stated the exceptions in terms of depreciation of the local currencies when a country registered significant “balance of payments disequilibrium” (if the depreciation was lower than 10% it was not compulsory to notify it to the IMF, a higher depreciation was compulsory to be notified).

The fundamental features of this phase in the evolution of international monetary system are (Figure 1C):

- The quantity of coins and notes (M_0) was determined by the quantity of dollars obtained from exports and from capital transfers (in this phase the development of Euromarkets was produced by this huge interest to grasp dollars from international commercial and financial transactions);
- Exchange rate was fixed to dollar in a narrow band (but the countries were free to depreciate their currencies in case of significant deficits of the accounts from the balance of payments);
- The dollar was fixed to gold (35 dollar for one ounce);
- IMF was created to: offer temporary international currencies from the quotas system to solve the balance of payments deficits; to encourage monetary cooperation (to avoid the competitive depreciation practiced in the previous phase) and to offer consultancy for monetary issues to the members;
- World Bank was created to offer extra funds for financing the development of less developed countries;
- The central banks existed in the last period and had a function concentrated in the administration of the system (central banks were less involved in the money production);
- The monetary systems operated with official fractional reserves mainly after the creation of central banks.

The main explanations regarding the failure of this system (the phase resisted almost three decades) are related to (R. Triffin, 1960): (1) The countries interested to increase their broad money exported more goods and services to United States that increased the aggregate supply and decreased the level of prices there. In the exporting countries, the aggregate supply decreased so the level of prices increased (the system was built the transfer efficiently inflation from USA elsewhere in the world). (2) The commercial deficit of USA and budgetary deficit produced by public expenditures (Cold War financing) required significant financial resources that decreased the confidence in the obligation assumed by USA to keep fixed the ratio between broad money and gold reserves (IMF had no rights to control this obligation of Federal Reserves). (3) The unclear mention about the right to depreciate your own currency (that “major disequilibrium of the balance of payments”).

In our opinion, this shape of international financial system suffered of the same problem with the previous shape: the money production through credit

expansion located outside of central banks that allowed fractional reserves to commercial banks. The fractional reserve system represents, in our opinion, the cause of the failure for both systems. The creation of money substitutes made by commercial banks could not be controlled by the central banks and it is impossible to estimate how much M_3 is created by printing M_0 . But in the economy the monetary aggregate M_3 (created by commercial banks and including money printed by central bank) acts as money with the same characteristics as coins and notes produced by central bank. So, the volume of international reserves (including gold) is impossible to be fully controlled by a monetary authority when the banking system uses fractional reserve privilege. The same problem existed in the case of dollars produced by Federal Reserve that (maybe) equalized the quantity of gold reserves but the dollars multiplied by commercial banks were impossible to be set equally with the quantity of gold reserves (there is no fiat gold, only fiat money). This impossibility for United States to defend the fixed price of gold in dollars and the impossibility of participating countries to defend efficiently their fixed price of dollar expressed in the local currency is the major cause of the failure for international financial system.

[D]. Exchange standard or no standard (1971 - present): After the breakdown of the gold-dollar standard in 1971, international financial system functioned without clear restrictions. The most significant regulations internationally adopted specified that: (1) the most developed countries could adopt free-floating currency regime (the macroeconomic strength ensured the necessary stability of local currency); (2) the currency of these developed countries will be used as international reserves assets; (3) the monetary role of gold was definitely removed; (4) the countries with less developed economic system were forced to administrate their exchange rate by pegging the local currency to a single strong currency (with free-floating regime) or to a basket of currencies (Figure 1D). The first currencies that declared their free floating regime (beside dollar) were: British pound (1972) and Swiss Franc (1973). European currencies declared their free floating in 1973 by adopting the “snake” form of European Monetary System. From that moment, in the system existed more currency options for international reserves. The role of IMF to establish the monetary policy for each member country was removed in 1977. From that moment, each country was free to choose the most appropriate monetary or foreign exchange policy. Fiat money production started to be a regular and common practice (in accordance with mainstream economic approaches developed for this kind of economic system operating with this kind of money). Central banks developed different monetary and foreign exchange policies, in order to neutralize the effect of money production: targeting the monetary aggregates; targeting the level of prices (inflation targeting) or targeting the exchange rate (using different currency regimes like dirty float, bands, crawling peg, currency board etc.).

The fundamental features of this phase in the evolution of international monetary system are:

- The lack of restrictive measures for money production;
- The local currency volume is correlated with the volume of foreign currencies obtained from exports, FDIs, FPIs or external debt;
- The system operates with central banks and fractional reserves;
- The system kept IMF and World Bank with a limited role in the international monetary coordination.

The main problem of this system consists in the presence of circularity problem when a central bank set the volume of local money (Figure 5).

