

# The Fraud Known as Fiat-Money

## Money is not created as Equals.

There are three different forms of fiat-money. First, there is cash, the coin is an asset of the Treasury and banknotes are the debt of the central bank in physical form, available to anyone. Second, there is funny-money or reserves in the central bank's accounts, which are liabilities of the central bank in digital form, which do not circulate as money and only are available to financial institutions. And third, commercial bank ledger-money, which represents ~ 97 of all fiat-money in circulation, exists solely as a fractional reserve digital liability of commercial banks in the form of deposits. These three, totally different and incompatible forms of money are forced into a parity-based exchange via a central bank, i.e., one form of money may be easily converted into another type of money even when they have nothing in common other than a unit of account.

The simplest test for any form of money is its redeemability into something with intrinsic value, a metallic coin has use or intrinsic value equal to its exchange value via its base metal, which must always be less than its face value. A banknote only has value if it has sufficient liquidity to exchange for metallic coins i.e., trade a one-dollar notes for 4 x 25 cent coins[1]. Central bank reserves are not money and not legal tender like coins and notes, but rather exist via central bank repos and collateral which has a variable "to market" repo price to cash. This reality can be observed in all modern-day fiat-systems, reserves are never converted into cash in any interbank payment, and often to enable payments to clear, the central bank also supports interbank clearing via **unfunded reserves** which have zero collateral requirements.

Commercial bank ledger money is Endogenous or fractional reserve-based money where only ~ 3% of any bank deposit can be redeemed into cash or central bank reserves at any given instant. The vast majority of this 3% capital backing of commercial bank deposits is held in treasury bonds which are a future dated IOU's which has a daily to market price, this ensures this ~3% banking can never be redeemable before maturity of these future dated Treasury IOU's.

*It is a fraud to pretend that these three types of money can trade at parity when they have nothing other than a unit of account in common, and all but a coin exists as a financial instrument obeying the accounting equation that the net value must always be zero.*

Since around 2007/8 there exists a fifth form of money, that is neither issued by a central bank (not a coin or banknote) nor any commercial bank. This form of money is used by electronic money institutions, consisting of non-banking institutions that are backed by commercial collateral, sometimes called stable coins[2] and commercial bank deposits. This is the case with PayPal, Wise, Venmo, and M-Pesa, which allow its members to make payments with their own-issued liabilities; with these new forms of fiat-money, a member can convert ones' cash or deposits into money in the balance in PayPal or M-Pesa to make payments, and can convert

back that balance into bank deposits or cash again; that is, hence they also trade at parity with the other four forms of money. This digital money is a new unregulated form of money, which evolved since the 2007/8 financial crisis.

Thus, we have ended up with perhaps six totally different and incompatible forms of fiat-money in circulation as payments within a currency area, where all but a metallic coin is ethereal and is not backed by or redeemable in any real-world value today. In fact, no form of fiat-money today can fulfill the unit of account function of money in which all goods and services are priced as central bank cash is constantly debased via inflation and compound interest and the reality that less than 3% of its value is redeemable at any given point in time.

With each new form of fiat-money, its redeemability is remoted to the point that it becomes non-existent, at which point it ceases to clear a payment and hence it ceases to be accepted within any trade as currency. This is the pathway to the final chapter of fiat-money and its relationship to society via its own debasement.

*Fiat-money exist or circulates via acceptance as money to defer a payment for goods and services, until it no longer clears a payment at which point fiat-money value goes to zero, with the sole exception of a metallic coin which alone has "redeemable" intrinsic value (even if less than its face value).*

## **Fiat-money, smoke, and mirrors**

Most people believe that money or currency is involved in bank capital when it never is. Bank capital is always provided out of **bank credit**. A central bank raises capital by the same means but has the additional facility of creating and then redeeming its **own bank notes**, swapping them across its books for permanent capital. For this reason, a note issuing bank or central bank is never stuck for permanent capital. Furthermore, when you read that a bank has permanent capital of a billion dollars, most people think it is paid up in hard money. But it is an illusion funded entirely by bank credit — credit created by the bank itself.

To explain the mechanics of such a fiat-money system, we can refer to how the Bank of England's capital was increased in 1697. The Bank was founded in 1694 to act as banker to the government with an original capital of £1,200,000. In the second half of 1696 the Bank had stopped payment due to a depositor's run on its stocks of silver, brought about by a shortage of new coin following the Recoinage Act of January that year, and its circulating notes fell to a discount of 20% to their face value. To restore public credit in the Bank, Parliament in 1697 determined to increase the capital of the bank by £1 million (the actual figure in the Bank's records was £1,001,171 10s, but no part of the increased capital was actually paid up in hard currency, which was silver (England was on a silver standard at that time). In pursuance of the Act £800,000 were paid in Exchequer tallies (effectively a loan issued to the Treasury by the Bank to allow the Treasury to subscribe for stock) and £200,000 in the bank's own depreciated notes which were taken at the full value in cash. Thus, at the first increase of capital from the original £1,200,000, £200,000 of the capital consisted of its own depreciated bank notes. And the Bank was then authorised to issue its own banknotes to the amount of this portion of the

increase in capital, so that the quantity of circulating banknotes remained the same.

Such are the methods by which the capital of a bank which issues notes may be increased. But the capital of a bank which does not issue notes may be increased by similar means. The essence of banking is to make advances by creating credits or deposits, and they can be used to increase its capital. Suppose a bank wishes to increase its capital and its customers wish to subscribe. In theory, they may pay in currency (that is bank notes) but today that never happens. But they can give the bank a IOU drawn on their account. This is the same thing as paying the bank in its own debt to subscribe for capital. It is the release of a debt owed by the bank to its customer, and that debt released then becomes a matching increase of capital. The recently agreed procedures for bank bail-ins, whereby a failing bank is recapitalised by exchanging bond obligations and large deposits for equity stock, accords entirely with these principals and is the way in which the capital of all commercial banks is increased.

Having clarified the procedures, we can now understand how the global banking system can be recapitalised with nothing but a future dated IOU which is never repaid. With this understanding of fiat-money and banks capitalisation, the full faith and credit in fiat currencies is bound to evaporate at some point in time, repeated on a global scale what happened in John Law's France in 1720.

We shall see in the next section, when money is not anchored in capital or anything of value, it forms the basis of a ponzi scheme where debt-based money is printed to repay the previous issued debt-based money, and the net result is debt is never repaid and the pyramid of debt simply increases, thus the ever increasing debt is the tradition pyramid scheme as defined and executed by fiat-money.

