

The Fiat Standard – Lecture 2 (The Never-Ending Bank Holiday) • Study Notes

How fiat began: not through deliberate design, but as a political workaround for insolvency and war financing. The “never-ending bank holiday” is the protocol installation of fiat.

1) Big Picture

- **Thesis:** The fiat standard emerged as a *default disguised as innovation* – central banks suspended gold redemption during crises, financed deficits with paper, and called it progress.
 - **Key lesson:** Fiat’s origin story is not engineering genius; it is government **managing insolvency**.
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2) Pre-War Setup: London as the Hub

- **Bank of England (BoE)** was the world’s financial center; sterling was the reserve currency.
 - The clearing role gave BoE confidence to **issue more pounds than gold held**, assuming foreign users wouldn’t redeem all at once.
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3) 1914: War Meets Gold Shortage

- **July 1914:** Depositors withdrew £12.3m from BoE’s £26.5m reserves (≈46%).

A gold run loomed.

- **War bonds issued:** £350m in bonds floated; <1/3 subscribed by the public.
 - **“Masterly manipulation”:** BoE secretly bought the unsold bonds itself, while the press (Financial Times) proclaimed oversubscription.
 - **Gold collection:** Citizens pushed to hand in gold at banks/post offices for paper; cost ≈1% of gold’s face value.
 - **Result:** Britain financed WWI with paper, kept the illusion of being on gold.
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4) The “New Alchemy”

- By **confiscating gold** and **issuing credit**, paper was presented as “as good as gold.”
 - This was financial alchemy: the philosopher’s stone became the **printing press + checking account**.
 - **Inflation followed:**
 - 1915 → +12.5%
 - 1916 → +18.1%
 - 1917 → +25.2%
 - 1918 → +22.0%
 - 1919 → +10.1%
 - **Cumulative:** +124% in five years.
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5) Post-War Choices

- **Honest option:** Return to gold at realistic parity → deflation + recession.
- **Political option (chosen):** Maintain inflated spending, avoid wage/price adjustments, continue credit expansion.

United States:

- Stayed on gold until 1917 → absorbed Europe’s gold.

- Sharp 1920 recession, but resumed redemption by 1922.

Britain:

- Attempted return to pre-war parity (1925).
 - Ignored inflation effects → gold undervalued, arbitrage drained reserves.
 - Chronic unemployment followed as unions resisted wage cuts.
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6) Exporting Inflation

- Britain pressured the US to inflate as well, reducing arbitrage pressure.
 - Together they created the **Gold Exchange Standard (1922)**:
 - Countries deposited gold at BoE/Fed.
 - Settlement networks added **saleability across space**, reducing the need for physical shipments.
 - But this system inflated the 1920s boom, leading to the **1929 crash** and **Great Depression**.
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7) Global Spread of the Protocol

- **1933 US:** Roosevelt's Executive Order 6102 → gold confiscation, devaluation (\$20 → \$35/oz).
 - **WWII & After:** Stronger governments, militarization, and eventual shift from sterling to the dollar.
 - **Bretton Woods (1944):** USD as reserve, still nominally redeemable for gold (foreign CBs only).
 - **1971 Nixon Shock:** Gold window closed; fiat dollar standard complete.
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8) The Fiat Standard Installation Protocol

1. Run unsustainable deficits.
2. Default on gold redemption (call it suspension/confiscation).
3. Replace citizens' gold with paper/credit.
4. Expand supply of paper notes/credit.
5. Impose controls on gold and capital flows.
6. Export inflation by persuading other nations to hold your currency as reserves.

Outcome: Both sterling and USD have lost **95% of their value vs. gold** since 1914.

9) Core Takeaways

- **Not engineered, but improvised.** Fiat was a patch for insolvency.
 - **Default rebranded as policy.** Confiscation of gold is default by another name.
 - **Saleability across space** became fiat's key advantage, but at the cost of **time preference corruption**.
 - **Replication:** Britain's template spread worldwide; by 1971, the fiat system was global.
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10) Study Prompts

1. Why did Britain use war bonds + covert BoE purchases instead of admitting insolvency?
2. How did **gold arbitrage** expose the false return to pre-war parity in the 1920s?
3. What role did the **Gold Exchange Standard** play in fueling the 1920s boom and Great Depression?
4. Why is confiscation of gold considered a form of **default**?
5. How does this "installation protocol" echo in modern fiat crises (capital controls, devaluations)?

11) Quotable Ideas

“By controlling banks and confiscating gold, central banks could create money by fiat. Paper was made as good as gold, and the printing press became the philosopher’s stone.”

“The fiat standard was not the design of an engineer. It was the central bank’s desperate solution to looming insolvency.”
