



Freely Falling Currencies

The freely floating currency system may have its advantages and disadvantages. However, it has fundamentally changed the way we look at currencies. In doing so, it has created one major obstacle. We now compare currencies with one another to check if they have gained or lost value. This way of measurement is bizarre to say the least!

Currencies are meant to be exchanged for goods. Hence, their value must be measured against the amount of goods that they can buy. Comparing them against one another will provide an extremely misleading image especially when all currencies are falling in value. That is precisely what is happening in the modern world. In this article, we will discuss how comparing currencies against one another presents a completely different image as compared to what the reality is.

All Currencies Have Lost Value in the Past Century

Under the so called freely floating currency regimes, nearly all of the currencies have lost value. The common man may not realize that their money is losing value right while staying in their pockets. In fact, it is even losing value when it is in banks and is earning interest! The interest earned is barely enough to provide a hedge against rising inflation. There is barely any real interest earned. In fact, most people lose money on a real basis when they park their currencies in banks.

The United States dollar has lost over 94% of its value in the past century. Similarly, other major currencies like the Pound sterling have also been in a major decline. This consistent fall in value is unprecedented given the fact that the value of the dollar remained almost unchanged for the century prior to this! That was the period when the dollar was backed by gold and silver i.e. with real value and fiat money was not the predominant monetary system of the world.

The case of the rapid decline in the value of the United States dollar is not unique. Rather all currencies have lost a lot of value in the past few years. This can largely be attributed to the rise of the fiat currency system worldwide and the fact that a floating rate exchange system creates a false impression that some currencies are gaining value whereas other are losing value when in reality everybody is facing a decline. It is the relative measurement which creates this distorted vision. The countries that seem to be appreciating are the ones that are experiencing the least fall in value. However, their value is declining and not rising!

Changed Standard of Measurement

The modern foreign exchange system compares the value of one currency against the value of others. Thus, the value of the dollar is compared against the British pound or any such other currency. Hence, the movements in the dollar are relative to the movement in the pound. In this kind of measurement, both the currency units are variable and hence there is no stable basis to compare against.

So, the dollar could be losing value in the real-world due to inflation and the case could be same for the British pound as well. However, if the dollar is inflating less than the pound, it will appear as

though it is appreciating against the pound! Thus, freely floating currencies end up becoming freely falling currencies. They gain or lose value when compared to one another whereas when it comes to buying goods and services in the real world all of them have significantly lost purchasing power.

This can be contrasted with the gold standard. The value of gold was considered to be constant and the value of currencies would rise and fall against the gold. Thus, when the currency appreciated against the gold it also appreciated in the real world i.e. less of the currency was required to buy increasing quantities of goods and services. This was the gold standard. As we can see that the alternate system has led all the other currencies into a freefall!

Affects Underlying Economies

The freely falling currency system severely impacts the underlying economies as well. Inflation has become a way of life in the fiat money world! Workers expect their wages to rise more than their productivity. The loss of value that currencies face is considered to be the time value of money! Also, since the freely floating currencies change in value every minute, an obscene amount of resources are spent on predicting its future value. Speculators who add no value to the real world also end up making fortunes!

Thus, **from a conservative standpoint, the gold standard was probably the best way in which the monetary system of the world could and should be organized.** Currencies were a store of value during the gold standard era whereas in the era of freely floating exchange rates, they have simply become currencies that are freely falling in value!