## **Fiat Money-Not Sovereign Money**

Sovereign money is issued by a state authority, sovereign money exists in the form of cash (coins and banknotes) and non-cash central-bank money, called reserves. Such reserves, however, circulate on bank accounts with the central bank only, and hence are not in circulation as money.

Most of the world's money today is private non-sovereign ledger money. It represents around 90-95% of the active money supply in public circulation (M1) in euro countries. Coins account for less than 1%, banknotes 4.5-9%. In Anglo-Saxon countries the situation is similar. Statistically, U.S. cash still accounts for 45% of M1, but in fact most of these dollar notes do not circulate domestically, being held as a safety buffer or circulating as a parallel currency abroad.

Normally, bank money is as liquid as sovereign money due to central bank RTGS based convertible via reserves, i.e., convertible within a Central Bank ledger. But in all modern banking systems sovereign money does not in fact circulate outside of this tiny less than 1% of the total money in circulation. Bank money, by contrast, is not money proper, not legal tender, but is a claim on sovereign money, a claim on having paid out cash, or having transferred such 'deposits' on demand. Bank money is but a balance-sheet item of a bank, thus basically unsafe and unstable. In a banking

crisis, money in a bank account simply does not exist anywhere and there exist no claim upon any bank equity or assets. Bank money, as monetary theory rightly states in this regard, is but a money surrogate we use as if it were money, in fact a cash debt, a liability of the bank to the customer which cannot be redeemed in sovereign money ever.

Sovereign money simply does not exist or provide any basis for a sound financial or banking system in any modern-day economy, as for the most part, demand deposits are backed up with a very small percentage of sovereign money, typically less than 1.5% in the US and the UK, and 2.5% in the eurozone.

The reality is private banks pro-actively determine the money supply, and central banks reactively re-finance the monetary facts the banks have created beforehand. Central banks always accommodate banks' demand. They may do this at higher or lower interest, which may change central banks' and commercial banks' profit margins, but not the volumes of banks' credit and deposit creation because this is highly interest inelastic. The dysfunctions and illegitimate privileges of the present bank money regime are self-evident in each and every cycle of bank runs, and the inevitable taxpayer bailouts or modern day back stops via unfunded magicked up funding from nowhere. We have created a fiat money system which is issued by commercial bankers but guaranteed by the taxpayer.

*The fact remains that fractional reserve banking is unstable and bank money is unsafe, and central bank money is all but non-existent.*

## **Fiat Money vs Sound Money**

Fiat money is generally defined as the currency issued by a government through its central bank. Such a currency is often stated to be backed by the economy of such a government. Fiat money is not based on the value of any commodity and, in fact, is created out of thin air. It exists because the government issuing such currency has assigned a value to it and declared it to be money. Here is where the term “fiat” a Latin word roughly meaning “let it be” comes from.

Central banks issue their own liabilities for use as money (central bank banknotes as money). But the central bank is not the only issuer of money in an economy. The multiplicity both of issuers of money and of payment mechanisms is a common feature in all developed economies. Commercial banks are the other primary issuers, their liabilities (i.e., commercial bank ledger money) representing in fact most (greater than 97% in most nations) of the stock of money. Thus, central bank and commercial bank money coexist in a modern economy. Confidence in commercial bank money lies in the ability of commercial banks to convert their sight liabilities into the money of another commercial bank or into central bank money upon demand, well a small fraction of their commercial bank deposits. In turn, confidence in central bank money rests in the ability of the central bank to maintain the value of the stock of currency (i.e., not only of the small portion it issues directly).

Money represents an obligation of different issuers, and consumers regularly exhibit preferences for holding and using different forms of money, which often vary for different types

of transactions. Yet the perception of the public is such that it uses the various forms of money interchangeably so long as they are denominated in the same currency. Two factors explain this: first, the existence of a form of money (central bank money) which has the support of public authorities and, second, convertibility of other monies into central bank money at par value. The combination of these two factors gives rise to the currency's single character, the certainty that "one dollar is one dollar", whatever form it takes (whether central or commercial bank money). And this "singleness" seems to be a necessary (but by itself not sufficient) condition for a currency to effectively become "the" measure of economic value, or the unit of account, shared by members of a modern economy. In practice, most - although by no means all - payment systems settle not in any form of central bank money, but rather in a financial instrument known as a repurchase agreement[3] or repo.

To facilitate convertibility between different forms of money, central banks support the existence of at least one payment system for their own currency that is widely accessible to commercial banks. Payment systems play a fundamental role in the economy by providing a range of mechanisms through which transactions can be easily settled. In these systems, banks hold funds at a common agent (referred to in the report as "settlement institution"). Payments between these banks are made by exchanging the liabilities of this settlement institution (the "settlement asset"[4]). Deposits at the settlement institution and the credit of the settlement institution (when available) are both accepted as money by all the participants in the system.

Fiat currencies are controlled by the central banks that issued them on behalf of their countries. Central banks then control the stability of such currencies and their supply in the market, via monetary policy. Fiat currencies can easily be moved and carried in comparison with equivalent values in Gold in and silver and other similarly high value commodities. Since all fiat-money is printable or mint-able by the central banks, they can be increased or decreased at will by the central banks or by the government at will, as opposed to rarer metals of high value such as gold or silver. Once too much of such a currency is printed or minted, it can lose value easily compared to other currencies such as the United States Dollar. This often gives the United States Dollar a major economic prowess, which it uses against other countries which may not see eye to eye with the United States on world issues or important matters that may affect lives and economies of countries. In no case is any central bank money used in any modern-day settlement system, in essence central bank money used is never in circulation as money. Central bank reserves when used as a settlement asset only has value when the central banks protect members from all potential losses and liquidity pressures arising from the failure of the settlement institution whose assets are used. The central bank must always bailout all commercial banks to guarantee that payments will always clear even if no reserves exist. To enable payments to clear in any modern-day interbank payment system, most central banks provide intraday credit to banks participating in these systems in quantities which in some cases dwarf the banks' overnight balances or their overnight borrowing from the central bank.