The quantity of Swiss Franc is correlated with international reserves of pounds (and gold). The quantity of pounds is correlated with existing international reserves of Swiss Franc and gold. Without any objective basis for dimensioning monetary aggregates, the production of money in any country with currencies that are used as international reserves has no limits. The problem is more complicated for a country without such full convertible currency that is not used as international reserve. The instability of exchange rate and prices are very high. The problem is more complicated when this money produced by the central banks are introduced in a system operating with fractional reserves. In this case, there will be no relevant correlation to be made in order to obtain an optimal monetary policy or a neutral money supply. The crisis is the result of this circularity in the money production. The solutions to solve the crisis involved an additional production of money (to bail out the erroneous allocations and to keep alive bad financial industries) that produced more confusion and more chaos.

3. Unsound solutions for current global crisis

When the real causes of crisis remain unclear, the solutions proposed were not effective and will propagate more the existing crisis. After years and years of “solutions”, the crisis significantly expanded and the time between them was significantly reduced, the crisis including, in fact, unsolved problems from the previous ones.

In the economic literature we can find a lot of pseudo-solutions that were incapable to solve the real causes of crisis:

[1] *The need for more regulation of financial systems*: Stiglitz, 2010 argued that the financial markets are unable to self-regulation. The regulations have, in his opinion, the role of restricting the profit maximization behaviour of bankers, their inadequate corporate governance, their innovative initiatives or their lack of transparency. In fact, the financial system is one of the over-regulated systems (or markets), even before crisis. There are a lot of restrictions available to the level of commercial banks: restrictions to invest money from deposits; restrictions to operate with fractional reserve; restrictions to financial leverage of the bank, restrictions regarding minimum equity capital to open and to operate a bank; restrictions regarding financial products and services; restrictions regarding the financial contracts (credit contract provisions). The financial system has no problem with freedom of action due to missing legal provisions but problem with wrong regulations “imposed” to the

banks that stimulate their wrong behaviour. The central banks approved a lot of regulations that are in fact privileges for commercial banks accepted to be money creator, as central banks are. It is not fair to claim the lack of sound self-regulation behaviour of bankers facing with huge moral hazard created by banking law that is defended by central banks (Iacob et. all, 2010).

[2] *Introducing a tax for short term financial flows*: initially this idea was promoted by J. Tobin, 1978 for global market. This tax was already applied in countries like Sweden, Columbia or Japan. In September 2011, European Commission proposed a tax of 0.1% for bonds and shares and 0.01% for derivatives by arguing that this measure will reduce price volatility, may decrease the liquidity, will slow price discovery by market participants and will reduce the prices of the shares (Krugman, 2009). In fact, this tax is a solution proposed in the spirit of Keynesianism that considers fiscal measures as being effective in neutralizing the monetary effect on shares' prices of monetary expansion. The tax will remove the incomes from the investors and will transfer them in the hand of public decision makers that will use discretionary for covering their deficits and public spending. It is impossible to separate between investors and speculators and to penalize such "wrong behaviour". This tax will altered the prices on stock exchange and will make them less sensitive to any change of fundamentals of companies listed on stock exchange. The prices will be less volatile or less influenced by market liquidity but more disconnected from

[3] *Introducing a single global currency*: This idea was not new and was initially promoted by International Monetary Fund after the breakdown of Bretton-Woods agreement. This global currency it is viewed mainly as a solution to the volatility of exchange rates (Aliber, 2011, pp. 338-339). The real problem with this measure is related to the institution that will be empowered to issue such currency. This currency will be not natural money and will resist only with aggressive support. The lack of existing competition between different currencies will complicate more the problem and will introduce more moral hazard at the level of public sector;

[4] *Using a currency basket composed by the most relevant currencies*: one version of this solution was proposed by Williamson, 1985 - the use of a synthetic effective exchange rate called "Fundamental Equilibrium Effective Exchange Rate" periodically adjusted and that includes the most important currencies of the world grouped in a "target zone system". Each country that has a currency not included in that basket should keep it in a band of +/- 10% (Egert and Evil, 2005). This system is weaker than Bretton Woods System because has the problem of circularity of fiat money production described in this paper. The production of money by central banks will divide the world into two parts: countries with currency included in FEEER and countries that are not included in that basket of currencies. Without any intrinsic value associated with each fiat money of FEEER, the basket will not be stable and will have the same problem as any fiat money controlled by a discretionary authority.

