A banker for all seasons: the life and times of John Exter – champion of sound money

By John Butler and Barry Downs
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The following is an introduction to a series of essays GoldMoney will be publishing, written by John Butler and Barry Downs, looking at the life and times of John Exter – leader in the fight against Richard Nixon, Alan Greenspan and the debasement of the US dollar. The source material for these essays includes John Exter's collected papers and works; the personal experiences, diary entries and recollections of the author; and interviews with former colleagues, friends and family of John Exter's.

INTRODUCTION

It was a fine spring day in Washington, DC. John Exter was in town on private business, advising a wealthy client as to her substantial investments. When his friend and former New York Fed colleague Paul Volcker, Chairman of the Federal Reserve, learned that John was in the neighborhood he dropped everything in his diary that day and requested that John come by his office. John agreed and later that afternoon arrived at Volcker's office for a three-hour chat.

At the time, the US was in a recession, by far the deepest since the Second World War. Yet inflation was stubbornly high. When he assumed the Fed chairmanship in 1979, Volcker had promised to bring inflation down at all costs. But by 1981, amid soaring unemployment, he was coming under unprecedented public criticism for a Fed chairman. Members of Congress from both parties were demanding that he be fired. It didn't help that he was a lifelong Democrat, yet serving under a Republican president and a Republican-controlled Congress.

Yet what really hit home was criticism from the common man, out of work and suffering from Volcker's bitter monetary medicine. John Exter was astounded that day to discover that against the walls of Volcker's office were stacked piles of one-foot planks of lumber, sent by unemployed construction workers in protest at the many building projects cancelled as a result of record high interest rates. Some of the 2x4s were even personalised. On one was written, "Because of your high interest rates, Mr Volcker, I've lost my job, my wife has divorced me and I'm losing my teeth and hair, you no good SOB." Volcker clearly needed some reassuring advice from those he respected most.

There was a long backstory to the economic mess the US was in at the time. In the 1960s, as the US government began to run chronic budget deficits – albeit incredibly mild by today's debased standards – **John and others had warned that this would lead, eventually, to a run on the US gold stock, a sharply weaker dollar and a surge in price inflation.** He was right on all counts. Now, over a decade later, Volcker had been tasked with dealing with these nasty consequences.

Appointed by President Carter to deal with the national economic malaise and restore confidence, Volcker wasted little time in implementing an innovative policy of explicit monetary targeting. Grounded in the academic tradition of the Monetarist "Chicago School", of which the esteemed Milton Friedman was Dean, monetary targeting was greeted with a combination of awe and horror by the public and politicians alike. What was it? Would it work in practice?

By 1980, alongside accelerating money growth, US interest rates had soared into the double digits, as had unemployment. Congress scheduled special hearings on monetary policy, a blatant attempt to pressure the Volcker Fed to relent in the fight against inflation. Volcker refused to even consider doing so. **The Fed would continue to let the money supply dictate interest rates and, thereby, dictate the path of economic growth, inflation and unemployment.**

In sharp contrast to his relentless, determined public persona, in private Volcker felt somewhat different**. In 1981, with money supply growth still accelerating, interest rates at nearly 20% and no end to the stagflation yet in sight, Volcker was at his wits end.** He had simply not expected that the fight against inflation could have escalated to this point. That spring afternoon he reached out to John for any advice he might be able to provide.

John was regarded by Volcker and his counterparts around the world as the central banker's central banker. Part retired since the early 1970s, he had been active in banking in the US and abroad since the 1940s, and had served as vice-president of the New York Federal Reserve, senior vice-president of the First National City Bank (Citibank) and the first Governor of the Central Bank of Sri Lanka (Ceylon), founded in 1950 following the independence of Ceylon from India a few years earlier. He was also an active investor. In the 1960s, he not only warned against the policies that he believed would lead to a dramatic devaluation of the dollar and rise in the price of gold but, witnessing that his advice was going unheeded by those in greatest power and influence, **positioned his investments so as to profit from them. And he did, handsomely.**

Following his retirement from Citibank in 1971, he went into private consulting work and managed his by-then substantial fortune. **He specialised in gold and gold mining investments** and sat on the board of ASA Ltd. His clients included wealthy investors in the US and around the world.

No other US banker of the time had such extensive domestic and international private and public banking experience. None had had his degree of foresight to invest their savings as John had, accumulating a large holding of gold and gold mining shares. He had literally seen it all, and had predicted much of what he eventually saw, including what was unfolding in the US in the spring of 1981.