*Central Bank Money is never used as a settlement asset within any payment system today, any failure to clear via a settlement asset, must be underpinned or backed stopped by the central bank as the lender of last resort to the commercial banks. All central bank reserves used to*

*clear payments have both credit, and liquidity risk, which must ultimately be backstopped by the taxpayer in one form or another.*

The value is often assigned in comparison with another currency or currencies and mostly, after the Second World War, all currencies are assigned values in comparison with the United States Dollar. The United States Dollar was, in an agreement in Bretton Woods, New Hampshire, United States, in 1944, assigned a value with respect to Gold and accordingly, the United States Dollar became the measure of other currencies. Some currencies may be measured against a basket of currencies but that is rare, and the United States Dollar remains the main measure of other currencies, to the extent some countries only use the United States Dollar and not even their currencies.

The inability of a country to raise enough United States Dollars to pay for essential goods causes many countries to fail, thus the United States Dollar has recently been used as a weapon to make many countries kneel, has turned the currency into a weapon. Many countries have been cut off the international money and financial systems. Even individual and domestic organizations are sometimes targeted. The result is that many countries now use their own currencies to pay for their trade obligations or other currencies and more specifically for their oil and gas imports, other than the United States Dollars speaks volumes on the trend. This is being re-enforced by the weaponization of the United States Dollar and the currencies allied to it such as the European and British currencies. The use of gold as a currency would help in the decolonization of the monetary system of the region, which remains to date tied at the hip to the international monetary system led by the United States Dollar, maintaining a gold currency would assist each sovereign nation to secure its economic independence and this would add on to its political independence.

Use of gold and the law of one price, with a stable value would lessen inflation, improve local production, link money supply to a physical commodity, and would not allow or assist import deficits as happens today. It would reduce conflict within the region and hence allow people to concentrate on economic development, not only to produce the region's food requirements but also all the other day to day requirements of the region including clothing, equipment, shelters, and housing.

Fiat currencies lose value as they can be printed without any limitation, causing inflation as has been seen many times in many parts of the world. If the world nations develop collectively together, it would, perhaps, be better if they all started together with gold as a "sound currency". This would allow stability and would be a safe haven against inflation. This would avoid debates and arguments on what new currency to be used or the choosing among the prevailing currencies. It would reduce the import bill and would encourage local entrepreneurs to produce goods locally. This would contribute to the growth of the economy and hence the peace and stability of the region. Conflicts in the region result, in the main, from competition on the currently low available resources.

Gold is a stable measure of value for all of the world's commodities and has intrinsic value, as a real-world commodity. Fiat currency has the value assigned to it by the issuing government and

its authorities. It has no intrinsic value. In the long run, gold always wins, so why not use it as the basis to value all currencies.

## **Constitutionality of Fiat Paper Money**

A fiat currency is a monetary system where the medium of exchange is untethered from any underlying measure of wealth or commodity. In a state of nature, sophisticated explanations would be needed to explain why anyone would accept a fiat currency and ascribe value to otherwise worthless paper. Indeed, why anyone would accept any form of currency that is not constituted by objects that have an immediate utility or qualities that sustain life is a phenomenon that begs explanation.

A sociologist might put forward the proposition that participants in the system accept the currency because of the tacit mutual reciprocity that each contracting party expects of the other. An economist, by contrast, might point to the fungible nature of the currency and the efficiencies realised through being able to transact with a multi-denominational, fungible medium. Notions of co-operation, reciprocity or efficient commercial exchange are no longer required when State power is engaged. The explanation as to why people accept a fiat currency system when State power props up and enforces the system thus becomes abundantly simple - choosing to shun the system or otherwise avoid it will be met with State sanctioned force. When the State demands taxation in a particular currency, that currency effectively becomes the base medium in society.

Australia currently has a system of fiat currency based on monetary notes issued by the federal government through the Reserve Bank of Australia. Yet in 1901, when the colonies joined together in a federation, this arrangement was not created, or even considered by the Constitution. The framers of the Australian Constitution never intended that the document they were drafting support such an arrangement. The existence of a system of federal government issued paper money in Australia owes more to political rather than constitutional design. Support for this perspective can be found in the text of the Australian Constitution and the monetary history of colonial Australia. In Australia, the issue of the constitutionality of the paper money system has never been openly discussed amongst scholars and the legal establishment, the High Court is actively avoiding the question. When plainly read and understood, the text and structure of the Australian Constitution in no way supports the existence of a federally issued fiat currency. Based on the text of the Constitution alone a strong argument can be constructed that a fiat currency arrangement is indeed not the underlying system originally contemplated. If proponents of fiat-paper money wish to see the Constitution updated to meet modern expectations of a fiat paper money system, a referendum pursuant to s128 is the only constitutionally legitimate means of achieving such ends.

At the time of federation, paper money that was un-backed by bullion or gold coin was unknown and the thought of a government issued fiat currency was outrageous. The accepted approach to constitutional reasoning in Australia holds that the text of the Constitution takes primacy. To sustain an argument that the text permits a fiat currency you must subscribe to a constitutional philosophy whereby the document can be bent and stretched to mean something that it

obviously does not mean. Under this philosophy the Constitution thus becomes a toolbox through which scholars and politicians rummage to find justifications for the expansion of government power rather than representing a genuine limit on government power.

*Apart from the inherent value of upholding the rule of law - in that the Australian government ought to abide by the terms of the Constitution. Fiat currency arrangements in Australia are premised on shaky constitutional grounds.*

## **Negative Rates and Fiat-money Collapse**

Effectively negative rates are antithetical to financial theory and create a perversion of asset and risk pricing models. When using a negative number as your risk-free rate to determine the present value of future cash flows, cash becomes more valuable than any asset. This creates a serious problem for the banking sector. Investors dump bonds for cash, but do not want to pay a fee (negative rate) to park money in the banking system.

As depositors withdraw their cash, bank capital becomes compromised, as they are unable to dig themselves out because their business model has been destroyed, first by compressed net margins, and finally by effective negative rates. This “run on the bank” thrusts the fractional reserve money multiplier into reverse, sucking liquidity from a system now fully reliant upon it.

Finally, for pension and entitlement programs, negative rates destroy the model. Aside from the inability to generate any yield from their fixed income investments to meet obligations, pensions use a discount rate to determine proper funding requirements. Using a negative discount rate would render all pensions technically underfunded. Quite a dilemma to say the least. In a nutshell, negative rates turn the entire model upside-down. Which is why right now you see investors chasing bonds for capital appreciation and buying stocks for the yield. Truly remarkable phenomena.

