

THE INTERNATIONAL MONETARY ORDER ON THE MOVE – *consequences for accounting*

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What Money is

Money is the universally accepted means of exchange.



What money does

Means of exchange function

Unit of account function

Store of value function

Means of deferred payment



The role of *free market* money prices

Money prices provide signals of (relative) scarcity, thereby:

- putting scarce resources to their most valuable uses;
- equalizing supply and demand; and
- making economic calculation possible.

Monetary accounting in a monetary economy

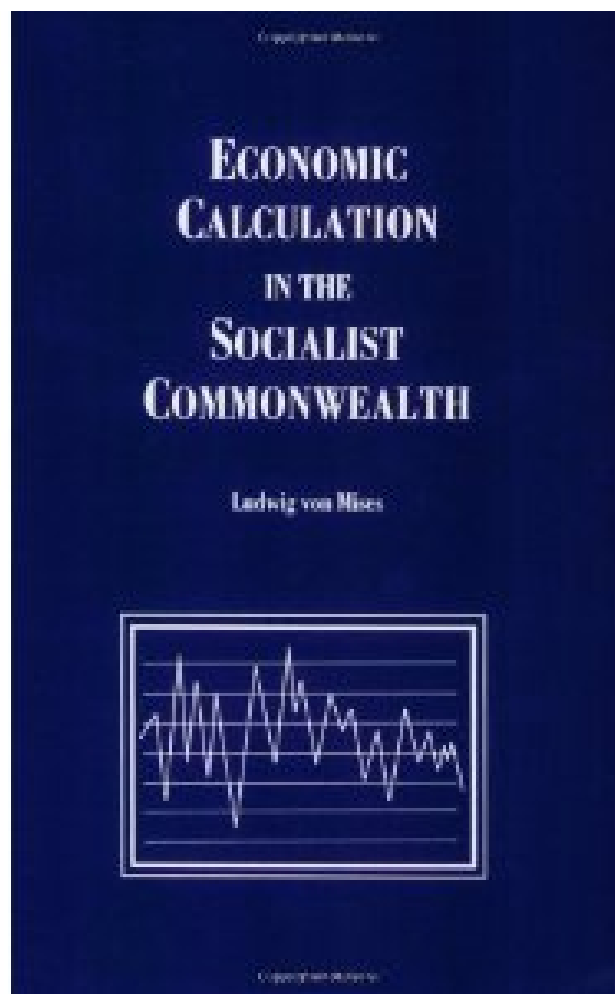
„Monetary calculation and cost accounting constitute the most important intellectual tool of the capitalist entrepreneur, and it was no one less than Goethe who pronounced the system of double-entry bookkeeping one of the finest inventions of the human mind.“

—Ludwig von Mises (1927 German), *Liberalism*, p. 97.



Ludwig von Mises
1881 – 1973

Monetary accounting provides the entrepreneur with an economic image (which is, of course, far from perfect) of the results of his operations. *He can calculate profit and loss*, so he is in a position to learn how successful or unsuccessful his transactions were.



Ludwig von Mises, *Economic Calculation In The Socialist Commonwealth*, published in 1920; the English translation was first published in Friedrich August von Hayek, ed., *Collectivist Economic Planning*, London: George Routledge & Sons, 1935.



Satellite view of both North and South Korea at night

Requirements for money in a monetary economy

In a market economy *there is no such a thing as stability*. This applies also to money, as *money is a good like any other good* (with money being the good with the highest liquidity).

A rise in the stock of money does *not* – unlike a rise in other goods (like bread, shoes, etc.) – confer a social benefit. The public is not made richer by a rise in the money stock, only some benefit at the expense of others (“Cantillon Effect”).

In terms of accounting and calculation, money works best *if its quantity doesn't change that much over time*, and if any such changes do not come in an (entirely) unpredictable fashion.

Inflation and monetary calculation

		Period					
		0	1	2	3	4	5
(1)	Purchase of machinery	-100.0
(2)	Write offs	...	20.0	20.0	20.0	20.0	20.0
(3)	Earnings	...	30.0	30.0	30.0	30.0	30.0
(4) = (3) - (2)	Profit	...	10.0	10.0	10.0	10.0	10.0
(5)	Machinery price, inflation adjusted	100.0	110.0	121.0	133.1	146.4	161.1
(6)	Write offs	...	32.2	32.2	32.2	32.2	32.2
(7) = (3) - (6)	Inflation adjusted profit	...	-2.2	-2.2	-2.2	-2.2	-2.2

Assumption: Inflation is 10% p.a.