Retired or not, John never shied away from offering helpful if potentially harsh advice when asked. So when a desperate friend asked for John's help, he was only too pleased to provide it. That said, John could have responded with an entirely justified degree of schadenfreude. After all, Volcker had been active in US policy circles since the 1960s and was among those who had not always heeded John's advice. But schadenfreude was not in John's character. Rather, he went straight to offering his friend his best, honest economic advice. **He suggested to Volcker that, in his view, he had already restored the Fed's credibility as an inflation fighter; that money supply growth would soon begin to trend lower; that the battle, as it were, had now been won and that *it was time for the Fed to start easing interest rates to stabilise the economy.***

Volcker found it hard to believe what he was hearing. He had expected John to recommend more of the same; to stay the course: Even higher interest rates perhaps, or tighter bank reserve requirements: some form of tough economic love, whatever was required to break the back of the rampant inflation. Yet John argued that this had already been accomplished, that Volcker could now begin to ease off the monetary brakes. How could he know that?

Perhaps it takes a true monetary hawk to know when Federal Reserve policy is convincing and credible and when it is not. John was a highly accomplished and experienced economist, and had an extensive analytical toolbox from which he could draw. In any case, Volcker appears to have followed John's advice and began to ease interest rates within weeks of their meeting. **Not long thereafter, money supply growth indeed began to slow, as did the rate of price inflation. By 1982 the inflation rate had fallen to under 3%, yet the economy was beginning to recover sharply.** The stock market rallied. Growth rates picked up. Unemployment declined. And yet inflation remained low. The dollar grew stronger. Not only was the recession over; the battle against the dreaded "stagflation" had been won. John Exter had been proven right, yet again, in his predictions.

In 1984, basking in this pronounced economic success, President Reagan was re-elected in a landslide. In that same year he publicly gave Volcker tremendous credit for his achievements and re-appointed him to a second term at the helm of the Federal Reserve. Yet little did Reagan know how things could have turned out differently. Had the Fed continued pressing on the monetary brakes for too long the economy would have failed to recover meaningfully prior to 1984 and Reagan might well have lost his bid for a second term. Volcker might not have received a re-appointment. The economy might have spiraled downward into a deep financial crisis. The US dollar might have lost global investors' confidence and continued to lose value, leading right back into the stagflation Volcker had long sought to end.

US economic and monetary policy might be made by institutions such as the Federal Reserve and the Treasury but all policies are the product of real decisions by real people, receiving real advice that they can either heed or ignore. John Exter's advice was at times heeded, at times not during his long career and retirement. In 1981, it was heeded, Volcker succeeded, Reagan celebrated and the country experienced what was rightly described during Reagan's re-election campaign as "Morning in America". That the dawn came as it did, as soon as it did, was quite possibly due to the sage advice of John Exter.

There was another interesting topic of discussion late that spring afternoon: gold. Volcker knew that John was an expert in gold and gold investments and he asked him what he thought of the outlook. **John explained why he believed that gold served as an insurance policy against financial calamity.** But then he went further. He predicted how someday, perhaps when it was least expected, there would be a sudden debt crisis, investors would rush into gold and the entire banking system would be at risk of collapse. Volcker removed his glasses, rubbed his eyes and said, “John, I hope you are wrong but I respect you too much to rule out your predictions.”

John Exter died in 2006, aged 95. He may not have lived to see the global financial crisis of 2008 unfold, but as with most major economic developments of his time, he predicted it. He was more than just an ordinary banker. He was a banker for all seasons, and a monetary theorist of the first order. This series of essays tells his story.