From a big picture standpoint, the progression is likely to be led by further debt deflation and economic contraction (Ice), followed by the final act of hyper-inflation as all sovereign debt and fiat currency becomes entirely mistrusted. What is now very clear is that the major central banks, who have all followed the same strategy, will never be able to normalize rates or their balance sheets, as “unconventional” monetary policy has driven the entire system past the point of no return. In the commercial sector, most banks will fail after struggling under the duress of declining loan growth, compressed margins, and finally, negative rates. Depositors will refuse to pay interest for banks to hold their money, and the ensuing run on the banks will generate capital impairments, insolvency, and ultimately nationalization of the commercial banking system, by the latest scam in town the Central Bank Digital Currency.

But, if this fiat currency cycle accelerates toward its conclusion, which is a highly possible black swan event given the circumstances, the ensuing secular bull market in commodities and natural resources will be the means to reboot the failed experiment with fiat-money and negative rates via a new form of “sound money”.



# The Banksters Ponzi Scheme

"All the king's horses and all the king's men cannot put the private banking system together again", for the simple reason that it in 2023 the Ponzi scheme has reached its mathematical limits. The banksters Ponzi scheme is a form of pyramid scheme in which new investors must continually be sucked in at the bottom to support the investors at the top. In the banksters case, new borrowers must continually be sucked in to support the creditors at the top.

The Wall Street Ponzi scheme is built on "fractional reserve" lending, which allows banks to create "credit" (debt) with accounting ledger entries, essentially fictitious capital. Commercial Banks are now allowed to lend from 10 to 30 times their "fictitious reserves," essentially counterfeiting the money they lend. The central banksters make use of the "magic" or parity to pretend that any private bank debt can clear when this fictitious ledger entry money flows between commercial banks. The Ponzi scheme fraud is papered over via "the central banksters lender of last resort" and an unfunded deposit insurance scheme.

But the fact remains it is just a giant global Ponzi scheme, with over 97 percent of the entire global money supply (M3) being created by private banks in this way. Fiat money, by definition of fiat, is not actually there, it is simply a promise for something 'in the future' this may be a future taxation based promise of just 'magic', but fiat money does not exist in the real world, at best one could perhaps expect the "coupon rate" income stream but that is also just ledger entries or more fictitious capital; no real world surplus value exists in the entire global banksters system in 2023.

The fiat money ponzi scheme basics:

**First**, it is impossible to create fiat-money without simultaneously creating an equal amount of debt. The current system is hence forced to increase debt continuously to enable the economy to grow. Given positive interest rates, debt with interest owed is an exponential function (interest on interest in subsequent periods), which is a problem in a world of finite resources.

**Second**, the marginal utility of debt has decreased as debt levels increased. Since 2007, US GDP increased by \$11 trillion, while the amount of debt outstanding grew by \$40 trillion.

**Third**, the amount of interest due on compounding debt levels is reaching dangerous levels in relation to nations GDP. If we (generously) assume an interest rate of three percent, more than 10% of GDP is siphoned off the economy for interest payments – each year. This does not even include repayment of principal.

The math underpinning this banksters Ponzi scheme as above, is the magic of "compound interest", it guarantees that "debt eats the world" as each year the level of debt increases until in 2023, it has reached the point that it is more than 1000% of GDP in many nations and is greater than 860% for the USA today. "Exponential economic growth required by the mathematics of compound interest on a money supply based on money as debt must always run up eventually against the finite nature of Earth's resources".

*The penny invested by Augustus Caesar in 8 BC would be worth 3 trillion, trillion, trillion, trillion dollars today at 6 percent compound interest.* The world only has around 100 trillion dollars in total real-world assets today. Hence the bankers and their payment systems exist within a perpetual motion machine based upon the math of impossible finance.

The current banking crisis is the crisis we had to have because in 2007/8 we kicked the can down the road to 2023, this crisis is in the banking system itself, which can no longer cover up the shell game it has played for centuries with other people's money. The parasite which is the global banking system has finally run out of its food source. But the crisis is not in the real economy itself, which is fundamentally sound – or would be with a proper credit system to oil the wheels of production. The crisis is in the banking system, which can no longer cover up the shell game it has played for three centuries.

While \$80 in capital can magic up \$1,000 in loans, an \$80 bond to market value **loss** wipes out \$80 in capital, reducing the sum that can be lent by \$1,000, but the \$1000 has already 'left the bank'. Since late 2022, all banks have been experiencing widespread bond negative yields as central banks pump rates to fight inflation from the 2020/21 pandemic, their 'to market'; capital base has shrunk proportionately, to the point in 2023, they cannot even manage the minimal 7% capital requirements, a fact recently demonstrated by SVB, Signature and Credit Swiss[5] etc. collapses.

The reality remains that human economic activities cannot keep pace with such degree of compounding even with a meager 6% compound interest rate. All systems that indulge in significant interest-based loans be they countries, companies or individuals are bound to fail. But before their eventual demise the struggle created by this compounding leads to immorality, exploitation, loot and plunder and cyclic global wars since 1914.

The moral of ancient and modern history alike is that a critical point inevitably arrives at which economies either adopt hard creditor-oriented laws that impoverish the population and plunge downward socially and militarily or save themselves by alleviating the debt burden. This attempt is necessarily in vain. No amount of money can sustain the exponential growth of debt, not to mention the freely created credit and mutual gambles on derivatives and other financial claims whose volume has exploded within the global banking system since the last crisis in 2007/8. The governments of the world are committed to "bailing out" banks and other creditors whose loans and swaps have gone bad. It remains in denial about the debt deflation that must be imposed on the rest of the economy to "make good" on these financial trends by our children's, children.

Global debt has hit a record \$300 trillion, or 349% leverage on gross domestic product. This translates to \$37,500 of average debt for each person in the world versus GDP per capita of just \$12,000. Government debt-to-GDP leverage grew aggressively, by 76%, to a total of 102%, from 2007 to 2022. Assuming 35% of debt is floating rate, this means \$3 trillion more in interest expenses, or \$380 per capita.

“Maybe the party is finally over. Maybe this is the end of the banksters 300-year reign, starting roughly with the creation of the Bank of England in 1694, the world’s banksters have finally succeeded in doing enough damage to the world economy that the rest of us are willing to act. When the embattled banks demand another round bailout the taxpayers must respond, it is time for a change, it is time to try “sound money” grounded in the real world, based upon economic production and surplus value, not exponential debt growth. The global banking system is “Dead Men Walking, and dead men tell no tales” ...