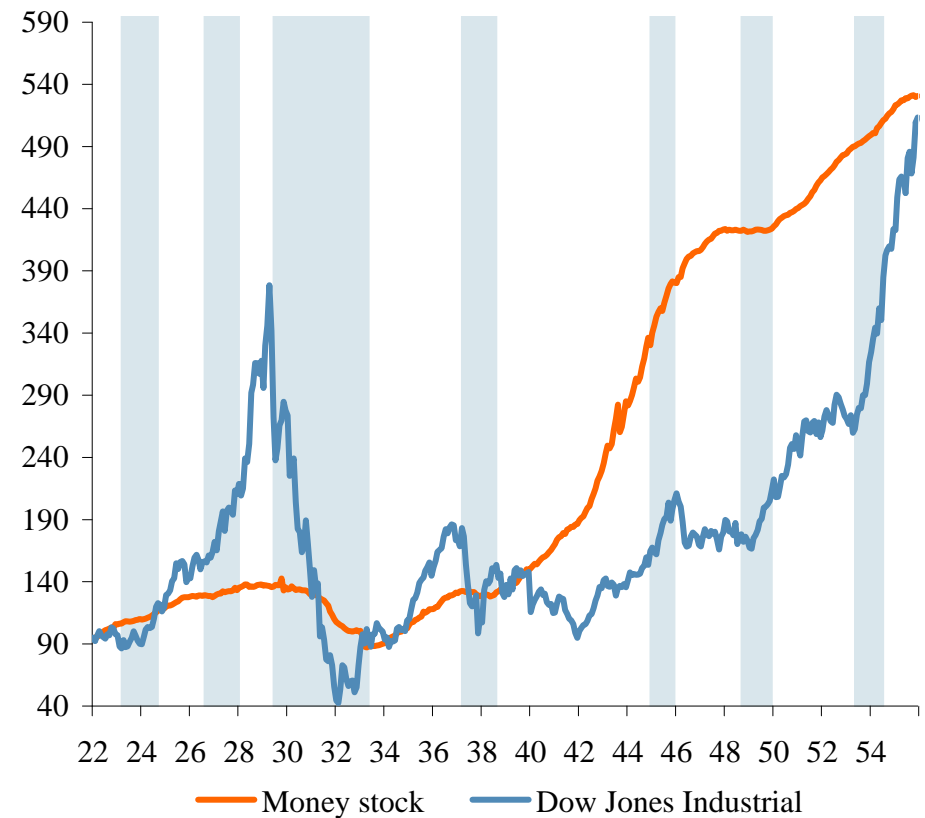
(6) = 161.1 (replacement costs) divided by 5.

The ‘cluster of error’

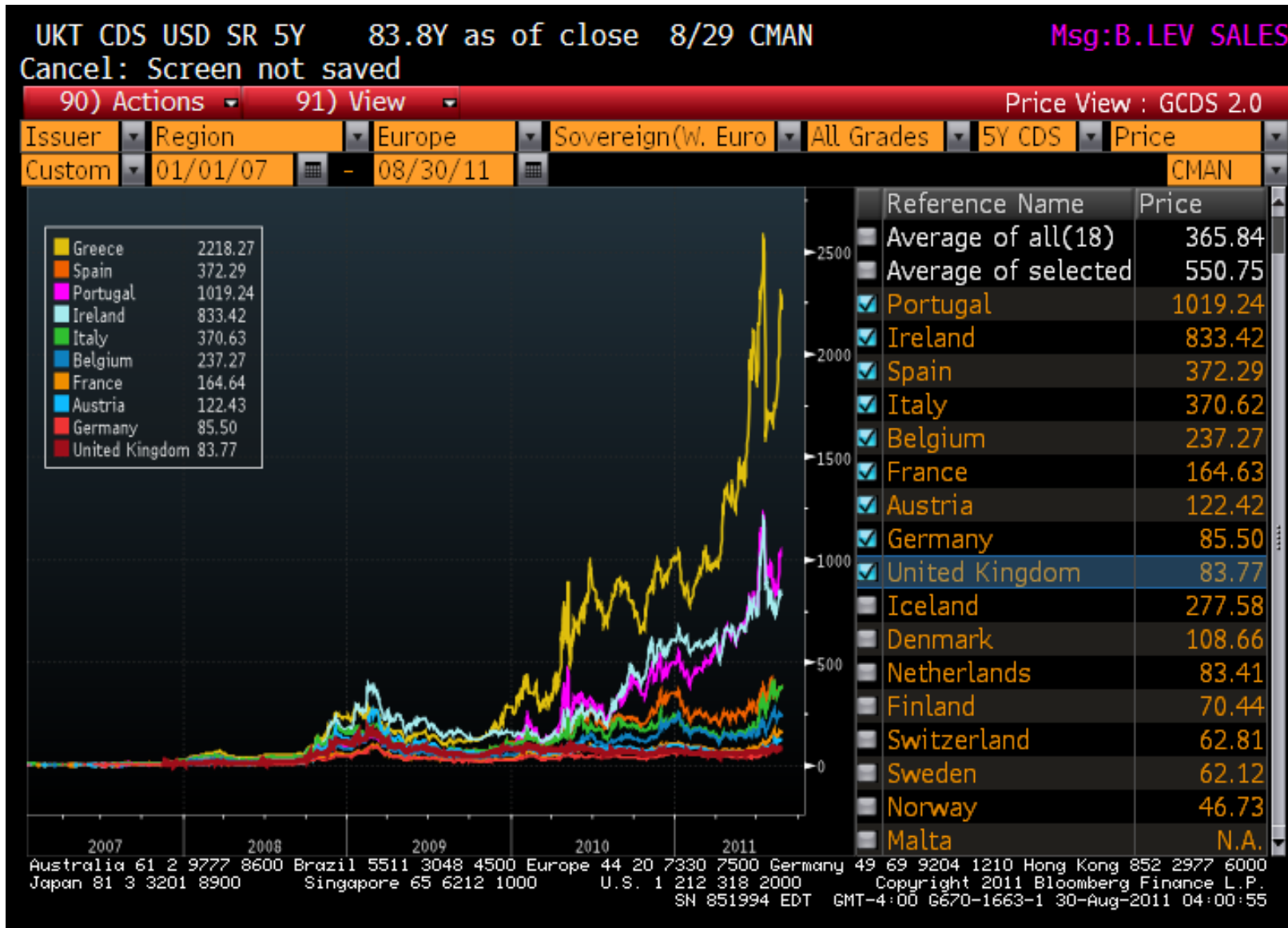
“[W]hy is there a sudden general cluster of business errors? (...) Business activity moves along nicely with most business firms making handsome profits. Suddenly, without warning, conditions change and the bulk of business firms are experiencing losses; they are suddenly revealed to have made grievous errors in forecasting.”

