Cost Free

By The Mogambo Guru

12/29/03 Mogambo on Monday! Our fearless leader explains how the reckless creation of money engenders both a "fraud" and a "horror" in one fell swoop.

When I see one of the cool new twenty-dollar bills, it is usually in the hand of a stranger, and I always think to myself "Man! I wish I had a bunch of those! Or even one!" But Dan Neel, writing a nice piece entitled "Fancy Greens and Pusherman Blues" at the NY Press, is more advanced in his thinking than that.

"The U.S. is making an incalculable profit on the roll-out of the snazzy new twenties," says Mr. Neel. He figures that the profit comes from the underground economy, who are being roiled by this new regime of currency issuance. "Wholesale drug resellers as close as two tiers above street-level distribution have begun asking buyers to separate older twenties from new ones to more quickly direct the old currency at laundering operations and retail purchases. The result is an accelerated rate of tax revenue for the U.S. government."

Now, I freely admit that my experience with the drug trade is very limited, although I wish I had a big ol' drug problem so that I could qualify for some of those luscious federal program benefits, with free food and housing and medical care and case workers to handle all my problems for me, and keep people from hassling me because I would be certified as a Person With A Disability And Therefore Possess Powers Beyond Those Of Mortal Men. But the few drug dealers I have run into always wanted cash, and I patiently tell them that I thought the first ones are supposed to be free, and that is how they get me hooked, and it is only AFTER I become an addict that they start charging me and they make all their money on the back end of the service period, but this is just the beginning of the service period, and therefore the drugs are free to me. But that is, alas, only in the movies, and in real life there is only that awkward moment when they are just staring at me in stunned disbelief, and then they tell me to get the hell away from them before they whomp me upside my freaking head, and I do.

Seignorage: Paranoid Seignorage

But getting back to Mr. Neel, he explains that "Such transactions are also the key to a little-recognized form of seignorage. Call it paranoid seignorage: a spike in tax revenue from resurfacing notes when the government refreshes its currency. Think of it as yet another way the government makes money from making money."

In case you are new to the concept of seignorage, he explains: "Seignorage is the difference between the value of money and the cost of its production. In the case of notes, the Fed buys at four cents apiece and sells them to banks at face value." Well, in actuality, the banks sells some T-bonds to the Fed for the money, or the Treasury deposits the money in the banks to use to pay government employees, and therefore the banks don't spend a dime or even have to do anything other than record the transaction in the books.

But looked at another way, seignorage is also a shining example of glorious government productivity, as two things are accomplished at once, namely, 1) some debt is extinguished and 2) the money supply is enlarged, committing both a fraud (the artificial extinguishment of debt) AND a horror (the precondition for resultant price inflation, as this extra money works its way into prices).

But I regret that Neel really falls short of the mark when he quotes "post-Keynesian economic theorist William Hummel," who has the temerity to write, "For a few cents worth of paper, the [U.S.] notes buy foreign goods and other assets at their face value, and as long as those notes remain overseas, those assets are effectively cost free."

Seignorage: "Cost-Free"

Well post-Keynesian economic theorist or not, if this Hummel fella thinks for one lousy minute that there is no effect on economies because of a large influx of U.S. dollars, or an outflux of U.S. dollars, or large influx of any currency, or a large outflux of any currency, or a medium sized influx or outflux, or even a small influx or outflux of money, influx outflux influx outflux in any country anywhere on the planet, and if he further believes that U.S. nationals burrowing themselves under a mountain of debt so as to finance raw, naked consumption are included in his definition of "cost-free," then I can only surmise that the term "post-Keynesian" means "complete idiot," because I am here to tell you that any movement of even the most insignificant amounts of money has far- reaching repercussions, because it must, and of all the words in the world that I would pick to describe the effects of money piling up anywhere, the very last descriptor on the list, down there at the very, very bottom of the list, is "cost-free." And if you don't believe me, then watch carefully what happens the next time my wife asks me for ten bucks, and you will note the HUGE effect that it has on me, starting out with the usual "What? Ten dollars? Do you think I'm made out of money or something?"

"Cost-free." Hahahahaha! I love it.

"Under the current system," writes Robert Blumen in a little essay called "The Dollar Crisis" on the incomparable Mises.org site, "the United States year after year imports goods from the rest of the world for consumption and pays for them with dollars. The dollars are then used by foreign central banks to purchase debt instruments from either the Fed or the private sector, in addition to U.S. stocks and real estate."

Now note what Blumen says here, leading to the point that assets we buy from foreigners are definitely not "cost- free": "Where these are Treasury securities, they are created out of nothing, requiring no savings by any American consumer. Under this arrangement, Americans are now freed from the ponderous burden of saving and the onerous requirement of first producing in order to later consume. Their consumption is offset by a growing indebtedness of the private sector and the Fed to foreigners. This state of affairs is unsustainable, and will come to an end with a deep fall in the exchange value of the dollar relative to other currencies." As we are now seeing, if you pay any attention at all to the fate of the dollar, every day.

Blumen draws extensively from a new book by Richard Duncan, "The Dollar Crisis: Causes, Consequences, Cure."

Seignorage: The US No Longer Creditworthy

Mr. Duncan writes, "How much longer will the rest of the world be willing to accept debt instruments from the United States in exchange for real goods and services? It is only a matter of time before the United States will no longer be considered creditworthy. It is only a matter of time before the United States will not be creditworthy." If it was me writing that, I would have capitalized that last sentence to read "It is only a matter of time before the United States will not BE creditworthy."

The dollar must collapse, forecasts Mr. Duncan, because it will become impossible for the U.S. to continue to sell one-half trillion dollars worth of debt securities each year (the amount required to offset the trade deficit) for very much longer, because foreigners, who are obviously a real stupid bunch of people, are not so stupid that they will never get smart enough to stop doing it.

Now this is the place where I take exception to that, as the great advantage of a fiat currency is that we don't have to sell nuthin' to nobody, much less a bunch of debt. We can print up all the money we want, anytime we want. We can have so much money floating around that we can retire the entire national debt in one stroke if we want. However, the resultant monetary inflation will, of course, filter through to inflation in prices, and then all the poor people start starving to death and getting uppity, and commerce falls to zero as everyone is afraid to go to the mall and have to wade through mobs of angry, homicidal people.

Seignorage: It's Not Okay

But Mr. Duncan anticipates that very objection when he says, "The more familiar effect of inflation, consumer price inflation, is the bidding up of the money prices of consumption goods as the money supply expands. However, inflation does not always take this route: asset price inflation occurs when credit money creation flows into financial assets." Namely, stocks and bonds and houses. Which is what we are seeing nowadays, as if that is okay somehow. It is not, in case you were wondering.

But back to the Blumen essay, in which Blumen goes on to say, "Bubbles are followed by busts, which usually result in banking crises, and then fiscal crises generated by the ensuing costly bailout of the banking system by the government."

Not to mention, of course, the inevitable bailout of every dirtbag country and THEIR banking systems that have fallen victim to the IMF's ministrations, which is the exact same thing on an international scale. And not to mention the bailout, in this case "debt-forgiveness" of Iraq and Afghanistan, since we decided to invade them and destroy their economies, which means that we taxpayers eat another huge cost.

And still, insists the aforementioned Mr. Neel, the U.S. consumer’s profligacy is, of course, "cost-free." Hahahahaha! I love it.

Regards,

The Mogambo Guru
for the Daily Reckoning

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— Mogambo Sez: It is almost over. You spent the whole year being good. Let’s hope it pays off better than it has in years past.