*Only time will tell. But however, the change may happen, it remains the author’s conviction that, one way or the other, a fair and intelligent monetary system will someday exist on the planet earth, and this book is a means to that end.*

“If the American people ever allow private banks to control the issue of their currency, first by inflation, then by deflation, the banks and corporations that will grow up around them will deprive the people of all property until their children wake up homeless on the continent their fathers conquered. The issuing power should be taken from the banks and restored to the people, to whom it properly belongs.” -- Thomas Jefferson.

## **The Silicon Valley Bank- The Bond Enigma**

Bank rates affect bonds prices as this is the math underpinning all Bonds, we will look at how SVB ran into trouble when the FED increased rates and the effect it has on SVB AT1 capital value (also affected its securities as well, but via a contagion flow from bonds).

Bond interest rates are the result of supply and demand for each bond on the market. That means each bond has its own interest rate (yield) which fluctuates constantly as the market changes its view in response to inflation prospects, the economic outlook, credit risk and the animal spirits of investors. When interest rates rise, bond prices fall, this relationship is a mathematical certainty because otherwise the bond market would freeze.

For example, a freshly minted 5-year government bond is offered to investors with a 3% coupon. The bond pays out 3% on its face value of \$100 for every year of its existence. In other words, annual interest of \$3 is due until the bond matures in 5 years’ time – whereupon the government pays back the \$100 face value on the maturity date.

But what if you own an older government bond that was issued when interest rates were lower (say during the pandemic)? Your bond only pays 2% coupon annually and still has 5 years left until maturity. Aside from its lower interest rate payment, your older bond is pretty much identical to the new 3% bonds. But you are not a winner.

In a world of 3% bonds, who would be mad enough to pay \$100 for your 2% bond? No-one, that’s who. So, if you are forced to sell your 2% bond (let’s say a bank run), you will have to drop its price (discount) to the point where it can compete with new bonds and buyers for your old bond exists.

Using the formula  $\text{Bond Price} = \sum_{t=1}^n C/(1+r)^t + F/(1+r)^n$ , that price is \$95.24. You take a capital loss of \$4.76 on the original \$100 you invested in the bond. You're not happy but your buyer will at least make the trade, because your discount bond gives them a yield to maturity of 3% over 5 years. That's because your bond's 2% payments plus the capital gain  $(100-95.34=4.76)$  they make when the government pays them the bond's \$100 face value in 5 years, matches the 3% they can earn buying a new bond for \$100 and holding that for 5 years.

Just as the market value fell from \$100 to \$95.2, SVB AT1[6] capital value fell by billions when SVB needed to liquidate and hence crystallised its unrealised "to market" bond losses when 2021 @1.5% bonds went to 4% in March 2023, to meet depositors withdrawals during the march bank runs.

*It's just Maths Folks..*

## Prologue

Because Treasuries are "risk-free" and therefore carry lower capital requirements for banks to hold against them, banks allocate more of their funds to them. This concentrates banking system risk in a single interest-sensitive security of treasury bonds. SVB is just the most extreme and reckless version of a risk present in all banks. For reference, the rest of the U.S. banking system has unrealized losses amounting to more than \$600 billion, some 25 times more than the losses that just brought down SVB.

There's no shortage of blame to place on central banks for having engineered such an unnatural banking market. Far from making banks "safe," the regulatory system concentrates risks, with the alphabet soup of Fed liquidity facilities standing ready to money-print their way out of any trouble, but this just add more debt to the system which is already drawing in debt.

## Maturity Mismatch-When the Magic stops

The demise of Silicon Valley Bank has triggered concerns about American banks. In many ways SVB was idiosyncratic, with its narrow customer base and largely uninsured deposits. But it illustrates a wider problem: the decade of low interest rates created serious imbalances in financial balance sheets, made painfully apparent by the response of monetary policy to rapid inflation. As global interest rates move up, maturity risk is coming home to roost.

Around half of SVB's assets were government bonds – surely the safest of assets. However, as bond-yields rose from the abnormally low rates of a few years ago to a more normal level, the current value of bonds fell sharply. A bond is assured of paying face value at maturity. But in the meantime, investors could benefit from the new higher interest rate by buying a new bond. The market price of the old bond had to fall to reflect this reality, when SVB was forced to liquidate its assets due to a bank run.

Borrowing short and lending long – i.e., maturity transformation – is a core function of the financial sector, but always involves risk. When interest rates are stable or falling, maturity

transformation looks like magic: lenders hold a liquid asset, which provides funding for illiquid assets. But when interest rates rise sharply, the magic stops. Either the lender, the borrower or the intermediary pays the price. When coupled with fractional reserve banking and digital money that can be withdrawn in seconds this is a proven recipe for a global banking system failure, which cannot be backstopped or bailed out.

*Silicon Valley Bank couldn't ignore its losses, but the Fed did.*

## US Dollar – Reigns over All

International balance of trade required real delivery of gold and that meant that any excess money printing by sovereign nations would cause gold to flow out of the country, potentially causing insolvency. Gold made foreign trade easier and its law of one price makes it difficult for any one nation to cheat.

But how did the US dollar become supreme over gold.?

Bretton Woods took place: About three quarters of all gold in the world[7] was in the U.S. This was because the U.S. had large trade surpluses against other countries and those countries shipped gold to the U.S. to balance those trades, though eventually, when they ran out of gold, the U.S. lent these countries US dollars instead of gold. The countries at war in Europe were net spenders as they were busy fighting WWII. As such, the U.S. had the gold and like the guy with a giant chip lead at a poker game, had enormous leverage over the proceedings.

What the delegates to Bretton Woods agreed was to add a level of indirection to this traditional gold trade. Instead of a strict **gold-based trade**, the U.S. imposed on everyone else a **gold-exchange standard** with the US Dollar as the **gold substitute**. Instead of using gold for international trade settlement, the US dollar would now be the settlement currency. The U.S. guaranteed the exchange of the dollar for gold at \$35 per ounce, but only to other central banks.

Eleven years before the Bretton Woods Agreement, U.S. citizens were barred from holding or converting US dollars to gold through Franklin D. Roosevelt's (FDR's) Executive Order 6102, this guaranteed the US state controlled all US gold.