A Banker for All Seasons Part II

By John Butler
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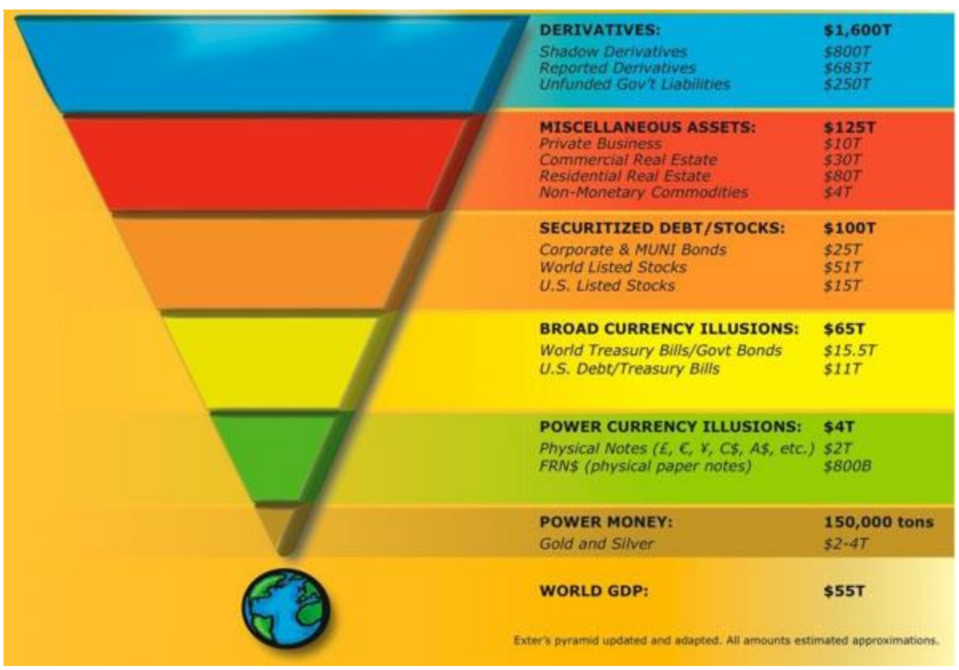
A BANKER FOR ALL SEASONS, PART II: John Exter's Views on Financial Crises, Money Demand and the 'Exter Pyramid'



This is the second in a series of essays discussing the life, times and monetary theories of the late John Exter (1910-2006). He was an economist, central banker, commercial banker, teacher and monetary expert. In this essay, we explore how John's experiences in academia and policy circles contributed to the development of his theory of financial crises and the 'Exter Pyramid'.

John studied Keynesian economics at university and then ended up teaching it at Harvard. But it was at Harvard, in about 1939, that he realized that Keynes's "new economics" had come to dominate economic thought and policy and that the road ahead was treacherous. By 1943 Exter had become totally disenchanted with Keynesianism. His main concern about Keynesianism was that it assumed a closed rather than international economy. **Exter also believed that the Keynesians failed to understand money and debt.**

After the war John Exter's career took him to the Federal Reserve and by 1962 he had been in the Federal Reserve system for a decade. Exter set up two foreign central banks, served as the governor of one, and ended up in charge of gold and silver operations at the Federal Reserve Bank of New York.

While with the Federal Reserve Exter became dismayed with how many dollars were being printed and how those dollars flowed out to foreign central banks who then turned around and bought US Treasury securities to hold as reserves. This in turn helped to keep US interest rates low, thereby supporting growth. What seemed a virtuous circle, however, could only last as long as foreign central banks preferred holding Treasuries instead of swapping their dollar reserves for gold instead. It was an international, high stakes, monetary confidence game. In 1965, France made the first big move out of Treasuries and into gold and other countries followed thereafter.

Exter believed the Fed was locking itself into an expansionism it dare not stop. He went on to say that the Fed was becoming a prisoner of its own expansionism and the risk was a credit expansion reaching total US debt levels far in excess of the country's GDP. He envisioned a major debt crisis ahead and believed the crisis would then turn the economy down, like nothing seen since the Great Depression. **He warned the Fed would find itself pushing on a string and would be unable to prevent a deflationary depression.**

Exter realized, by the late 50's and early 60's, what had evolved was a debt based, debt driven economy and monetary system and to illuminate it's structure he devised an upside down debt pyramid as his model. He presented the US debt pyramid and drew attention to the fact that all foreign economies also had debt pyramids. The structure, precariously perched at its apex, was by its very nature unstable which Exter believed was also true for the financial system generally. In his original inverted pyramid were junk bonds, all illiquid debtors, commercial paper, bankers acceptances, developing economies' debts, CD's, Federal government debt, corporate and municipal bond debt and paper currencies. The categories with the greatest risk occupied the broad part of the pyramid. Further down the pyramid were less risky debt categories and the risk declined until Treasury Bills and cash (Federal Reserve Notes) were reached at the very tip of the pyramid.

