

Mesmerized

The technocrats, bureaucrats or *fonctionnaires* are coming. More dark suits, more dark ties and more dark indifference towards the electorate. Who ever thought the push to support the Euro would threaten democracy? What's the definition of an expert? A guy from out-of-town with a briefcase. That's this crowd, well removed from the real world, but probably very familiar with *le Guide Michelin*.

A Canadian friend who lives in central France recently observed that his six immediate neighbours all wanted to jettison the Euro and bring back the French Franc. All six, no exceptions. The rest of Euroland is probably not that different, but that's not the message from the political or bureaucratic elite.

My God, they are all tiresome. They have put a new twist on the word propaganda. Yes, sir, to devalue from the Euro, to eliminate all or part of the Euro, would be a fate worse than death. Why? Because all the bureaucrats' bureaucratic friends in Brussels, Frankfurt and so on would be out of a fat job. Who would pay their pensions? Who would pay rent on the palatial Euroland offices?

We heard the same lamentations a decade ago when Argentina was considering devaluing by cutting the dollar/peso link. "Oh, no, you can't do that" cried the US, the IMF and the big New York banks. "You must send interest rates to the moon, you must protect the peso." But Argentina devalued anyway, repudiated the debt, and was much the better off for it. Several years later they settled with the bond holders (at about 30 cents on the dollar?) and life went on.

Throughout the sweep of history individuals, corporations and countries have hit the wall. Doubtless they have been criticized, probably with justification. But at least some of the blame, and often most of the blame, should be levelled at those well-heeled managers who (with other people's money) bought the bonds, or advanced the credit without doing a scrap of due diligence on basic matters like asset coverage and earnings coverage. As we have said before, if you give a drunk a case of whiskey, what do you expect? Is there any real difference between the drunk and a politician in the grip of financiers? Just

how did Greece (and Europe and the US and, and...) all get themselves into the current mess?

But what is far more unsettling than the bureaucrats' incessant attempts to put lipstick on a pig is their blanket refusal to think about, let alone create, a monetary system to serve mankind in the future.

This lack of system, this lack of discipline, this lawlessness is why we are in an unprecedented, and irreparable, global fiasco. The President of the Dallas Federal Reserve (Mr Richard Fisher) recently noted, on Canadian business television, that the greenback was a fiat currency, but he could have noted that all currencies are fiat currencies these days. No matter, few in Europe and fewer in America know what fiat means – perhaps a funny little Italian car?

For well over 2000 years until the 17th century we had a monetary system that was cumbersome, but it worked. It was bi-metallic, gold and/or silver. Nothing else. However, "cumbersome" was an understatement – it might cost 30% of value to transport a lot of money from Genoa to Antwerp. Moving chests of gold ducats, silver pesos and silver taels needed horses, wagons, guards and a lot of time and travel expenses. Barbary, English and Dutch pirates made transport by sea a dubious alternative.

Silver discoveries in Eastern Europe and Japan plus huge gold and silver discoveries in the New World lifted the economy out of the Dark Ages (when there was not much trade at all) and lubricated the Renaissance. They helped finance expanding trade (and lots of wars) from the 16th century on. As well, new tools, instruments and laws (Isaac Newton's laws on action and reaction, Boyle's laws on behaviour of gasses and many others) all helped boost economic activity. One law that was enunciated during that period was Gresham's Law (bad money drives out good), a truism that manifested itself with the advent of Central Banks in the 17th century, and with them the gold standard. The gold standard enabled a Central Bank to issue paper notes in proportion to gold held in the vault. These notes were seen as being as good as gold and were in fact as good as gold so long as the bankers didn't stretch Gresham's law.

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The simplicity and effectiveness of the gold standard substantially reduced the cost of doing business and really greased the economy and what became the Industrial Revolution from the 17th century. It also kept inflation under control. Sir Isaac Newton was, interestingly, one of the early Governors of the early Bank of England.

However, after a two hundred plus year run, the gold standard pretty well came to an end with WW I, the first (but not the last) big war to be financed by borrowing and printing. After the disasters of the depression and WW II Bretton Woods was created and lasted a mere 25 years before being destroyed by the technocrats and the political elite forty years ago. This delivered us into a monetary wilderness and people cheered. As stated by the rock group Dire Straits, "Get your money for nothin'..." It is considered inconvenient to mention Gresham's law today because it's not just some money that is bad, it's all money, trillions upon trillions, that is bad. Mr Fisher spoke the unspeakable.

The first fiat empire set to fail appears to be Euroland. Even German bonds are having a rough go –

presumably markets have concluded that Frau Merkel will ultimately capitulate and print. The technocrats still dream that investors can be induced into buying more Sovereign bonds but la la land has changed. Investors are finally doing their homework and now they don't want to hold any of the toxic junk, let alone buy any more. This presents a bit of a problem since all governments need to borrow ever increasing quantities of money to stay afloat.

But the real chaos will start when fear of Sovereign debt moves across the Atlantic where investors are sitting on unheard of volumes of paper, none with any shred of asset value backstopping it, and all placed when people thought "Well, governments can always raise taxes to service this stuff." Sure.

Gresham, or his ghost, could never grasp that matters could get so far out of hand. Nor can markets, so they generally sit like rabbits on a road staring mesmerized at oncoming lights. But there is no sense complaining – the trick is to ascertain where the disenchanting bond money, the disenchanting currency positions, will go and, in our view, the most important place will be the stock market.

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