[5] *The monetary control*: is a solution that is focused on coordinated monetary control. The monetary authorities from different countries (especially

those with hard currencies) should correlate their quantity of money (monetary aggregates). The correlated growth rate for these monetary aggregates could ensure a better stability for exchange rates (McKinnon, 1981; Kato and Semmler, 2005; Rose, 2006). A similar correlated coordination on the quantity of treasury bonds issued by different countries could ensure a higher stability of interest rate. In fact, this proposal is ineffective in a monetary system that operates with fractional reserves (the central banks has no objective criteria to estimate how much is expanded one printed monetary unit by the commercial banks that use fractional reserves). The creation and destruction of money is impossible to be coordinated between monetary authorities that have no possibility to know how much money is expanded in the whole system.

[6] *International capital movement controlled by market authorities*: The openness of capital account from balance of payments it is viewed by few economists as a source of crisis. Initially, foreign investors and creditors from developed countries flooded a developing country with their money and suddenly they withdraw financings at the first sign of a macroeconomic problem. The movement of capitals in this case is associated to the crisis and capital controls could be effective to protect a country against such behavior (Magud and Reinhart, 2007; Pasini, 2011; Yeyati et al., 2009). The real problem is not the volume of these international funds available to be invested on emerging economies and that could be easily transferred from a country to another. If these funds are real savings (resulted from a sacrifice of present or past consumption) that already produced an effect in the source country, the movement of them will be not quite easy. Moreover, the freedom of these capital funds could be vital for emerging economies that register low saving rates, providing a good chance for the development of capital goods industries (that could increase the technological level of emerging countries and innovative capacity).

[7] *Introducing new operating procedures for financial systems*: The financial system is considered as a deregulated one and the crisis was produced by the lack of rules regarding financial leverage of banks, bonuses system proposed for top managers (a lot of banks continued to pay them after the government bailed-out the system) or the risks that the banks should assume in their financing operations (Roubini and Mihm, 2010; Talbott, 2009). In fact, the financial system is the most regulated system. In this system the price of capital (interest rate) is almost totally controlled by central banks (the state) through direct and indirect monetary instruments. More regulations applied to the banking system will make it more complex and bureaucratic. The connection of the commercial banks with the state is very strong: the banks are forced to invest the deposits only in the treasury bills issued by the state and the state and the central banks provide any necessary liquidity for them. The commercial banks are viewed as private business but, for almost their activity (credit based on fractional reserves, the refinancing operations with the central bank, investment in government bills), the banks operate as a government body. The problem is not the mixture between investment banking and commercial banking (the idea of universal banks) but the fatal mixture between sound

banking (private savings, private loans) and unsound banking (the privileges offered by state and central banks). The problem is not the lack of regulations but wrong regulations applied to this sector.

If we add to all this unsound solutions the *permanent and unconditioned bailout of financial sector* using different governmental programs (TARP for instance), the *privileged access to zero cost liquidity*, the *increase of weight of investments of commercial banks in governmental bodies* (that increased public debt and public deficits) we can easily see that the problem became more and more complicated and without a sign of recovery for long period. In fact, these solutions altered more the private sector and kept alive the unsound economy that did a lot of errors in the past (before crisis). These measures are very ineffective and are made in the spirit of more interventionism as a solution for the failure of interventionism.

4. Sound solutions that could solve the crisis and could stabilize the system

The current international financial system operates only with fiat money (all the currencies are produced without intrinsic value). All the problems that generated the crisis are derived from these misunderstandings regarding the nature of money and capital. The sound solutions that could correct the situation are the following:

[1] *Introducing 100% reserve banking system*: This will remove the commercial banks from the process of money production from nothing. The money from demand deposits will be kept 100% in the accounts of the deponents and will be not borrowed simultaneously to different people (Huerta de Soto, 2009). The money volume introduced in the global economy will be significant lower and this will make exchange rates and interest rates more predictable and more connected to market conditions;

[2] *Modifying the condition of term deposit contracts*: Term deposits are now treated as demand deposits that give to the depositors the right to withdraw their money before its maturity. In this case the banks are always exposed to liquidity risk and are in the position to claim their recovery from the central banks;

[3] *Interest rate for refinancing the commercial banks should be removed or should be significantly increased*: Today the central banks are the main providers of money as “capital”. The central banks granted a very important privilege to the commercial banks (and indirectly to the state that sells securities to banks): to borrow money with almost zero cost. This is very profitable for all of them but this monetary policy destroys the real savings (the cost and the stress for banks to gather private deposits is significantly higher than the cost of obtaining liquidity from the central banks) and induce a very harmful moral hazard. This moral hazard is the real cause of a lot of problems: [a] a wrong governance in financial institutions; [b] hazardous investments in risky instruments; [c] the greed of bankers or investors to gain from their “speculations”. This measure will automatically increase the weight of equity

in the total liabilities and will improve the interest of banks to recover their lack of liquidity by attracting deposits from the investors (savers);

