Is the Collapse of the Dollar Inevitable?

by Victor Aguilar

Abstract

The socialists and the Austrians are at opposite ends of the spectrum of views on inevitability. Socialists believe that the government can turn on a dime, veering away from economic collapse towards a socialistic paradise simply by giving the right person the authority to print money. And how would the Benevolent One accomplish this feat? According to the Debt Virus Theory, it is as simple as printing money and spending it directly into the economy, rather than buying Treasury Bills.

On the other hand, the Austrians believe that a “distortion-reversion process” is inevitable. Credit expansion is unsustainable and this, apparently, is true no matter how benevolent the chairman of central bank may be and no matter what he spends newly created money on, whether on social programs or in the discount of good bills, at not more than sixty days’ date.

Is hyperinflation the inevitable result of inflation? This is the question I address.

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In my *Critique of Mathematically Perfected Economy*, I write:

> *The basic flaw in the logic of modern socialists* (*Montagne*, *Cook*, *Zarlenga*, etc.) *is confusion between motivation and capability. "He's* privately controlled!*" the socialist sneers at the Federal Reserve chairman, the unspoken assumption being that, were the socialist put in charge, he would immediately open the floodgates of wealth and prosperity for us all. It would be a veritable socialistic paradise, if only the Benevolent One were given the authority to print money! But, the fact is, the Fed is in a box. If a socialist were put in charge, he would be in the same box.*

In my *Critique of Austrian Economics*, I write:

> *Rothbard discusses an inevitable "distortion-reversion process" but says little about how it actually plays out. Apparently forgetting his master's regression theorem, he declares "the continuance of confidence in the banks is something of a psychological marvel" (1970, p. 867).*
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> *Garrison (2001, p. 44) redefines the Production Possibilities Frontier, PPF, to be* sustainable *combinations of investment and consumption, but says nothing about what is so unsustainable about a credit expansion. Since he defines consumption on the PPF (which is real) to be the same as consumption on the Hayekian triangle (which is nominal), the unsustainability* cannot *have anything to do with a devaluation of the currency.*
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> *So we see that Mises, writing in 1949, was really the last Austrian to make much of an effort to explain or predict interest rate spikes. After that, their discussion of this issue, including Mises' later writings, increasingly took on the tone of a morality play, with the greedy bankers getting their "inevitable" comeuppance.*

Clearly, the socialists and the Austrians are at opposite ends of the spectrum of views on inevitability. Socialists believe that the government can turn on a dime, veering away from economic collapse towards a socialistic paradise simply by giving the right person the authority to print money. And how would the Benevolent One accomplish this feat? According to the Debt Virus Theory, it is as simple as printing money and spending it directly into the economy, rather than buying Treasury Bills. Stephen Zarlenga writes:

> *Infrastructure repair (including human infrastructure - health and education) would provide quality employment throughout the nation. There is a pretense that government must either borrow or tax to get the money for such projects. But it is a well enough known, that the government can directly create the money needed and spend it into circulation for such projects, without inflationary results.*

On the other hand, the Austrians believe that a "distortion-reversion process" is inevitable. Credit expansion is unsustainable and this, apparently, is true no matter how benevolent the chairman of the central bank may be and no matter what he spends newly created money on, whether on social programs or in the discount of good bills, at not more than sixty days' date.

Is hyperinflation the inevitable result of inflation? In America we have only had one bout with hyperinflation and, over 200 years later, the phrase "not worth a Continental" is still part of our language. "In conclusion," I write in my *Critique of Mathematically Perfected Economy*, "to Montagne, Cook, Zarlenga and anyone else who claims that they can open the floodgates of prosperity by spending paper money directly into the economy, I say: '*The Debt Virus Theory is not worth a Continental!*'" Debt Virus Theorists' followers are mostly laymen (for obvious reasons) and, when I wrote this, I fully expected any American with a passing interest in economics to be familiar with the expression, "not worth a Continental."

Indeed, the collapse of the Continental *was* inevitable because, having spent Continentals directly into the economy (mostly for soldiers' wages), the Continental Congress had nothing in their portfolio with which they could buy them back. They were, in fact, benevolent men who had no desire to see their newly-won nation racked with hyperinflation, but they could no more recall the paper money that they had printed than Frankenstein could recall his monster.