Exter's original, upside-down debt pyramid balanced on the world's existing known quantity of gold, which at that time was a block representing about 140,000 metric tons. He put gold outside the pyramid because it represented the only real money in the world; it had no liability against it and it was the only asset refuge that could not default or be arbitrarily devalued in a crisis. In the Exter scenario, at some point people would lose faith in the financial system and move down the money pyramid to cash and then outside the pyramid entirely and into gold. So he envisioned the price of gold would be rising against all currencies as the value of debt and other securities declined.

John Exter was always reminding people that US dollars are debt obligations of the Federal Reserve and when FDR made it illegal for Americans to own gold, in 1933, the convertibility aspect of the dollar into gold ended for Americans. Americans were paid $20.67 an ounce for gold turned in and in 1934, under the Gold Reserve Act, the treasury raised the price to $35 an ounce. For Americans the dollar had been a promise to pay in gold but when convertibility ended Exter deemed the dollar had turned into an IOU nothing. The dollar remained convertible for foreigners, until 1971, when Nixon closed the gold window. So, for 42 years the dollar has been a total IOU nothing.

When John Exter came up with his inverted debt pyramid model, some 50 years ago, he was concerned that expanding illiquidity and existing debt in the system had already reached critical mass and the Fed was fast approaching a time when to revive an economy, which had turned down, would become impossible. **But with the end of international gold convertibility in 1971, the Fed gained the ability to keep inflating indefinitely. As long as there was the political will to keep it going, total debt relative to the size of GDP could reach astronomical levels. We now know that it took until 2008 for the system to become so supersaturated with debt that a collapse was finally triggered.**

In retrospect, the Exter debt pyramid model developed 50 years ago was able to keep expanding as long as clever financial innovation after innovation was introduced, enabling ever more leverage. The mushrooming derivatives market with its credit default swaps, collateralized debt obligations, which are a major force in the derivatives market and items like mortgage backed securities have all taken up residence at the top of the inverted Exter debt pyramid. According to Exter's model, those derivatives with the weakest and longest links to base money are the first to be rejected when confidence evaporates and the liquidation process then cascades into the value of the underlying collateral, eventually reaching the least risky securities and, at the tip of the pyramid, cash itself. Cash can't default, but unlike gold, it can be printed and devalued at will, and as we know, throughout history and without exception, paper monies have become totally worthless.

Let's look at the block of gold the Exter pyramid teeters on: In 1974 gold became legal for Americans to again own. By 1975 the gold price began to rise, reacting to increased inflation, around the world. The metal then made a major move which took it to $850 an ounce (London PM fix) on January 21, 1980. John Exter saw it as people simply converting whatever currency they were holding and leaving his pyramid for gold. But, the move ended abruptly in 1980 and gold began to be liquidated with proceeds going back into the debt pyramid and a 20 year generally declining gold market began which ended in the gold price bottoming out at $255.60 an ounce level (London PM fix) on April 2, 2001. The 1975 to 1980 period however, turned out to be proof of what happens when enough people exchange paper money for gold money.

It's now been five years since the 2008. Notwithstanding record global monetary and fiscal stimulus, growth has generally been disappointing in the US, Europe, Japan and, as 2013 unfolds, in many emerging markets as well. Currency debasement has been rampant but confidence in the paper money system generally has been maintained. The price of gold, which briefly reached $1,900 in August 2011, has declined back to around $1,300. Data also indicate that some holders of gold , mainly via the gold ETF market (ie 'paper' gold market) have sold out and are back in the securities and derivatives thereof in the Exter debt pyramid.

If John Exter were still alive, he would undoubtedly argue that on two separate occasions within the past forty years it's been demonstrated that investors seeking to reduce financial risk have reached the cash category in his debt pyramid, but then have lost confidence in whatever paper monies they were holding, and have chosen to move out of the pyramid entirely and into physical gold money. He would then look at the failing health of the 2013 global financial system, riddled with debt and leverage even more excessive than five years earlier, when the 2008 debt crisis nearly brought down the US and global financial system. **The only conclusion he could possibly reach is that future moves from paper money into gold money will be magnitudes greater than what has already occurred twice in the past forty years.** Will one of these be sufficient to collapse the system entirely? Will investors someday demand a return to gold-backed money? No doubt these are questions he would ponder.