The gold-exchange standard gave the U.S. the unique ability to print dollars that everyone else had to accept, even if it wasn't backed by physical gold. Gold wasn't being shipped for international balance of trade payments; dollars were. The Bretton Woods agreement established the US Dollar in place of gold as the currency for international trade and subsequently gave the U.S. hegemonic economic power over all nations as only the US can issue US dollars.

The U.S. 's method of monetary imperialism is using three-letter organizations. The IMF, BIS, WEF and the World Bank are some of the institutions that are used for this domination. These organisations essentially give the Cantillon-losing countries loans to dominate or exert control over them, via US Dollar denominated Debt.

## US Dollar Sanctions – The How

All access to US dollars must go via the NY Fed (there are many Feds in the US) this means any cross-border payments which uses USD (~ 80% of all payments today) MUST hold an ES account with the NY Fed (RTGS) or find a third party who has a ES account with the NY FED. There are only eight foreign banks which are physically located within NY (a US regulated Bank) which hold these ES accounts. An example is the Australian Commonwealth Bank (New York Branch) SWIFT CTBAUS33XXX.

Hence to get to the NY FED RTGS and hence USD for trade-based payments, they must all connect to SWIFT (SWIFT is essentially a VPN network) a closed messaging system, as banks have no way to independently connect to other banks (yes, the global banking system has not yet heard of, or use the Internet)?

All cross-border payments denominated in USD (independent of the actual trade currencies MUST flow via a) SWIFT connection and b) via one of the eight foreign correspondent banks which hold ES accounts (USD) with the NY FED... These are essentially currency swaps with the foreign nations' central banks and local RTGS ES accounts.

This US sanctions the world, which no one can circumvent if a) USD is the reserve currency used in global trade, b) no banks can connect to one another without a SWIFT connection.

Lastly the US swap lines solve the global payments liquidity problem. Through swaps, the same eight foreign central bank can exchange its own currency for dollars directly with the Federal Reserve. Central banks can therefore trade with the Federal Reserve the unlimited resource they have, their own currency, for the resource their troubled banks need, U.S. dollars. Then, the foreign central banks lend these dollars to their banks and stabilize their own currency payment system. This way, the Federal Reserve can help countries avoid liquidity crunches of their own and prevent these local stresses from in turn damaging the U.S. economy and all dollar denominated global assets.

The Treasury and the Fed conduct foreign exchange operations since early 1962, when the Federal Reserve commenced such operations at the request of the Treasury. Operations are conducted through the Federal Reserve Bank of New York (FRBNY), as fiscal agent of the United States and as the operating arm of the Federal Reserve System. All cross-border US Dollars must flow through the FRBNY and one of the eight foreign banks which hold an ES account (regulated/licenced as a US bank and located in NY). Essentially if anyone "touches" a USD, then they are drawn into the US legal system. A US dollar-denominated payment will involve multiple service providers acting inside the United States, even if the originator and the receiver of the payment are located abroad. This is because virtually all dollar-denominated payments are processed via the U.S. correspondent banking system. Thus, all parties which hold US dollars or trade in US Dollars are subject to US law.

It is self-evident that a foreign bank cannot leapfrog into the U.S. payment system and avoid the contact with U.S. correspondent banks. The use of the payment system is reserved for

members – and membership is reserved for U.S. financial institutions or U.S. branches of foreign financial institutions. If you don't agree to be held to account by US law, even if there is no international legal basis for the US to extend its jurisdiction inside foreign nations sovereign jurisdiction, you are simply cut off from US dollar liquidity and payments.

*Thus, the tool for US based sanctions upon the world was born.*

## US Dollar Currency Swaps

The earliest currency swap between central banks dates to February 28, 1962, the U.S. Federal Reserve and the Central Bank of France signed a currency swap agreement which took effect on March 1. The U.S. was urging European countries to intervene in the foreign exchange market to maintain stability of the USD exchange rate. By this agreement the Central Bank of France credited 500 million Francs into the U.S. Federal Reserve account, while the Federal Reserve credited US\$50 million into the account of the Central Bank of France. The currency swaps during the Bretton Woods era embraced the obvious purpose of saving the U.S. from its ultimate dollar crisis in 1971 and served as a cooperative means to suppress the trend of underselling the USD and buying other currencies. After the collapse of the Bretton Woods system in 1971, strong foreign exchanges were needed by most countries to stabilize their domestic markets in the enduring financial crisis. Although U.S. economic power has been on a relative decline, the status of the USD via the use of US dollar currency swaps has acted as the major stabilizer of the international financial market remains unchallenged.

The US dollar is by far the most widely held and transacted international currency. Strains in dollar funding markets outside the US can disrupt financial conditions inside the US as well. If foreign entities were to experience difficulties accessing dollars to settle their transactions denominated in US dollars, the strain could destabilize the flow of international payments. US Dollar currency swap lines between central banks enable the receiving central bank to obtain foreign currency and redistribute it locally to its domestic banks **without having to use its foreign reserves**.

The Bank for International Settlements estimates that banks have a total of \$52tn of notional obligations in dollar swaps and forwards. About half of that (\$26tn) is made up of credit extended to non-bank clients based outside the US, a group that includes companies and large investors. The non-banks' exposure has climbed more than 50 per cent in the past six years[8].

Under a currency swap agreement, the lending central bank, for example, the Bank of England (BoE), requests US dollars from the Fed. In exchange, the Fed receives an equivalent value of pounds calculated at the market exchange rate. The BoE then lends the dollars to banks in the UK, charging interest. For the life of the swap, the BoE has a dollar liability, which takes the form of an account at the Fed, and the Fed has a pound liability, which is an account at the BoE. When the swap is over, the BoE returns the dollars to the Fed and the Fed returns the pounds to the BoE. The BoE also pays to the Fed the interest earned on the funds lent.

The Fed bears no exchange risk on these transactions since the loans are made and reversed using the same agreed exchange rate. Also, as the receiving central bank determines the banks within its country to which it lends dollars, the Fed has no contractual relationship with those institutions and therefore does not bear any credit risk related to the downstream borrowers.

U.S. Dollar swap lines are the most well-established and well-utilized, due to the status of the U.S. dollar as the world's dominant reserve currency[9], its liquidity, and its perception as a safe-haven currency. In the United States the Federal Reserve operates swap lines under the authority of Section 14 of the Federal Reserve Act and in compliance with authorizations, policies, and procedures established by the FOMC.