[4] *Commercial banks should be limited in their investments in treasury securities*: the weight of state securities in the total assets of banks should be limited to no more than a value (10% for example). This will reduce the appetite of public entities to waste their resources on projects without economic value and to be more careful with deficits and public debt. The role of state on financial markets will be significantly reduced and the interest rate will be lowered and closed to capital market conditions;

[5] *No bailout schemes for financial institutions*: This privilege is unique in the whole economy, the banks and other financial institutions benefiting from this bailout implied by “too big to fail” institutions. The difficulty to declare bankruptcy for an “important” bank or insurance company generate a very harmful moral hazard (the bank being encouraged to be involved in more and more risky credit operations);

[6] *Reintroduction of gold as money*: Is the most difficult but the most reliable measure that will replace the “legal” and imperfect money that we are forced to use today as medium of exchange with natural money discovered by market selection after many years of exchange. The gold will provide real intrinsic value for money and will keep away the public entities from the production of money. The use of gold will eliminate the foreign exchange risk providing more transparency to all fundamental prices: interest rate, prices for factor of production. The entrepreneurial decision will be significantly improved by eliminating political and monetary intervention. The real entrepreneurs will not be aggressed anymore by the actions of monetary and political entrepreneurs that are using their power given by the authority to produce money to create their own profits. The structure of production will be not harmed by the production of money. The current “boom” and “recession” cycles will be replaced by natural evolution of economies based on their real competitiveness not on a false one induced by international depreciation of currencies. This is the most difficult solution requiring a very strong political support. It could be introduced step by step: introducing a competition between any types of commodity to be used as money (the right to use any money you want for your transaction); a strict control on the production of money operated by central banks (monetarists suggested a growth rate not higher than 3% that is quite closed to the growth rate associated to gold production); total liberalization of gold market (including the public gold reserves located in the central banks).

5. Conclusions

Current crisis opened strong debates regarding solutions recommended to solve the problems. The solutions provided by Keynesists and Monetarists have no positive impact and pushed the global economy in a deeper recession. The sound solutions are clear but are very difficult to apply due to the lack of

political support (the number of net beneficiaries from the current financial system based on fiat money being more than the net losers). The real entrepreneurs involved in productive processes are more and more aggressed by political entrepreneurs (those that have the power and privilege to sign contracts with the state financed by securities bought by commercial banks and refinanced by central banks) and monetary entrepreneurs (commercial banks, financial institutions that benefit from unfair privileges offered by central banks). After years of monetary socialism and market interventionism, the real economy and markets are shutting down their operations. Any sound solution becomes more and more difficult to be applied and any measure that defends the current status-quo is considered providential.

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Appendix:

Figure 1A: The functioning of Gold Standard



Figure 1B: The functioning of Gold-Exchange Standard

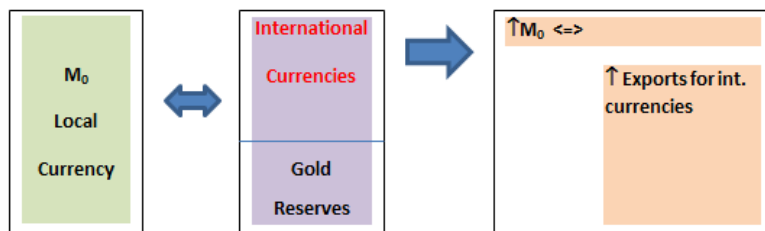


Figure 1C: The functioning of Gold-Dollar Standard

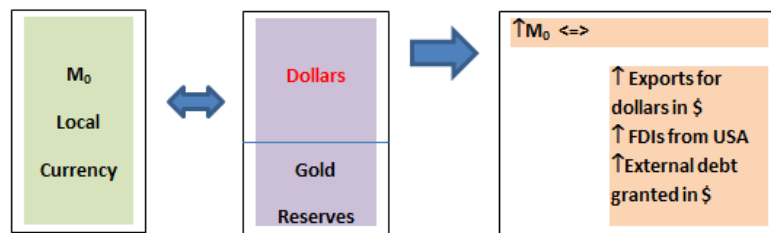


Figure 1D: The functioning of Exchange Standard

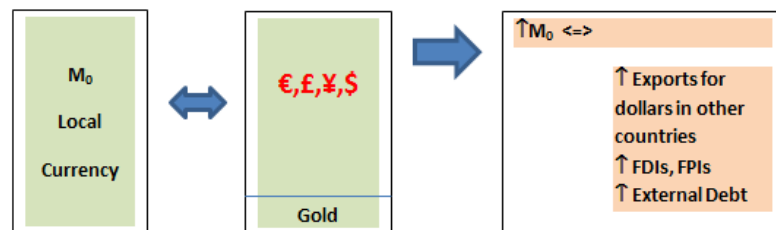


Figure 1E: Circularity problem in modern international financial system