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A Banker for All Seasons Part III

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A Banker for All Seasons Part III: John Exter's Detailed Predictions of the Global Financial Crisis and the End of the Fiat Dollar Standard

This is the third in a series of essays on the life and works of the late John Exter (1910-2006), a prominent economist, central and commercial banker and educator.

John Exter grew up during the Great Depression and saw his father, a bond trader in Chicago, lose everything when the stock market crashed in 1929. This traumatic incident and the prolonged misery and suffering which followed during the Great Depression, sparked Exter's interest to get to the bottom of what factors were responsible.

What made John Exter a unique individual was his unusual background within both international central banking and the mainstream financial world.

In search of a compelling explanation, Exter studied economics. In 1936 John Maynard Keynes published his famous General Theory. By the late '30s and early '40s Keynesian economics had come to dominate US economics faculties. Exter received a full education in it at Harvard, where he was a graduate student. Following his graduation he taught Keynesian economics himself. But by 1943 he recognized Keynesianism was seriously flawed and rejected it, believing that the monetary stability provided by a gold standard was the only sustainable policy. In the 1950's Milton Friedman introduced his Monetarist, Chicago-school economics and when Exter examined this, he rejected it too, as ultimately unworkable.

On leaving the world of academia, Exter joined the Federal Reserve system, where he worked through the war years. Following the war he was assigned the job of setting up and governing two foreign central banks, the Central Bank of Ceylon and The Central Bank of the Philippines. He later returned to the US, where he oversaw the gold and silver operations at the Federal Reserve Bank of New York, serving as Vice President.

Exter's last official stint in the mainstream world of economics, central banking and commercial banking was as Senior Vice President at First National City Bank, (Citibank). His created position was that of overseeing all government and central bank relationships. This required frequent travel. John Exter would arrive in a country without a Citibank office, meet with local officials, and shortly thereafter a branch would open.

Exter knew most of the world's central bank governors by their first names, as well as all IMF and World Bank executives. While with the Federal Reserve and Citibank, Exter travelled the world addressing forums of central bankers, academicians, mainstream economists, and business executives. Invariably his theme was the wisdom of a global gold standard and the flaws inherent in Keynesian and Monetarist economics. Exter pulled no punches in forecasting that the world would be left eventually in another Great Depression as the cumulative result of Keynesian and Monetarist policies.

He attended the annual IMF and World Bank meetings, right up until the mid-90s, and was regularly sought out for his economic and monetary views in the corridors near where the meetings were being held. John Exter's views on gold and central banking policies thus reached the top levels of those institutions.

John Exter's stern warnings were generally rejected by economic officials and central bankers, but over and over again he was invited back to address those who valued his views nevertheless. One such group was The Economic Club of Detroit.

In December 1980 John Exter addressed The Club, founded in 1943, and the concise message he left with the group is helpful in understanding the world's dilemma presently. What he had to say explains why the 2008 debt crisis occurred and why the monetary policy response to date has been inadequate in addressing the causes. He titled his address "Gold and the World Money Crisis."

John Exter began by informing his audience that, whether they knew it or not, they had been brainwashed throughout their lives by some combination of Keynesian or Monetarist economics, the only economics taught in US universities for more than 40 years. (Now in 2013, it should be pointed out that Keynesianism and Monetarist economic policies have dominated for more than 73 years.) Exter then went on to say that he never really accepted the 'new economics' and remembered life under the 'old economics', i.e., a full gold standard, back when phrases like "the almighty dollar," "good as gold," and "sound as a dollar," had real meaning and reflected domestic and global confidence in our money.

In the late '30s and early '40s Exter explained how Keynesianism had become the gospel while he was in Harvard graduate school and then Milton Friedman came along with his Monetarism in the 1950's and it made no sense either as a monetary alternative to a full gold standard.

John Exter then referred to two previous addresses, one in 1962 and another in 1966, also before the Detroit Economic Club. The first was entitled "The Gold Losses" and the second was "Financing Freedom's future: Can We Moderate the Boom?" In both instances, Exter was critical of the Fed, explaining that our chronic payments deficit and resulting gold losses were caused primarily by monetary policy, i.e., the printing presses were running too fast. He implored the Fed to end its easy money policy and recognize the importance of sound money. Failure to do so, he warned, would weaken the dollar, result in more rapid gold losses, and eventually cause a global monetary crisis. Also, in the two previous addresses, John Exter warned that a country can pay its international debts only by either using its credit or its international assets – which were its gold. He regarded the gold standard system, as it was then operating, as satisfactory. To make it sustainable, Exter went on to say, we only had to accept its implied monetary discipline and live with it.