The foreign currency that the NY FED acquires is an asset on its balance sheet. The dollar value of amounts that the foreign central banks have drawn but not yet repaid is reported in the line "Central bank liquidity swaps". Because the swap will be unwound at the same exchange rate that was used in the initial draw, the dollar value of the asset is not affected by changes in the market exchange rate. The dollar funds deposited in the accounts that foreign central banks maintain at the Federal Reserve Bank of New York are a Federal Reserve liability. In principle, draws would initially appear in the line "foreign and official" deposits. However, the foreign central banks generally lend the dollars shortly after drawing on the swap line. At that point, the funds shift to the line "deposits of depository institutions".

When a foreign central bank draws on its swap line to fund its dollar operations, it pays interest to the Federal Reserve in an amount equal to the interest the foreign central bank earns on its tender operations. The Federal Reserve holds the foreign currency[10] that it acquires in the swap transaction at the foreign central bank (rather than lending it or investing it in private markets) and does not pay interest. The structure of the arrangement serves to avoid domestic currency reserve management difficulties for foreign central banks that could arise if the Federal Reserve actively invested the foreign currency holdings in the marketplace. The swap lines curtail the distressed selling of various types of U.S. financial assets by foreign nations.

In December 2007, it would supply up to \$20 billion to the European Central Bank (ECB) and \$4 billion to the Swiss National Bank (SNB) for up to six months. The Fed extended the swap lines, to additional central banks and for larger amounts, in March 2008, May 2008, and September–October 2008. The last extension involved the largest quantity of dollars, as the Fed also removed limits from the swap lines with the ECB and SNB as well as the central banks of the United Kingdom and Japan.

*The swap mechanism made U.S. dollars accessible to commercial banks all over the world, including those that did not have a subsidiary in the United States or eligible collateral that would allow them to borrow directly from the Federal Reserve. The swap lines underpin both the international role of the dollar and safeguard the U.S. economy from financial turbulence abroad.*

Central bank liquidity swaps have maturities ranging from overnight to three months. In September 2011, the total of lending by the Fed had come to \$10 trillion (or standardised to



1-month loans, \$4.45 trillion), over half of which had gone to the ECB: all loans were repaid in full, and profits made by the Fed on swap repayments in 2008-9 alone came to \$4 billion.

*US Dollar swap lines underscore the Dollars Dominant Role within global trade payments.*

## **The Basel III- Regulated Capital Hoax**

The 2007–09 Great Financial Crisis (GFC) revealed several weaknesses in the capital bases of internationally active banks: definitions of capital varied widely between jurisdictions, regulatory adjustments were generally not applied to the appropriate level of capital and disclosures were either deficient or non-comparable. These factors contributed to the lack of public confidence in capital ratios during the GFC. To address these weaknesses, the Basel Committee on Banking Supervision (BCBS) published the Basel III reforms in December 2010 with the aim of strengthening the quality of banks' capital bases and increasing the required level of regulatory capital.

Common Equity Tier 1 capital (CET1) is the highest quality of regulatory capital, as it absorbs losses immediately when they occur. Additional Tier 1 capital (AT1) also provides loss absorption on a going-concern basis, although AT1 instruments do not meet all the criteria for CET1. For example, some debt instruments, such as perpetual contingent convertible capital instruments, may be included in AT1 but not in CET1. In contrast, Tier 2 capital is gone-concern capital. That is, when a bank fails, Tier 2 instruments must absorb losses before depositors and general creditors do. The criteria for Tier 2 inclusion are less strict than for AT1, allowing instruments with a maturity date to be eligible for Tier 2, while only perpetual instruments are eligible for AT1.

Total available regulatory capital is the sum of these two elements – Tier 1 capital, comprising CET1 and AT1, and Tier 2 capital. Each of the categories has a specific set of criteria that capital instruments are required to meet before their inclusion in the respective category. Banks are required to maintain specified minimum levels of CET1, Tier 1 and total capital, with each level set as a percentage of risk-weighted assets.

Summary, the totality of the regulatory capital is set to a minimum of 8% with Common equity set to a minimum of 4% as AT1 to market price can go and has gone to zero via CoCo and the normal operation of Bonds are future claims upon treasury debt.

*Hence Basel III re-enforces the Fractional Reserve Banking system, which in a crisis like 2007/8 and 2023 can only manage to repay around 4% of all depositors funds during a bank run on the banking system..*

# Gold Intrinsic Value

Gold given its rarity, gold does have a perceived value and has played an important role in the global monetary system since ~ 200 BCE. Additionally, while short run catalysts are few, the precious metal is still tied to long run drivers of price appreciation, including limited supply and robust demand.

As is the case in any market, gold prices are determined by supply and demand. Regarding supply, while commodities in general are scarce, gold is the epitome of a rare good, with 39% of annual supply, on average, derived from recycling new and old scrap metal. This inherent rarity has given gold its reputation as a global store of value and notable hedge against fiat currency (supply driven) inflation.

Given that the supply of gold is relatively stable, changes in aggregate demand have a disproportionate effect on the price. Most of the gold consumption is jewelry purchases. However, given the illiquid nature of jewelry, financial investments - primarily through liquid exchange traded funds - are a core driver of intra-day gold prices.

Representing 36% of gold demand on average, investors poured into the asset, as a flight to safety, during the recession. Not surprisingly, as an improving economy has begun to deflate many 'safe haven' assets, gold has suffered. Nevertheless, with jewelry manufacturing and investors together representing more than 85% of demand, gold prices remain independent of many economic variables, most importantly inflation. With no direct tie to global growth, the intrinsic value of gold is based on negative investor sentiment, as it has historically served as a hedge against depreciation of the U.S. dollar.

The small volume of Central Bank gold has very little intrinsic value, and most probably the worst possible currency in trade, its value lies in its ability to universally price every commodity, via the law of one price. The World Currency Unit was a snapshot of dematerialised 400 oz bars held by, and last audited in the world's central bank, hence its value should be in 2023 some 23 times that of each bar today, based solely upon supply vs demand free market pricing. It achieves its universal value via the conversion of dematerialised non-fungible gold into a fungible Coin with face value which prices the world's trade via the same law of one price, and hence represents currency perfection.