—Rothbard, M. N. (2000 [1963]), *America’s Great Depression*, 5th ed., Ludwig von Mises Institute, p. 8.

Money stock and Dow Jones Industrial stock market index*



Source: Thomson Financial, Bloomberg, NBER, own calculations. - *Indexed, January 1922 = 100. - Shaded areas recession periods according to NBER.





Milton Friedman
1912 – 2006

“(...) a world monetary system has emerged that has no historical precedent: a system in which every major currency in the world is ... on an irredeemable paper money standard (...).

“The ultimate consequences of this development are shrouded in uncertainty.”

Friedman, M. (1992), *Money Mischief: Episodes in Monetary History*, Harcourt Brace Jovanovich, New York, 1992, pp. 249, 252 – 4.



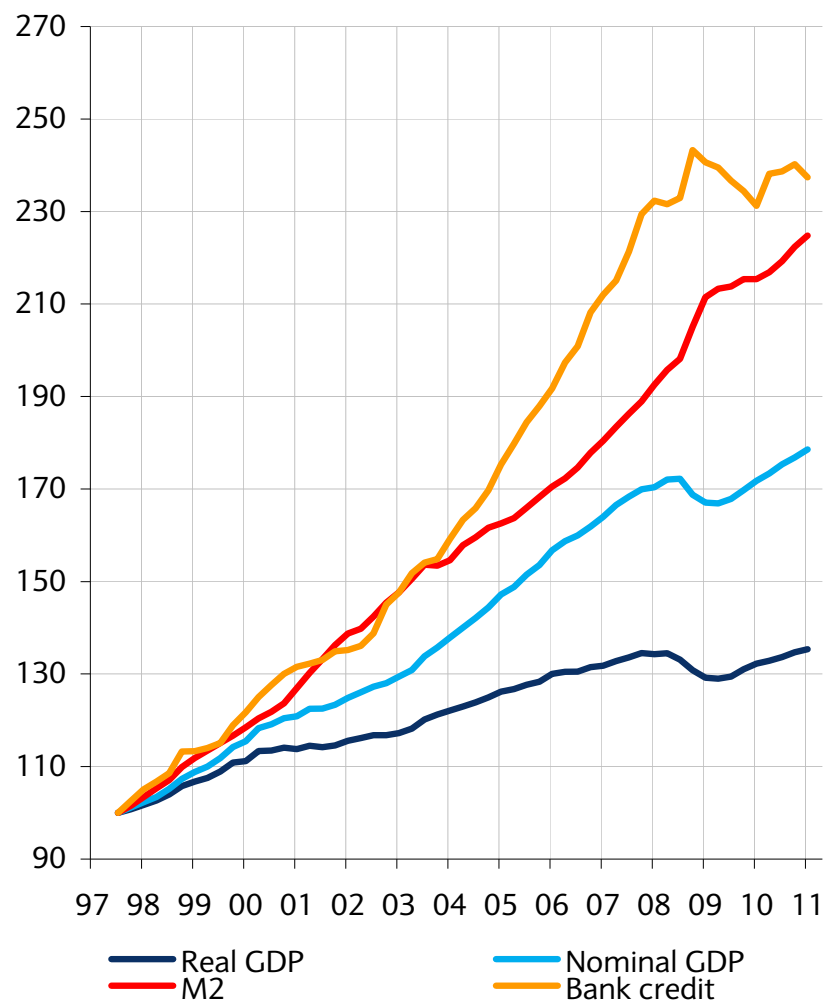
Friedrich August von Hayek
1899 – 1992

“The past instability of the market economy is the consequence of the exclusion of the most important regulator of the market mechanism, money, from itself being regulated by the market process.”