Exter told the 1980 club attendees that back in 1962 he was hoping to persuade the American people to maintain monetary sustainability and had hope that enough people would communicate with their representatives in Congress with the message for the Fed to stop the reckless expansionism. However, he said by the time of the 1966 club address he had largely given up hope because Keynesianism and Friedman's Monetarism had become too deeply embedded in people's minds, not only in America but also abroad. Exter added that to protect himself and his family, he had already begun to accumulate gold.

John Exter told the 1980 Club attendees that when he took charge of gold and silver operations at the New York Fed in 1954, US gold reserves were $24 billion, valued then at $35 an ounce. By 1962, gold reserves had fallen to $16 billion and by 1966 to $13.5 billion. Exter then explained that two years later, in 1968, the Bretton-Woods member central banks closed their gold windows to private people and set up a so-called two-tier system, an official tier in which the Fed and other central banks sold gold to one another at $35 an ounce and a private tier in which all others had to buy and sell in a free market at a generally higher fluctuating price.

Although this situation was clearly unsustainable, due to the arbitrage opportunity it created for speculators, for three and one half years, Exter explained, the fixed exchange rate system was maintained. But on August 15, 1971, when US gold stocks had fallen below $10 billion, President Nixon closed the gold window even to other central banks. All other central banks then decided to close their gold windows too, protecting their own precious reserves from a speculative drain. John Exter went on to say that for the first time in history the dollar and all other currencies became irredeemable in gold. He coined the phrase "IOU nothing" currencies to describe what the world currency system had become.

The Club attendees were advised to understand that the event meant that all central banks went into a de facto default and their "IOU nothings" began trading in foreign exchange markets against one another at rates that changed moment by moment throughout each working day. A so called floating exchange rate system had been created, along the lines long advocated by Milton Friedman and his Chicago School colleagues. John Exter added that since all exchange rates were actually sinking against gold the system should be called a "sinking exchange rate system". He mentioned that the system was supposed to function with clean floats but quickly these became dirty floats, with most central banks intervening repeatedly in foreign exchange markets to control rates in attempts to manage their economies. Prices and costs began rising in all currencies creating inflation worldwide. Exter told the group the battle for sound money had been lost and to prepare for the worst in the years to come.

John Exter described the breakdown of the international gold standard as a monumental economic disaster in the works. He went on to say that an irredeemable paper money, floating exchange rate system was a non-system which would lead eventually to monetary chaos and would end in a worldwide depression even worse than the Great Depression.

Exter lambasted modern, activist central banking for its excessive expansionism, explaining to the gathering that it operated in defiance of monetary discipline and likened it to bridge builders defying the law of gravity. He went on to say the Fed had the greatest responsibility for this situation because the dollar is the most important currency. It was under JFK that the monetary expansionism became reckless, as Exter explained, in the attempt to get the American economy moving again.

John Exter said the expansionism took the form of purchases of U.S. Government securities. He told the group that when he joined the New York Fed, in 1954, its Treasury holdings were $28.5 billion. By 1962 the Fed's holdings had risen to $36 billion and by 1966 were up to $51 billion. As of December 1, 1980 the Fed held $140 billion in U.S. Government securities. Exter added that Fed purchases of Government securities would need to end to the bring about monetary stability and a return to a gold standard. He held little hope of the Fed changing its ways.

Historically unprecedented, is how Exter described the whole world of "IOU nothing" currencies. He explained that before only one or a handful of currencies occasionally became irredeemable and worthless, like the Continental dollar of our Revolution. We still say "Not worth a Continental." The assignats of the French Revolution became worthless as did the Austrian schillings, Hungarian forints and German reichsmarks following WWI.

Exter explained that, throughout history, an irredeemable paper currency was like a single leaking sinking ship surrounded by tightly built seaworthy redeemable currency ships to which passengers on the sinking ship could flee. But following 1971, all irredeemable paper currency ships were sinking, with not a single seaworthy ship anywhere to which to flee. He forecasted that passengers on all ships would eventually discover that their best refuge is a tiny island of gold, long since forgotten.

Speaking to the Detroit Club 33 years ago, John Exter believed there was a contest under way between irredeemable "IOU nothing" paper money and gold money and believed gold money would end up winning because paper is a poor store of value and gold, the best throughout history.

