# ROAD MAP TO SOUND MONEY: A LEGISLATIVE HEARING ON H.R. 1098 AND RESTORING THE DOLLAR

## HEARING

BEFORE THE

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DOMESTIC MONETARY POLICY
AND TECHNOLOGY

OF THE

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**Tuesday, September 13, 2011**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC MONETARY
POLICY AND TECHNOLOGY,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2:35 p.m., in room 2128, Rayburn House Office Building, Hon. Ron Paul [chairman of the subcommittee] presiding.

Members present: Representatives Paul, Jones, Luetkemeyer, and Huizenga.

Chairman PAUL. This hearing will come to order. Without objection, all members' opening statements will be made a part of the record.

Are there any other opening statements? Okay. I will make a brief opening statement and then we will go to our witnesses.

The monetary issue has been an issue that I have been fascinated with and interested in for a long time. I became much more aware of the significance of this issue back in August of 1971, with the breakdown of the Bretton Woods agreement. At that time, I was quite convinced and remain convinced that we have ushered in a special age that probably did not exist in the same fashion ever before. And we now have been living for 4 decades with a total fiat world currency, and it has created a lot of problems for us.

I am convinced also that we are on the verge of a change from the current status. Just as significant as it was in 1971, something had to give, and there was a change. And I think this is what the conflict in the markets and the chaos in the markets is telling us.

But too often, the people in the Congress are looking elsewhere to solve the problems. We, as a Congress, have lived way beyond our means because the people in this country wanted us to live beyond our means, and the monetary issue of course is very significant because it actually facilitates the spending.

So without the type of system of money that we have today, there would have been a limitation on the massive expansion of the size of government, spending, taxes, debt, and the crisis that we are facing right now. But very few are even thinking about monetary policy as a significant contributor to the economic problems we have today. More attention has been given to the Federal Reserve in recent years than it has in the past but we have a long way to go. But there are more and more people on both sides of this issue who are recognizing that monetary reform eventually will come. The big question is, is will they try to patch this up or transfer this into another system that is not much better than the one we have?

In many ways, that is what we did in 1971. We had a dollar reserve gold standard that broke down, and then we ushered in something actually worse and it probably lasted a lot longer than a lot of people expected. But today, because of the crisis, I think many are just wondering what is going to happen.

I have had a position for a long time about what I think we should do with the Federal Reserve; I don't believe it contributes all that much. But I have also taken the position that if I had the authority to do it, I probably wouldn't take the key, lock the door, and just allow the system to work its way out. I think that would be very chaotic, and that is not my position. So as early on as the Gold Commission in the early 1980s, even up until now, I still believe that the best way to go from one system to another is to try to allow the market to help us.

The British made a serious mistake when they tried to go back on the gold standard in the 1920s at an old ratio of the dollar to the pound and it obviously failed. Of course, it was blamed on the gold, not on the policy of transition.

So the market has to help us on this, the market has to help us if we ever want to relate our currency to gold again. I have been fascinated with some of the work of Hayek and others that talks about allowing currencies to compete with one another, let the markets sort it out. And it is a lot less threatening. Other countries are talking about that. The Mexican Government has talked about it. The Swiss Government has talked about just allowing other currencies to circulate within their own country. And when you think about it, that is what happens internationally all the time. Currencies fluctuate all the time, and that is one of the ways that they were able to keep the system together, is allow the competing currencies to fluctuate on a minute-to-minute basis.

So there is no reason in the world that we couldn't adapt to allowing competing currency within our own country. And then if people just love Federal Reserve Notes and want to spend Federal Reserve Notes and save in Federal Reserve Notes, let them do it. But others who might think that another system is better, I think we ought to talk about legalizing it.

To me, I would like to summarize and say, why don't we legalize the Constitution? The Constitution has been rather clear. It might not have given us the perfect monetary system and we didn't follow it very well. But at least it did indicate that the Founders didn't like paper money. They did not like emitting bills with credit. They did not like fiat money. And if we were to look just to the Constitution, it would mean that we should reconsider commodity money, something that governments can't control, can't monopolize, and let the market work.