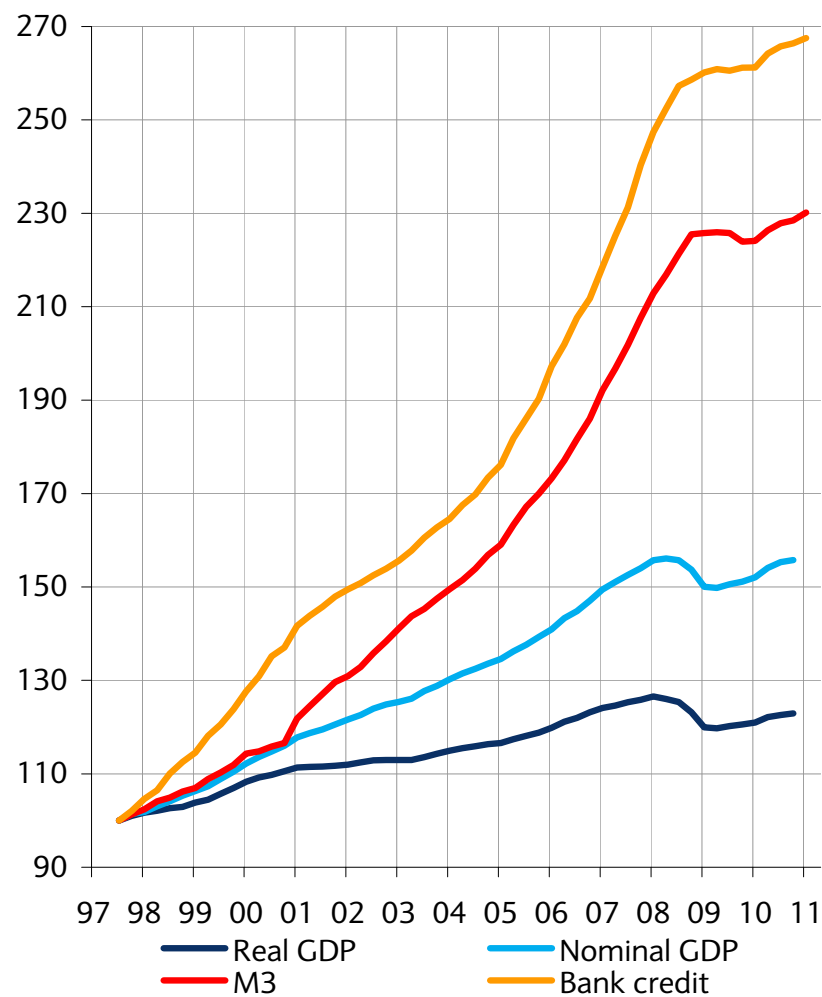
Hayek, F. A. v. (1976), *Denationalisation of Money*, The Institute of Economic Affairs, London, p. 102.

Bank credit, money stock and GDP*

(a) US

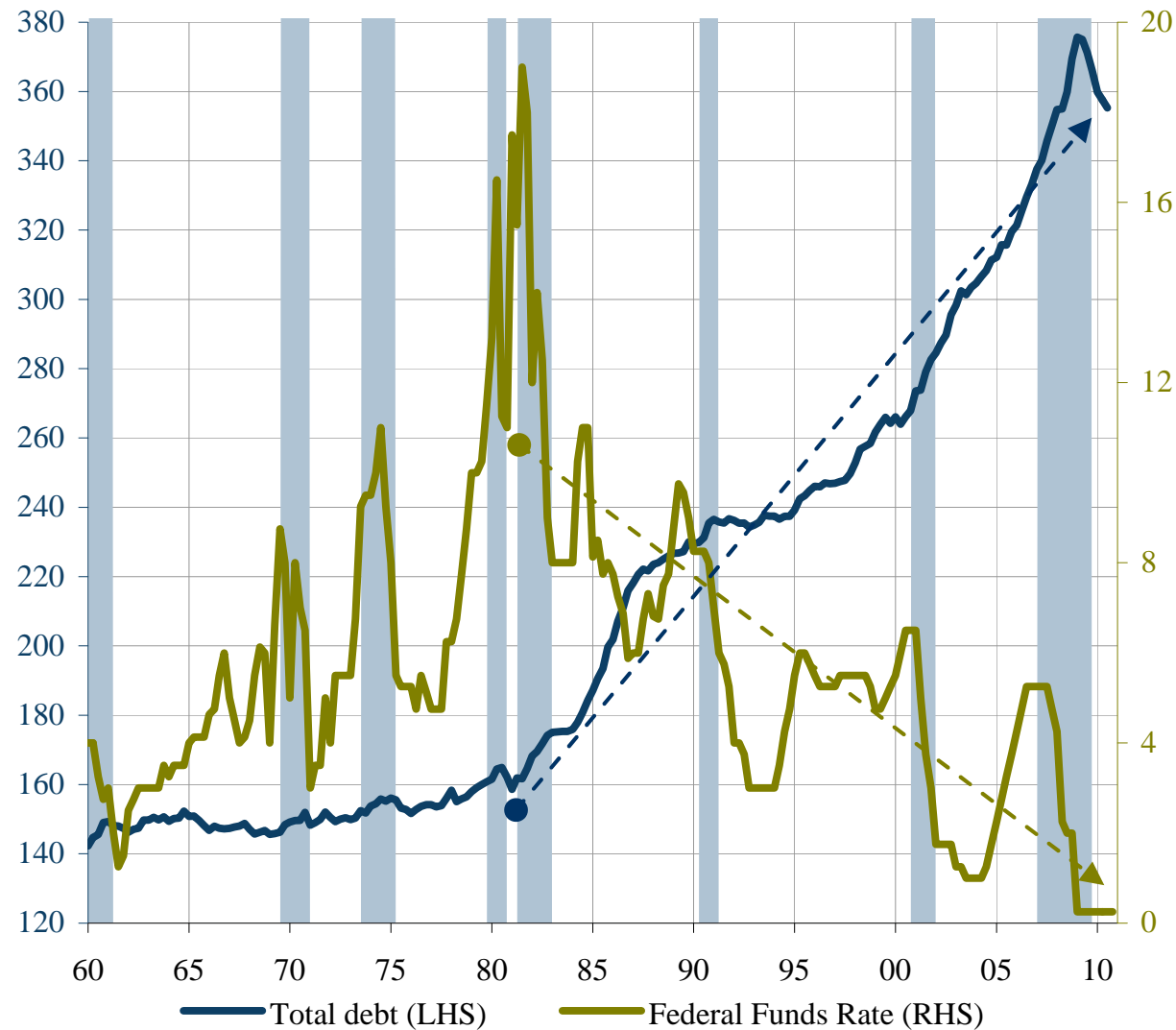


(b) Euro area



Source : Thomson Financial, own calculations. *Series are indexed (Q3 '97 = 100).

