The U.S. money supply that can be accurately counted,

the M2

MONEY SUPPLY

is government money plus bank deposits and
non-institutional money-market funds.

But the actual real

EFFECTIVE

MONEY SUPPLY

of the entire world can only be estimated approximately,

and is made up of precious metals plus all government and bank money plus *any* loans of *any* type on *any* thing *any*where.

This world uses - and has been using for thousands of years - what is termed a " ***fractional reserve banking system***".

We know, since recorded time, that goldsmiths were issuing paper receipts for gold and these circulated as paper money does today.

These early goldsmiths got rich by writing up many more of these receipts for gold than they had gold backing for because only a fraction of people came in - *at any one time* - to actually obtain their gold.

This " ***fractional reserve banking system***". works in today's banks as well because only a fraction of the people with money in the bank come in - *at any one time* - to get their money out. Therefore, your government and other governments claim, banks only need to keep a fraction of their money in reserve; this is a certain percentage of their money that is never loaned out.

This " ***fractional reserve banking system***". keeps far more people employed than if only precious metal coins are used as money. However, it is not a stable system and it has severely broken down time and time again throughout the ages. It only seems to work OK when intelligent people running a strong central bank control the world's money: such as when the Bank of England and then the United States Federal Reserve in the late 1940s and early 1950s ruled the roost. Constantine set up a system where there was no inflation whatsoever for two hundred years. But unfortunately today, with many countries running the show, the money system is beginning to show the same instability that it produced over and over again in the dim and distant past.

On November 14, 1974 Henry Kissinger made a speech saying ". . . The Industrial nations now face a collective payments deficit of **forty** **trillion** dollars, the largest in history . . . The nations of the developing world now face a yearly deficit of **twenty** **trillion** . . ." (this can be found in ***The Coming Deflation*** a book by C.V. Myers 1976, page 199)

Today in the year 2012, the deficit for the developing nations is probably closer to a **hundred** **trillion** and the deficit for all the industrial nations is in the **hundreds** **of** **trillions**.

Not even considering the over one quadrillion - *yes, over **one quadrillion*** - dollars worth of derivatives, the amount of the **effective** **money supply** in circulation, in this world, is somewhere between 12 - 30 times the amount of the world's gold and printed paper currency money. This banking money supply, my friends, is the worrisome money because it expands or shrinks along with mob psychology.

Thus, most of the money used in this world is not real money; it is **borrowed** **money** created by the banking system and this money is basically controlled - increased or decreased - via the way the greater number of people are thinking at that particular time.

People can spend borrowed money - driving up prices - exactly the same way they can spend real earned money.

So all this bank type money - *any loan on any thing anywhere* - causes inflation, exactly the same as printed money. And when it is removed then it causes deflation (falling prices).

These deflations - caused by bankruptcies and defaults lowering the money supply - come fast! And the more money involved, the faster they come and the damage caused is more severe.

In the 1929 stock market crash, stocks eventually lost 90% of their value. But if Europe comes unglued, the results to world stock and bond markets could be far worse than that. Remember, now we will also be having derivatives adding to the deflationary fire.

This fractional reserve banking system gives us **both** severe i**nflations** - such as in Germany where at the end of 1923 a person needed 726 billion marks to buy what one mark bought in 1921 - and severe **deflations** as the one in the U.S. that began abruptly in 1929.

It's a banking system that is far better than slavery in getting a huge amount of work out of the people but it often lacks a good steering system that can keep it going straight down the road. It always wants to waver either toward inflation or deflation.

Governments can prevent deflations if enough money is spent fast enough. Recently the U.S. spent enough fast enough but Europe unfortunately didn't. Soon there will be major defaults and bankruptcies in Greece. And Spain with over one fourth of its people already out of work is headed for possible revolution. Europe has poured its money - *a bit too late* - into these and other small countries leaving practically nothing for Italy's future problems and Italy's much larger economy is the one I most worry about.

Therefore, this gives *(my estimation)* close to a fifty-fifty chance - *as this Euro problem continues* - that a severe deflation may be coming to all of us providing China slows down considerably too. But China is the one country that has enough capital to keep expanding regardless of a world slowdown. My hope is that China keeps moving people from the farms and into her newly built cities thus keeping expansion in China above 5% and providing all of us a lesser chance of a severe deflation..

However, if a world-wide deflation does indeed happen, while this page is still on the internet, then I think this **effective money supply** concept is the simplest and best way to comprehend exactly **why** it did happen.

This world's population, just in my lifetime, has grown from just over one billion to seven billion today who we are barely able to feed. This exponential population, energy and monetary growth is simply **not sustainable!** The long-term consequences will be highly inflationary as society breaks down but at first will come a **deflationary collapse** of this exponentially growing bubble.

Daniel P. Fitzpatrick Jr.

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For **4 Decades** of my writings: click *http://www.amperefitz.com/4.decades.htm*