So, those are basically my thoughts on this issue. I am anxious to hear the remarks from Dr. Parks and Dr. White on these issues, because I have studied this for many, many years and there are still a lot of questions to answer.

We do have a bill, H.R. 1098, which is far from a perfect bill. But it is a place to get started in talking about what we might do and how we can do it because things could change rapidly. Although many of us have been thinking about this for many, many years, things could move rapidly. Currency destructions, the end of currencies sometimes move much quicker than anybody dreams that it could. So a major crisis could come. It could come next month or next year or in a few years. But to me, there is no guarantee that we have 5 or 10 years to keep studying this. I think that we need to get people engaged in this and talking about it and understanding the monetary issue.

So I am very grateful to our two guests for coming today and for being willing to submit their remarks and answer some questions for us.

I will now go to our first witness. Dr. Lawrence Parks is the executive director and founder of the Foundation for the Advancement of Monetary Education. Dr. Parks has studied money for 30 years and was a student of the free market economist Murray Rothbard. His writings have appeared in The Economist, Pensions and Investment, and The Washington Times, among others. He has authored and produced over 200 educational videos on the U.S. monetary system. Dr. Parks is a member of the United Association of Labor Education and UAW 1981, AFL–CIO. He received his Ph.D. in operations research from the Polytechnic Institute of New York University.

Dr. Parks, please go ahead and give your summary and then we will go to our next witness.

**STATEMENT OF LAWRENCE M. PARKS, PH.D., EXECUTIVE DIRECTOR, FOUNDATION FOR THE ADVANCEMENT OF MONETARY EDUCATION**

Mr. PARKS. Thank you very much, Dr. Paul. It is a great honor to be here, and I appreciate the opportunity to testify in support of H.R. 1098, the Free Competition in Currency Act of 2011. I am honored to have been invited.

I know it must sound like hyperbole, but I believe that H.R. 1098 is perhaps the most important piece of legislation ever to come before the Congress, because H.R. 1098 is necessary to make a transition from a certain catastrophic collapse of our unauthorized by the Constitution, dishonest, and unstable legal tender, irredeemable paper-ticket-electronic monetary system.

While I suspect that this committee will be most interested in how this bill will affect jobs, debt, economic growth in capital markets, pensions, and a host of other important and timely topics, I am going to focus my opening statement with an example of the dishonesty, which is the Achilles' heel of the present system, by highlighting one of the many misrepresentations about our money.

There are three take-away points from my testimony. The first is that the system is not in conformity with the Constitution. The second, and very importantly, it is dishonest. And third, it is unstable and in the process of blowing up perhaps while I am testifying here today.

One can be certain of a complete collapse of this monetary system because there is no longer any market-based self-correcting mechanism for increasing debt, increasing the money supply, and increasing leverage. And any system, any physical system, any social system, any system without a self-correcting mechanism blows up. With no exceptions, the history of legal tender irredeemable paper-ticket money is that its purchasing power always approaches its cost of production, which is zero.

I want to explain why the system is dishonest. There are a myriad of misrepresentations and nondisclosure of material information about what we call a dollar. No amount of regulation or oversight committees will cure dishonesty. The only remedy is honesty.

To illustrate what in my view is the most egregious example of this dishonesty, I give an example of silver, although the same principle applies with gold. Now it was and remains inconvenient for people to carry around silver dollars because they are heavy and bulky. So what people did—let's have the first exhibit up there—is that they deposited their silver dollars typically in a bank and received in exchange a promissory note, a.k.a. a banknote or a note that bore the inscription that so many dollars had been deposited and the note was payable to the bearer on demand.

Here is an example of a United States note. And notice that this is not a dollar. At the top of the bill are the words, "United States Note." I don't know if you can see it from where you are sitting but under the image it says, "will pay to the bearer on demand one dollar." Well, what is a dollar?