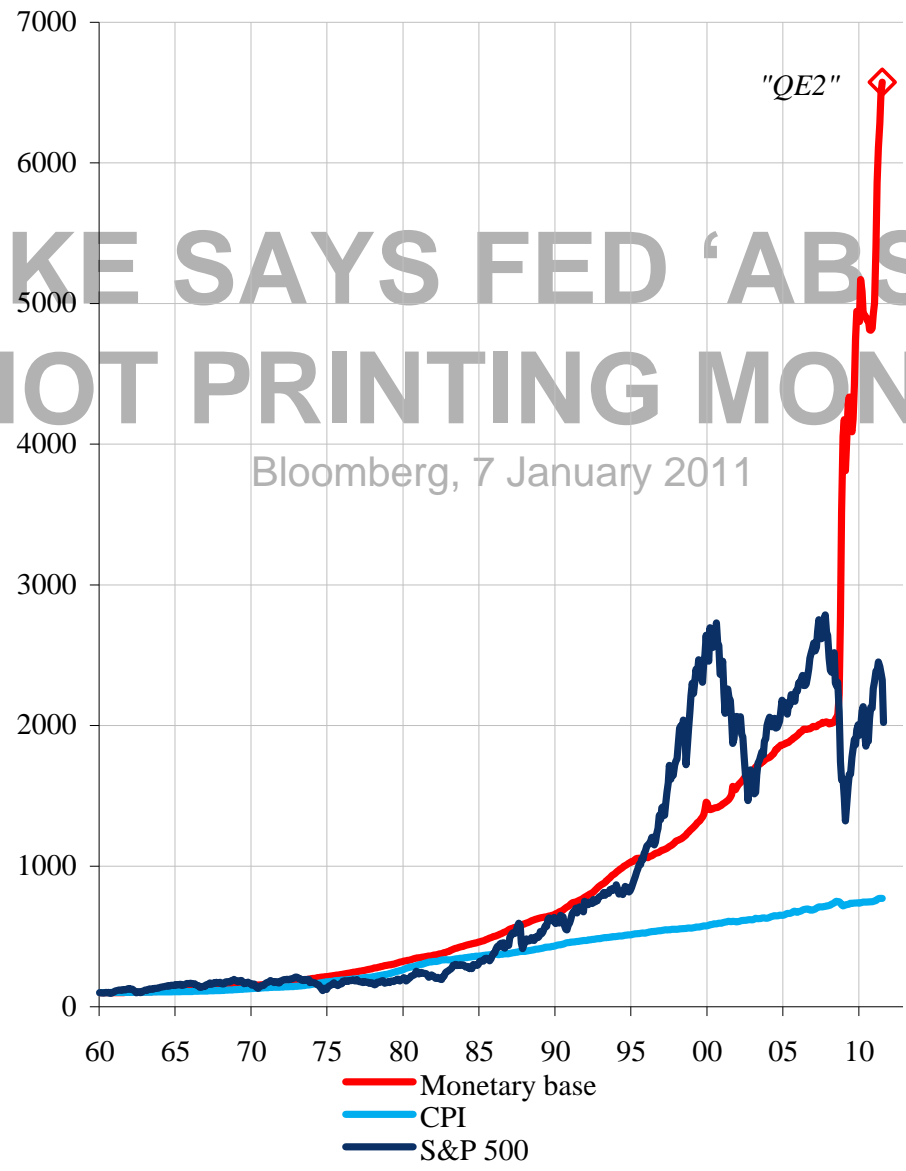
US total debt level in % of GDP and Federal Funds Rate (%)



Source : Thomson Financial, own calculations. Shaded areas represent recession periods according to NBER. Effective Federal Funds Rate up to 1971-Q1, thereafter target rate.