Exter warned that continuous printing of "IOU nothing" paper money would produce asset and consumer price inflation, and history demonstrates clearly that inflation produces a massive redistribution of wealth from workers to owners of capital assets.

John Exter explained that the future monetary world was quite predictable. As long as central banks and governments continue to run paper money printing presses, the gold price will inevitably rise. The only way to stop the rise would be for countries to return to the gold standard, to make their paper currencies once again freely redeemable into gold at a fixed price, and to accept the monetary and fiscal discipline of such redeemability. He thought that was not a realistic prospect because the Fed and other central banks would have to stop buying government securities or other paper assets, which they would not willingly do.

Exter pointed out that there was a hard money plank in the Republican Party platform in 1980. Ronald Reagan campaigned with the warning that "No nation, in history, has ever survived fiat money that did not have precious metal backing." He went on to say it was one thing to recognize the problem but quite another to have the political courage, strength, and will to solve it.

At the time of his address, the gold price was $635 an ounce and Exter forecasted that in central banking's "IOU nothing" paper money world, gold will eventually rise to not only $1,000 but ultimately to many thousands of dollars and finally, at some unknown future date, to infinity, when the dollar hyperinflates and becomes worthless.

John Exter told the group that, over time, the international marketplace will relentlessly destroy paper money by refusing to hold it and take the world back to gold regardless of what US authorities do. He also said that if the Fed doesn't stop its buying of government securities, it will destroy not only the dollar but itself as well.

At the time of the Detroit Club address, Exter said it had been only 13 months earlier that the US Treasury had its last auction of a million and a quarter ounces of gold. IMF gold auctions of 25 million ounces each, over four years, didn't end until May, 1980.

Exter told the group it was quite simple how the world got into such a money mess. A big part of the answer lies in the fact that both Keynes and Friedman have been the most influential economists, going back as far as the 1930's. They had openly advocated irredeemable paper money. Keynes came first and his followers taught that the gold standard was a barbarous relic.

They treated balance of payments deficits and gold losses with benign neglect. John Exter explained that when he said "they" he meant governments too because governments had completely gone over to Keynesian economic policies. He added that Friedman and his Monetarist school came later, in the 1950's, and Friedman called himself a noninterventionist and a strong advocate of laissez faire, free market economics of the old Adam Smith variety. But in money, which Friedman claimed matters most, he revealed a split personality. In violation of all of his free market principles, Friedman consistently urged the Fed, a creature of government, to intervene constantly, day by day, by buying government securities in the money markets to increase his money supply, as he defined it, at a constant rate.

In his further discussion of Milton Friedman, John Exter said Friedman presumed to define money as only paper. Friedman denied that gold was money. Going back to the 1960's, Exter explained that Friedman advocated that the US Treasury sell off all its gold at auction in the free market. Friedman viewed gold as just another commodity, like copper, lead or zinc and he was against all price fixing so he would not fix the price of gold in dollars, any more than he would fix the price of copper or automobiles. John Exter thought that was the cart-before-horse thinking of the most blatant sort. Exter added that gold didn't get its value from the paper dollar but it was the paper dollar that got its value from gold. It was only its redeemability, in gold, that made the dollar good as gold.

John Exter reminded the audience that, in the long run, governments are powerless to determine what money is. They have made their paper "IOU nothing" legal tender; prohibit people from using gold as an alternative; threaten to demonetize it, phase it out of the system; sell off their stocks in the marketplace to frighten us out of gold and back into paper; they even invented a new monetary unit, the SDR, or special drawing right, as an international currency. Like the "IOU nothings" the SDR isn't a promise to pay anything, merely an arbitrary unit of account. Moreover, the SDR has neither an obligor nor a maturity date, so John Exter referred to the SDR as a "Who-owes-you-nothing-when?"

Exter further reminded the group that, in the long run, it was the international marketplace that would determine what money is, but neither the Keynesians nor the Friedmanites recognize that the marketplace is not our servant but our master. History is clear that, beyond a certain point, irredeemable fiat money will be repudiated by international creditors as their balance sheets become excessively bloated and subject to arbitrary devaluation by the currency issuer, in this case the US.

