Catapults and coin tricks: what Ben Bernanke learned from the Greeks

Ashley Owen

Many people regard inflation as a relatively recent phenomenon – it was a problem in the 1970s and it appeared to have been cured in the great 'disinflation' of the 1980s and 1990s. But inflation is not a recent phenomenon, and it certainly has not been 'cured'.

The central banks in the US, Japan, Europe, UK and Switzerland are all doing their best to fuel inflation using the oldest monetary trick in the book – printing money to repay debts with debased currencies, and inflate away the real value of the debts. There is no other hope of repaying the mountains of government debt – with ageing populations, pensioner numbers growing more quickly than the workforce, unaffordable welfare commitments, and politicians promising even more tax cuts.

History is littered with episodes where governments abandoned fixed currency systems to print excess amounts of money (usually to finance wars or repay debts). The resulting inflation led to civil unrest, often involving the violent overthrow of governments. Peace and prosperity is generally only restored with a 'hard money' system, where a government's ability to create money is restricted by the supply of a limited hard currency, usually silver, gold or a common currency like the euro. This has been the pattern ever since Ancient Greece, where it all began.

Two destructive inventions

Dionysius (405 – 367 BC) was the despotic tyrant of Syracuse in Sicily during the wars between the Corinthians, Athenians and Carthaginians for control of Syracuse. Dionysius invented two great weapons of mass destruction – the catapult and money debasement. The catapult was effective in destroying the Athenians, but Dionysius' debasement of money in his own city resulted in inflation, unrest and rebellion.

Dionysius had run up huge debts to the public and he wanted an easy way to repay the debts without raising taxes. He recalled all the one drachma coins in Syracuse (on penalty of death), and then over-stamped each coin with a 2 and used these newly minted '2 drachma' coins to repay his debts. The people were not happy! Doubling the total face value of money in circulation just doubled the money price of everything. A bag of grain was still a bag of grain, but its price in drachma was now effectively inflated by 100%. The money the people received in repayment of their debts only bought half as much as it did before the debasement.

Plato's tin pot scheme

The philosopher Plato was also a soft currency man. Under his guidance, Dionysius introduced coins made from tin in 388 BC but the plan failed. The people knew the value of the tin in the coins was only a fraction of the artificial value stamped on them, so they had no trust in the coins and the experiment failed. The coins soon fell to the value of the tin: virtually worthless. Plato was sold as a slave as punishment. In the ensuing economic and social turmoil, the rule of Dionysius and his son Dionysius II collapsed. The Corinthians finally restored order and democracy, and made peace with Carthage in 343 BC.

Fortunately Plato's student, Aristotle learned the lesson and became a hard currency man. He introduced a common silver-backed currency across Greek states and territories. Governments were restricted from creating money by the supply of silver. Confidence was restored, prices were stabilised, trade and commerce flourished, the citizens became wealthy. Alexander the Great, Aristotle's own student maintained the hard currency stance, but after his death in 323 BC, the currency was debased repeatedly and the economy declined along with the empire.

History repeats itself

Almost every country in every era, from Syracuse to the US, has succumbed to the temptation to create money at a rate higher than the rate of growth in output in the economy. The outcomes have been remarkably consistent: economic disruption, price inflation and social and political unrest. Inflation often provided the catalyst for violent rebellion and revolution. Individuals and businesses want a system of money they can trust, where the money has real value and substance and where prices remain stable and predictable.

These episodes often take many years to unfold. Japan has been printing money furiously since the 1990s. The US, UK and Europe joined in during the GFC with Switzerland more recently, in spectacular fashion. Bernanke added 100% to the monetary base in 'QE-1', added another 100% in 'QE-2' and is now embarking on a potentially unlimited 'QE-3'. To date, investors have not been concerned about inflation. Unemployment rates are high and yields on long term government bonds are at multi-century lows – investors globally are not assuming any risk of inflation or default for many years. Five countries actually pay negative yields on their short term government debt so investors are paying governments to take their money!

Although the crisis has taken many years to build, perceptions can change quickly. Once inflation is out of the bag it is devilishly difficult to contain. Un-printing money is much more difficult than printing it.

Bond yields are very low now, but a sudden catalyst can change sentiment 'on a dime'. Yields will start to jump, probably in the US first, as the drivers of economic growth are stronger there than in Europe, UK or Japan. Investors everywhere will suddenly realise that it is crazy to lend their hard earned money to profligate governments for 10 years for a lousy 1 or 2% with no inflation hedge. The stampede to get out of bonds will be on and the next inflationary spiral will have begun.

Ashley Owen is a director of Third Link Investment Managers and joint CEO of Philo Capital Advisers.

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3 comments on "Catapults and coin tricks: what Ben Bernanke learned from the Greeks"

1. John Joneson December 4, 2012 at 5:46 AM said:

   Thanks, Ashley, a really interesting historical perspective, and let's hope bonds paying little or no interest can continue to find buyers, or governments around the world will have a problem.

   Reply ↓

2. David Bellon December 30, 2012 at 10:45 AM said:

   Ashley,

Interesting article – I enjoyed the financial history lesson. A lot of the printing money / inflation arguments are based on the formula:

$$MV = Py$$

where M is money supply, V the velocity of money (or the turnover of printed money), P the average price of goods and services, and y the total quantity of all goods and services sold during a period of time.

There are a number of articles suggesting that this time around inflation will not soar as V (velocity of money) has fallen significantly. In coming to your view I guess you have the view that V can increase when the economy improves.

David Bell

Reply ↓

3. Warren Birdon February 4, 2013 at 4:27 PM said:

   I agree with David. The times when 'printing money' has been simply inflationary and created social disruption have been when economic growth has been running at potential or above. During times of suppressed, sub-par growth, when there is a large output gap in the economy – which shows up as low V in the quantity theory equation David referred to – stimulatory monetary policy has a role to play in closing that gap. Only once that has happened does inflation become a risk, if the stimulus is not removed in time.

   Reply ↓

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