US monetary base, CPI and S&P 500

BERNANKE SAYS FED 'ABSOLUTELY' NOT PRINTING MONEY

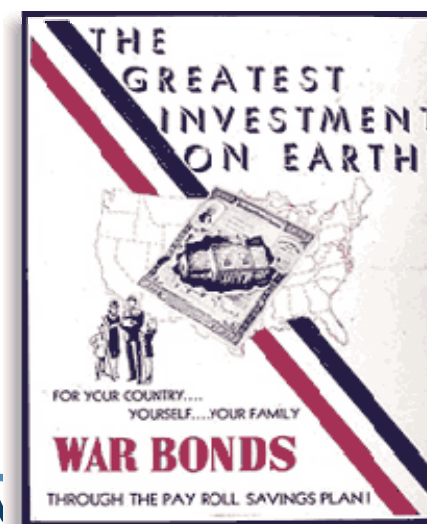
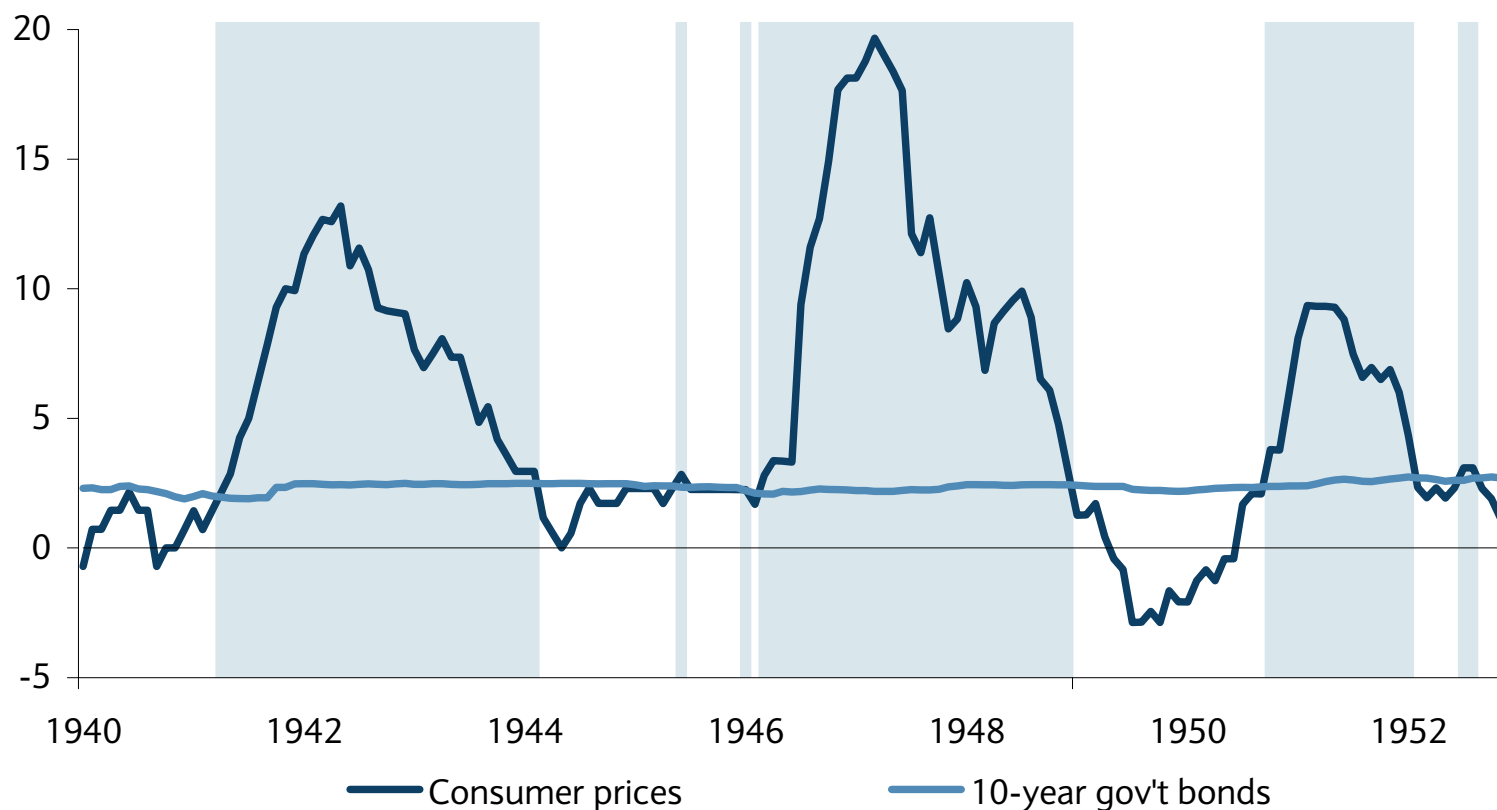


Bloomberg, 7 January 2011

Source: Thomson Financial, own calculation.

*Series are indexed (Jan '60 = 100).

US consumer prices (% y/y) and 10-year gov't bond yields (%), 1940 - 1952



World War II War Bonds poster

Source: Federal Reserve Bank of St. Louis, R. Shiller, own calculations.

Shaded areas: Consumer price inflation higher than nominal yields.

“The global crisis resurrected deep-rooted concerns about the functioning of the international monetary system (IMS). Despite its relative stability, the current “non-system” has the inherent weaknesses of a setup with a dominant country-issued reserve currency, wherein the reserve issuer runs fiscal and external deficits to meet growing world demand for reserve assets and where there is no ready mechanism forcing surplus or reserve-issuing countries to adjust.”

—KDI/IMF Conference on Reconstructing the World Economy, February 25, 2010, Seoul, Korea, <http://www.imf.org/external/np/seminars/eng/2010/kdi/pdf/ims.pdf>



Conference of Bretton Woods, July 1944





“The system should also consider employing gold as an international reference point of market expectations about inflation, deflation and future currency values.”