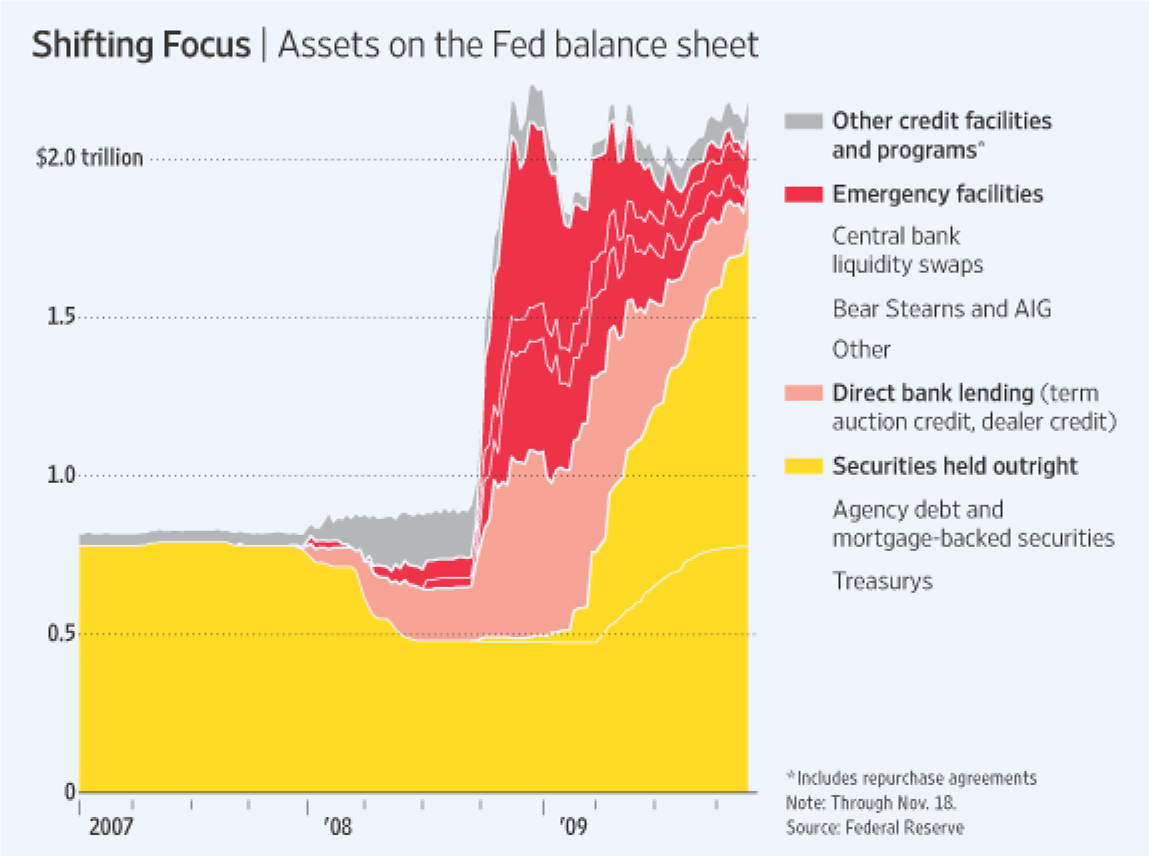
But surely the Federal Reserve is smarter than the Continental Congress! Until as recently as last year (2007), I would have responded to this question with a begrudging "yes." As much as I dislike the United States having a central bank (I advocate free banking), I will admit that, by buying only short-term Treasury Bills, the Federal Reserve has given itself a portfolio with which it can buy back dollars in the event that inflation should threaten to turn into hyperinflation. Unless the Federal Government itself collapses – by losing a war, for instance – there will always be a market for T-Bills. The three months it takes for these bills to mature is just not enough time for the government to collapse. Selling T-Bills for cash and destroying the cash is a painful, recession-inducing process, as evidenced by our experience during Reagan's first term, but it *can* be done. Contra Rothbard, hyperinflation is *not* inevitable under a central bank.

So what has Ben Bernanke done to make me question his intelligence, if not his benevolence? He polluted the Fed's portfolio with AAA-rated securities, which I have mocked as being "about as marketable as the chocolate-covered cotton balls that Milo Minderbinder was trying to foist on people in Catch 22." Everybody knows that, in spite of their impressive-sounding AAA rating, these securities are really just packages of sub-prime loans that nobody wants – what I defined in my *Devil's Dictionary of Economics* as "worthless crap." If people wanted them, in the sense of being willing to pay cash for them, then we would not be having a credit crisis in the first place.

Bernanke's actions have made the question of hyperinflation a murky one. The Austrian's depiction of hyperinflation as being the inevitable fate of central banking has always been cartoonishly simplistic, and it remains so. However, economists of all schools must now admit that hyperinflation is at least a possibility. If the dollar appears to be on the verge of collapse, what will the Fed do about it? Sell their AAA-rated securities for cash and destroy the cash? But what if nobody is impressed with the AAA rating and won't buy their securities at any price? Then the Fed will be in the same position as the Continental Congress: Benevolent men with no desire to see their beloved nation racked by hyperinflation, but who have no more ability to recall the paper money that they have printed than Frankenstein had to recall his monster.

Of course, not all of the Fed's portfolio is in AAA-rated securities and not everything with an AAA rating is worthless crap. They still have lots of T-Bills and there is a market for at least some of their AAA-rated securities. This is why the question of hyperinflation has become so murky. The bottom line is that nobody – not even Ben Bernanke – really knows what the Fed's portfolio is worth these days.[1] For this reason, I would be very leery of any economist, from any school, who speaks confidently about the future of the dollar. Is the collapse of the dollar inevitable, as the Austrians claim? Or are we at the dawn of a socialistic paradise, provided only that we eliminate the Fed and just have the Treasury print money and give it to Congress to distribute, as the Debt Virus Theorists claim? The answer is certainly somewhere between these extremes, but where exactly I cannot tell you.

[1] Since this paper was written in the spring of 2008, Bernanke has also begun purchasing commercial paper and long-term T-Bills. Note that the Fed polluting their portfolio is no more inflationary than buying short-term T-Bills; any purchase made with cash created out of thin air causes inflation. The Fed could bail out the automakers by buying used cars and stacking them on top of each other the length of Pennsylvania Avenue and it would not be any more inflationary than if they issued their notes only in the discount of good bills, at not more than sixty days' date. What buying crap does is make withdrawing cash from the economy more difficult in the event that inflation should ever threaten to become hyperinflation. Causing inflation and setting up a situation in which hyperinflation is difficult to check are not the same thing. This is a rather fine point, but one which many critics of this paper do not seem to grasp.



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