Next slide [image of a silver dollar]. That is a dollar, as put into law by Alexander Hamilton in the Coinage Act of 1792. But then the promise to pay a dollar—let's have the next slide—was defaulted. Here is the punchline. The broken promissory note, the dishonored promissory note is now represented as being a dollar. This is a gross misrepresentation and is dishonest. This piece of paper is not even a valid note. The signatures of the Treasurer of the United States and the Secretary of the Treasury are gratuitous and deceptive.

In other words, what we use for money are just dishonered promissory notes that are misrepresented to be dollars. It means that all of the securities in our capital markets at home and abroad are denominated in dishonored promissory notes. This has immense implications for trade, jobs, pensions, military preparedness, and almost everything else that is important.

People have the notion that the Congress can make the dollar anything the Congress wants it to be and back it with specie or not or whatever. This is demonstrably false. The highest law in our country is the Constitution and all of our laws have to be in conformity with it. The word "dollar" is mentioned twice in the Constitution but it is not defined in the Constitution. It is mentioned in connection with the Slave Tax, which is no more, but it is also mentioned very importantly in the Seventh Amendment, which guarantees everyone a right to a trial by jury for any dispute $20 or more.

If it were true that the Congress could redefine the dollar, that would mean that the Congress could redefine the Seventh Amendment, which is ridiculous. And so the question comes up, what is the objective meaning of the dollar? And in fact, for the Seventh Amendment to have objective meaning, the dollar has to have an objective meaning. And what they are talking about in the Constitution itself—next slide—is the Spanish Milled Dollar, sometimes called the piece of eight. The Spaniards had built mints all over the colonies and the Spanish Milled Dollar was ubiquitous. When independence was declared, the colonies adopted the Articles of Confederation, which gave the Congress the power to issue money called "continentals." Here is an example of a continental $30 bill.

Next slide. I don't know if you can read it from where you are sitting, but notice it "entitles the bearer to receive 30 Spanish Milled Dollars, or the Value thereof in Gold or Silver." The value of a coin is its specie content.

After independence was achieved and the Constitution was adopted, the United States did not want to rely on Spanish mints for its coins. The United States wanted its own mints to mint its own coins, including dollars. To that end, Alexander Hamilton, then Secretary of the Treasury, wrote the Coinage Act of 1792, wherein he tells us exactly what a dollar is. And what a dollar is, is 371.25 grains of silver. Where did Hamilton get that crazy number? That was the silver content of the Spanish Milled Dollar. They couldn't just introduce some arbitrary coin because everybody had contracts in terms of dollars. So the Constitution requires that the dollar be a weight of silver. Now some might claim that if Hamilton defined the dollar this way, perhaps it can be defined another way. And that is not true either. Hamilton's definition of a dollar was not arbitrary. All he did was write into law what was already a fact.

Here is another way of looking at this issue. Go to the next slide, please. Suppose we have a sign that says "cat" and we hang it on a dog. Does the dog become a cat? And suppose the Congress passes a law that says all the dogs with cat signs are now cats—go to the next slide—now are all of these dogs cats? And the answer is no. Conceptually, this is no different than taking a piece of paper, printing the word "dollar" on it, adding seals and signatures, and calling it a dollar. And this is precisely what has happened to our money.

Clearly, there is no easy remedy. How could such an immense fraud be perpetrated? There are several reasons but one of the most important ones, which H.R. 1098 will go a long way to correcting, is that we are coerced into using fraudulent money by the legal tender statutes. By getting rid of legal tender, H.R. 1098 is necessary and may be sufficient to help pave the way to an honest monetary system.

I am going to stop now and give you a chance to address any questions or issues that may come to mind. Thank you so much.

[The prepared statement of Dr. Parks can be found on page 24 of the appendix.]

Chairman PAUL. I thank you. I would like to go next to Dr. White.