John Exter told the audience he saw the marketplace as a crime and punishment world whereby if you make a mistake, in it, you will suffer for it. He added but if the government or central bank makes a mistake, they suffer too. Exter believed our central bank was making a horrendous mistake by entering into the marketplace and buying government securities. The trouble is that those who do the buying, the politicians and bureaucrats in government don't suffer for it. He said it was all of us, we the people, who suffer and have our futures undermined.

To look at the functions of money, **Exter explained, illuminated the basic problem. Money has to function as a medium of payment, unit of account but it's most important function is as a store of value.** History, moreover has shown us that any money that does not serve as a good store of value ultimately has ceased to serve as money, i.e., people in the marketplace refuse to accept and hold it.

Exter pointed out that good store of value must be a commodity, especially one desirable and, above all, scarce. He explained that abundant things can serve the medium of payment and unit of account function but the marketplace will ultimately destroy them and make them worthless if too abundant. John Exter added that over thousands of years gold has remained as the supreme store of value money, outstripping its principal competition, silver.

John Exter viewed paper as hopeless as a store of value. He told the audience paper is so abundant we fill trash bins and litter streets with it. He added, only the ink on it gives it value and it must spell out a promise to pay something like gold that is good store-of-value money. Exter reminded the group that the dollar was so long freely redeemable in gold at $20.67 an ounce that the words "almighty dollar" became part of our language.

Exter then reminded the audience that in 1933 Roosevelt made gold $35 and irredeemable by Americans, by prohibiting them from holding it inside the United States. He added that Eisenhower in January 1961 even prohibited them from holding it outside the United States.

The eventual breakdown in the international monetary system, Exter explained, was one thing, but he also saw coming a breakdown in the dollar system. He said that was for another session devoted to the end of the dollar, and why it would happen.

John Exter told everyone that the inflationary process is not simple and straightforward and that costs and prices will not rise continuously. To the contrary, he envisioned the time when costs and prices, in dollars, will actually fall, and there will be ushered in a long drawn out period of deflation. Exter believed that ultimately there would be a hyperinflation, but first would come a prolonged and painful deflation. He felt a hyperinflation was many years away.

Exter explained the reason for deflation was the debt structure, which Keynes and Friedman totally ignored. He said both the gold standard and dollar systems were breaking down for the same reason, because financial intermediaries in it, and many others, had violated the cardinal rule of finance not to borrow short term and lend or invest long term, particularly at fixed interest rates. Anyone who does that consistently over time must eventually go bust. He finally loses all or most of his liquid assets.

When the Fed closed the gold window to foreigners in 1971, John Exter said it defaulted on its promise to exchange gold for dollars and had it not closed the gold window, the U.S. would quickly have lost all its gold, it's only liquid asset. He explained that the underlying problem was that the Fed borrowed short-term from the public and banks by creating demand notes and deposits payable in gold on its books and lent long term to the U.S government by buying its securities.

John Exter wrapped up his address to the Club by identifying the world's known illiquid debtors, at that time, i.e., banks, thrifts, governments, corporations and people around the world whose obligations were payable in dollars and who had borrowed short and lent long on a far larger scale than the Fed whose obligations had been payable in gold. He then described what happens when short term interest rates go above long, the economic downturn impact and especially the impact on illiquid debtors. In 1978 short- term interest rates had moved above long above long-term rates. There was an economic downturn under way and Exter thought there was the possibility of a deflationary depression in the period ahead.

John Exter saw the Federal Reserve and central banking community setting the world up for an eventual financial collapse, in a world without the discipline of a gold standard. He spent his lifetime becoming perhaps the world's greatest authority on the monetary economics of gold and he crusaded around the world, spreading his wisdom. The sad part about it is that his gold message and warnings reached the highest levels in central banking but those central bankers had to operate within the political spheres of their respective governments. Those governments, to this day, are still swayed by the Keynesian and Monetarist philosophies which have gotten the world into so much trouble.

September 17th this year would have marked the 103rd birthday of John Exter. Were he alive today his message would be to prepare for an eventual global financial catastrophe, which ends in a market forced return to a gold standard with the redeemability aspect of paper money restored. For this to happen, when measured in dollars, the gold price would have to be in the thousands of dollars an ounce for a return to global financial stability.

John Exter, towards the end of his life, described the world's central banks as having entered a period resembling the last act of a Greek tragedy. The playwrights were John Maynard Keynes and Milton Freedman. Central bank governors and the politicians who enable those governors will end up as the cast of characters disgraced and blamed for the impending disaster.