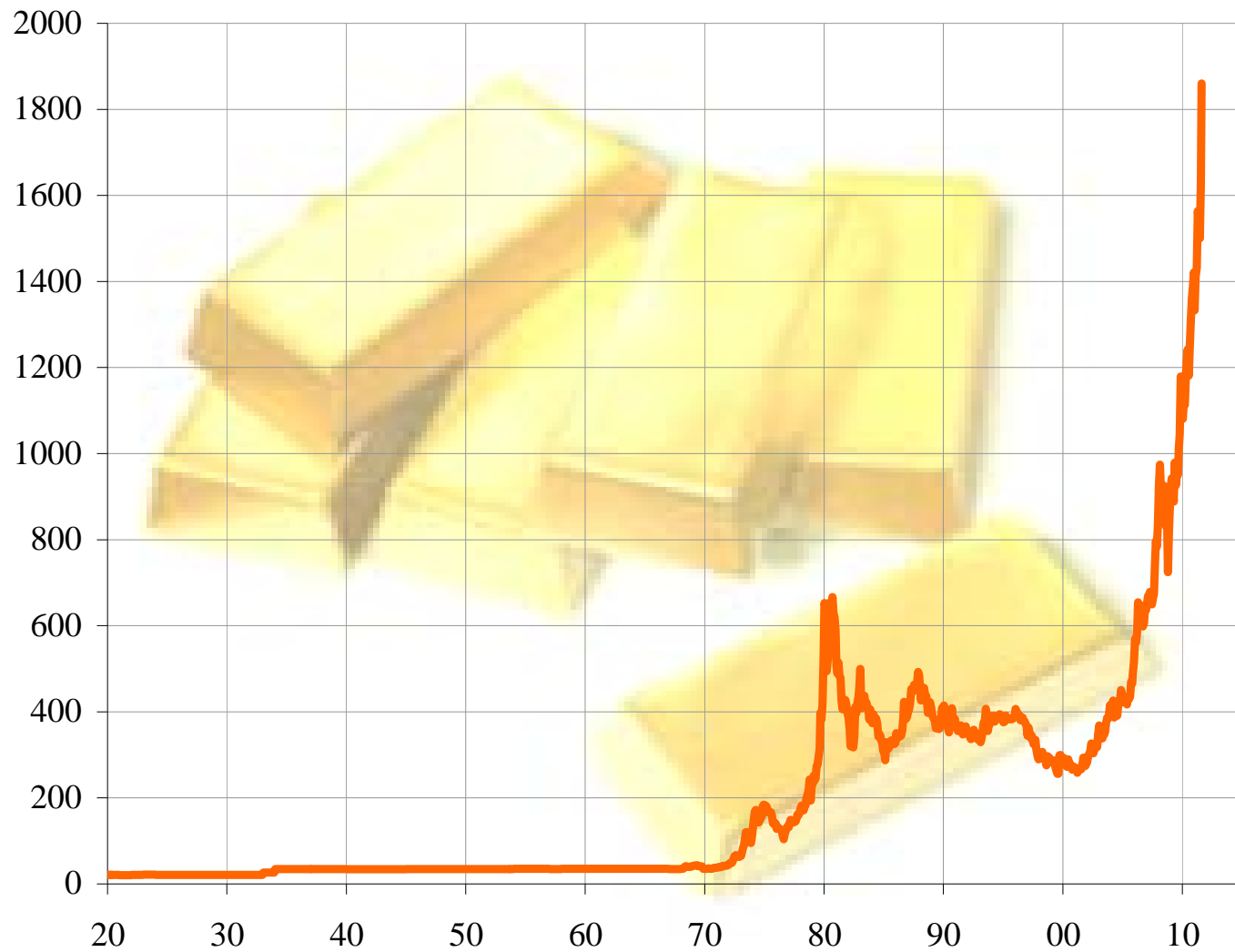
Source: Zoellick, R., The G20 must look beyond Bretton Woods II, in: FT, 7 November 2010.



“The desirable goal of reforming the international monetary system ... is to create an international reserve currency that is disconnected from individual nations and is able to remain stable in the long run, thus removing the inherent deficiencies caused by using credit-based national currencies.”

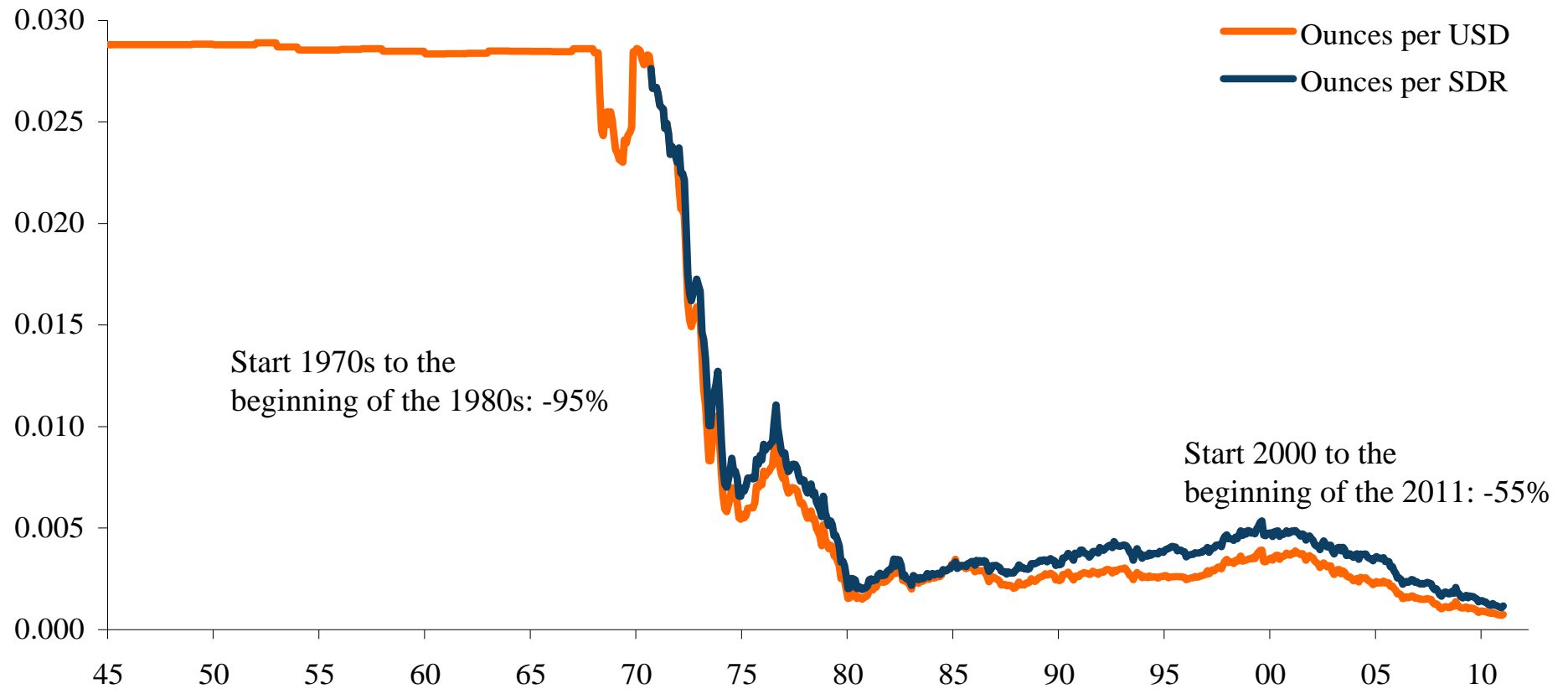
Source: Zhou Xiaochuan, Governor of The Peoples' Bank of China, Reform the International Monetary System, 23 March 2009.