Dr. Lawrence White is professor of economics at George Mason University, where he specializes in the theory and history of banking and money. Dr. White has written extensively on monetary systems with over 40 articles published in academic journals, including the American Economic Review and the Journal of Monetary

Economics. He has also authored three books on monetary matters, including "Competition and Currency: Essays on Free Banking and Money." He received his Ph.D. in economics from UCLA and his undergraduate degree in economics from Harvard.

Dr. White, you may proceed.

**STATEMENT OF LAWRENCE H. WHITE, PH.D., PROFESSOR OF ECONOMICS, DEPARTMENT OF ECONOMICS, GEORGE MASON UNIVERSITY**

Mr. WHITE. Thank you, Mr. Chairman. Thanks for the opportunity to discuss my views on H.R. 1098, the Free Competition and Currency Act of 2011. I am going to have to be very sweeping given the limited time, but I will be happy to answer any questions you might have about historical or other details.

The idea of competition in currency, or you might call it competition among currencies, is fairly straightforward. We know as a rule that open competition gives us better products, higher quality at lower cost. For example, we have faster and more reliable package delivery thanks to the competition of FedEx and United Parcel Service with the U.S. Postal Service. The main point I want to emphasize today is that competition in currency isn't any exception to this general rule. More competition promotes better currency.

Let me give you some examples. Throughout history, currency has been better provided by freely competing private enterprises than by government monopoly or by legally protected private monopoly. The United States had competing gold and silver mints at one time during our gold and silver rushes and they produced very trustworthy coins. These private mints ended only when they were suppressed by Civil War legislation, part of which H.R. 1098 aims to repeal. Redeemable private tokens and redeemable bank-issued paper currency notes have also been popular forms of money in the 60-plus parts of the world where they have been allowed.

H.R. 1098 would lift legal barriers to currency competition. It wouldn't immediately remove the U.S. Treasury or the Federal Reserve System from issuing currency. But—and then this is the second point I want to emphasize—competition would give the Fed better incentives to provide the kind of money that people want. Sound money, stable, valued money, trustworthy money. It would give the Fed better incentives to avoid creating inflation, in other words, because its customers could begin to go elsewhere. The U.S. dollar already faces competition, and I would say useful competition, in the international arena. People have a choice in international trade. Between the dollar and the euro, the Swiss franc and they can invest in gold and silver. So there are many monetary standards in the world.

H.R. 1098 would open a door to similar kinds of competition within the domestic arena between Federal Reserve Notes and other currencies. It won't make the Federal Reserve Note go away, as Dr. Paul said, if people want to use Federal Reserve Notes. New forms of currency won't gain a foothold in the market any faster than the public has reason to prefer them to Federal Reserve Notes. So the Fed can retain its business as long as it provides a high-quality product. But if the Fed slips up in quality control, meaning if double digit inflation should unfortunately return to the

United States, then the American public would find it very useful to have trustworthy alternatives to Federal Reserve Notes that are depreciating in their pockets.

So this Act offers three concrete reforms. And let me talk about them briefly. Section 2 of the Act removes legal tender status from Treasury coins and Federal Reserve Notes. Legal tender has a more narrow scope than is often realized. It relates to the discharge of debts. So the phrase on Federal Reserve Notes, "legal tender for all debts" means that under current law a creditor is barred from refusing payment in Federal Reserve Notes. But it is perfectly feasible to have debt contracts without legal tender, and, in fact, there is already an important class of contracts that are today exempt from legal tender provisions.

Under Title 31, Section 5118(d)(2), the obligations created by gold clause bonds are not discharged by delivery of legal tender today. That section says that the bond issuer has a contractual obligation to pay in gold. That is what the contract says, and that will be enforced. So removing legal tender status from U.S. Treasury coins and Federal Reserve Notes more generally would simply broaden the freedom to denominate debt contracts in whatever people want, not just dollars, not just gold. But they might want silver. They might want to say the debt is only discharged by checks or wire transfers of dollars, or it could be silver coins or it could be units of foreign currency, claims denominated in consumer index bundles or wholesale commodity bundles or it could be Bitcoins.