## Sovereign Debt

It is estimated that at the end of 2021 there existed greater than USD 300 trillion of foreign sovereign debt<sup>[11]</sup>, this is debt that is owed to an entity which exists outside of the jurisdiction of the sovereign debtor. There are many routes for this debt to exist, most are via the IMF<sup>[12]</sup> and hence are USD denominated debt, some while USD denominated are carried as local currency-based debt, but in all cases the debt issuer is not a resident of the sovereign nation.

## The Problem

In essence the IMF peddled the concept of “debt restructuring is a fraud” it only works because of the fraud that somehow the debtor must bear all risk and that the lender is not a party to default risk. In the case of the IMF the corrosion peddled is if a sovereign nation defaults or debt is not restructured then the IMF will not allow the sovereign nation to assume yet more debt, this is essentially a hollow threat as one cannot repay debt with yet more debt. Debut which violates the law of debt and defaults is a crime against humanity and represents a form of economic slavery.

Additionally the concept of “debt restructuring” is mostly a means to increase the level of debt, or a debt-for-asset-swap which forces the debtor to transfer ownership of sovereign assets to the foreign lender, which is also a legal impossibility as there exist no concept of a supra sovereign jurisdiction to enforce such ownership transfers outside of the ability of a sovereign to simply nationalise[13] all foreign ownership at the stroke of a sovereigns’ pen.

## **The Solution**

Hence there exist a single legal solution to the any default by a sovereign nation and the 300 trillion of foreign debt, the lender has been compensated for his risk, and the default is hence born solely by the lender who can assert his legal rights in the absence of any supranational jurisdiction upon any collateral claims if they exist.

The concept that posts-a-default there exists, and further lender claims which are not explicit in the loan agreement are self-deprecated, and the lender must legally bear its own risk and take the haircut or loss associated with its own calculated risk.

## **The Law of Debt and Defaults**

Somewhere in the history of the world, common sense has been left behind, in this section we restate the laws of debt as it applies to all debt and the contractual relationships and obligations of the parties to debt itself.

*Default risk is the possibility that a debtor will be unable to pay its obligations in a timely manner if at all. If the debtor defaults, the issuer of the loan can lose part or all the original investment and any interest that was owed. The issuer of any loan adjusts the interest rate to match its calculated default risk for each individual debtor, hence the combination of interest paid and or collateral is the sole basis for the issuance of the loan to the debtor, as all loans are 'chose in action' based upon the jurisdiction of the debtor.*

*In the event of a debtor default, the risk is borne solely by the issuer of the loan.*

*In the case of sovereign loans there additionally exists "Sovereign Risk", namely a foreign debt issuer has no legal recourse to any sovereign asset upon default, this is by definition of Sovereign Risk. No Sovereign nation can cause any foreign debt issuer to issue any debt in their sovereign nation, it is a purely voluntary action of the foreign debt issuer.*

*Sovereign risk-based debt cannot be restructured, it must always default, this is how a free-market works...any alternative represents a moral hazard to its community and humanity as a whole...*

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[1] In most currency areas the value of coins vs bank notes within the M0 supply is around 1: 27, hence only 1/27 of the value of bank notes can be converted into coins.

[2] Since their introduction, stable coins have proven to not be as stable as envisaged. Nevertheless, stablecoins' growth and potential to be used as a medium of exchange and store of value under certain conditions are unambiguous. Stablecoins that are properly backed by fiat money may be regarded as the sixth form of (challenger) money.

[3] A repurchase agreement (repo) is a short-term secured loan: one party sells securities to another and agrees to repurchase those securities later at a higher price. The securities serve as collateral.

[4] The safe functioning of a payment system is dependent not just on the quantity of the settlement asset. It also depends crucially on the quality of the asset. The "safety" of settlement assets, essentially means the likelihood of the asset retaining its value to the holder, and hence its acceptability to others as a means of payment.

[5] In March 2023, CHF 6 billion of Contingent Convertible or CoCo bonds went to zero over one weekend, and the Credit Suisse tier 1 capital went from ~ 14.1% to less than 8%, and hence breached its capital requirements. As all bonds, by definition, within the secondary market (caused by deposit withdrawal stress) can go to zero, the fractional reserve system is designed to fail, and fail it did for Silicon Valley Bank, and the CoCo bonds were not the backstop (bail-in) that they were designed to perform post 2007 financial crisis, as they went to zero before they converted into bank equity.

[6] Common Equity Tier 1 capital (CET1) is the highest quality of regulatory capital, as it absorbs losses immediately when they occur. Additional Tier 1 capital (AT1) also provides loss absorption on a going-concern basis, although AT1 instruments do not meet all the criteria for CET1. Additional Tier 1 capital is defined as instruments that are not common equity but are eligible for inclusion in this tier. An example of AT1 capital is a contingent convertible or hybrid bond, which has a perpetual term and can be converted into equity when a trigger event occurs. As Credit Swiss found out the hard way CoCo bonds can go to zero over a single weekend in March 2023.

[7] In 2023, the US still maintains the largest holdings of gold in the world.

[8] Dollar dominance is striking in this FX market segment, greater than in any other aspect of dollar use. As a vehicle currency, the US dollar is on one side of 88% of outstanding positions — or \$85 trillion. An investor or bank wanting to do an FX swap from, say, Swiss francs into Polish zloty would swap francs for dollars and then dollars for zloty.

[9] In March 2020, is another policy innovation designed to preserve the Fed's hegemonic position at the top of the global financial cycle without altering its fundamental dynamic announced that central banks and other international monetary authorities with accounts at the Federal Reserve Bank of New York, can borrow up to USD 60bn via repo arrangements with the Fed by using US Treasuries collateral. This repo facility thus incentivises non-US central banks to borrow against US Treasuries rather than selling them during periods of dollar illiquidity. This ensures a sustained demand for US Treasuries during periods of turmoil.

[10] The Fed does not pay interest on the foreign currency that it received in the swap but agreed to leave the foreign currency with its counterpart central bank; this sidestepped monetary control issues that might have bedeviled the foreign central bank if the Fed had withdrawn the reserves and lent them in the open market. This structure means that the swap line program guarantees income for the Fed throughout its existence.

[11] It is a legal reality, there is no bankruptcy court for sovereigns that can compel the debtor and its creditors to resolve a default. The risks—overborrowing and potential default—remain with the lender to this day.

[12] In some cases, the debt is in IMF Special Drawing Rights, but SDR is essentially a simile for USD debt, as an SDR is effectively drawn against and pegged to US Dollar peg.

[13] Reassert sovereignty over all Sovereign or jurisdictional based assets.