US\$ per ounce of gold



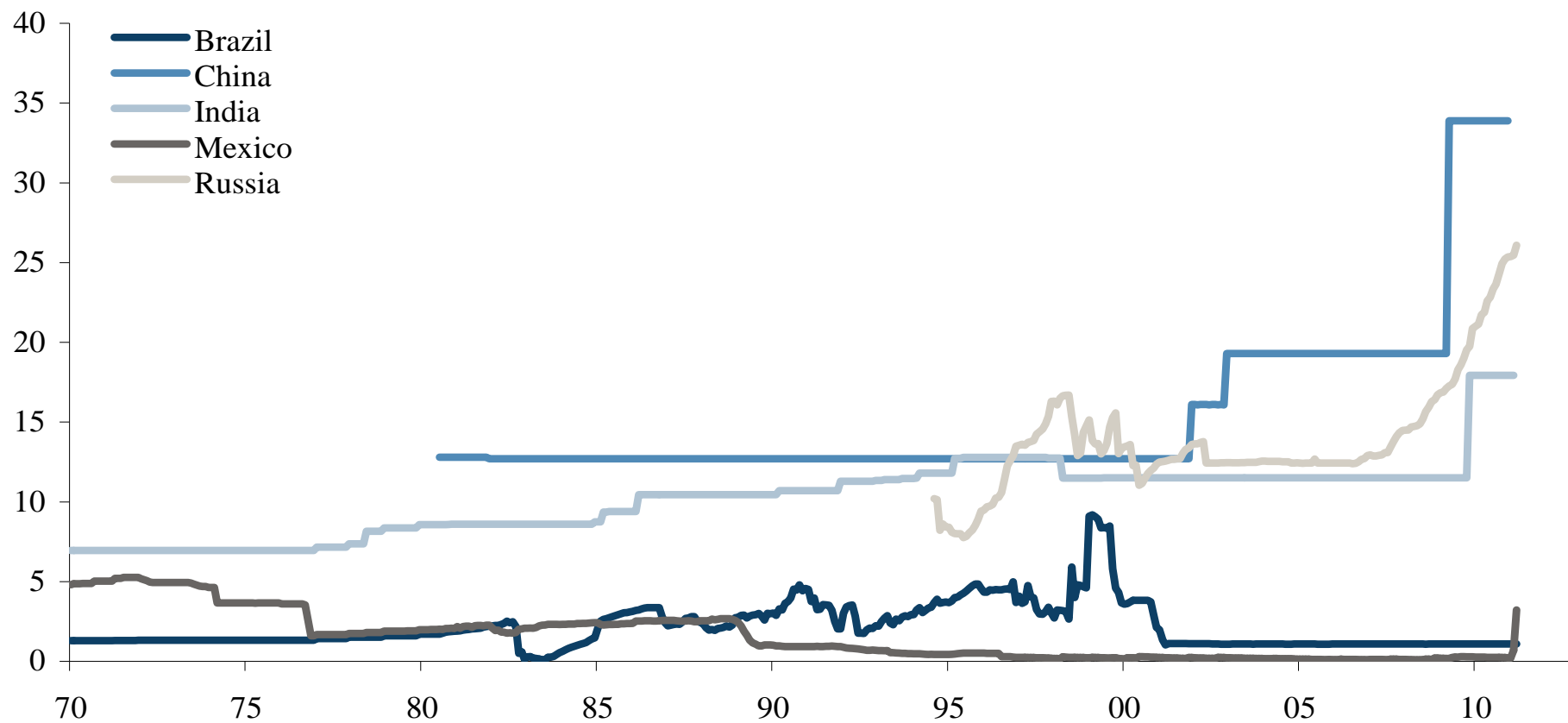
Source: Bloomberg.

Gold ounces per USD and Special drawing rights (SDR)



Source: Bloomberg, own calculation.

Official gold reserves, ounces mn



Source: IMF, Bloomberg.

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