Section 3 of the Act rules out Federal or State taxes on precious metal coins, whether minted by a foreign government or by a private firm. That would allow a more level playing field for competition of private coins with the U.S. Treasury coins without the special tax disadvantages which now handicap private coins. Sales taxes on acquisition, capital gains taxes on holding them, right. Federal Reserve Notes are not subject to those taxes.

Section 4 of the Act repeals Title 18, Section 486. That section bans privately produced coins of gold, silver or other metals and it repeals Section 489 which bans disks that are merely similar to official coins. Section 486 is the relic of the Civil War that I mentioned. It was part of an effort to boost the acceptance of the wartime paper greenbacks by banning competition from the private gold coins that were being produced. Repealing that would again allow producers to make and consumers the option to use privately minted silver and gold coins if they like.

I think the question we should ask, in the words of Seth Lipsky in a recent Wall Street Journal article, is whether it makes any sense to "suppress private money that is sound in order to protect government-issued money that is unsound."

I have mentioned that Section 489 would also be repealed. That I think is a section that is redundant at best and far too sweeping at worst. It outlaws making or possessing "any token, disk or device in the likeness or similitude as to design, color, or the inscription thereon of any of the coins of the United States." It is redundant at best because there is already another section that outlaws counterfeiting and we are not talking about repealing the laws against counterfeiting. But this section is simply about similitude. And if you took it literally, it would outlaw all silver medallions because after all they are the same color as silver dollars and quarters and dimes. So it is too sweeping because it can be used to suppress private coinage, what we might say victimless private coinage that doesn't involve counterfeiting and doesn't involve any other fraudulent intent.

So to conclude, competition in currency is a very practical idea. It is an idea that offers sizable benefits to the public when the quality of the dominant currency becomes doubtful. Now we all hope that Federal Reserve Notes retain their value. But for those who are skeptical, they should have another alternative. U.S. citizens would benefit from H.R. 1098's removal of current legal restrictions and obstacles against currencies that could provide useful competition with Federal Reserve Notes and Treasury coins.

Thank you.

[The prepared statement of Dr. White can be found on page 87 of the appendix.]

Chairman PAUL. Thank you. I will start off with the questions. The first question will be for both of you.

What do you think the arguments will be by the establishment? How will they come back and describe what we are trying to do? And why is it—I think it is well known that governments have always wanted to cling to a monopoly power over the currency, and it must be related to that. But could you give me an idea of what you think they will be saying or trying to describe what is going to happen? And if they claim that this would be terribly chaotic, what are some of the answers that we might give to those questions that they raise?

Mr. WHITE. I suspect that the argument might be made that you are encouraging people to abandon the U.S. dollar and, thereby, you are undermining the U.S. economy. Right? But the answer is that the fate of the dollar or the purchasing power of the dollar is in the Federal Reserve's hands. And all we are doing is giving people the option to make the transition to a more stable system if the Federal Reserve Note should begin to deteriorate in value, in reliability.

If we look at the experience around the world with paper money, we know that high inflation is not impossible, and we have had double digit inflation in the United States. And where people are free, they start—in a country with very high inflation—in Latin America we see this many times—they prefer to start moving their savings into a more stable currency. And then they start posting prices in the more stable currency so that they don't have to repost them every day. And then they start accepting payment in the more stable currency. Having that freedom makes the public a lot better off. So giving people an additional option doesn't undermine the stability of the current monetary system. That is under the control of the people who issue the current money.

Chairman PAUL. Dr. Parks?

Mr. PARKS. What I suspect they are going to do is to ignore this altogether, not raise any objections at all, just leave it alone. However, should any objections come forth, I think the best response is that the irredeemable paper-ticket money is going away, and, in fact, the history of the world is that these paper moneys always go away. Why should this one be any different?

Second, the irredeemable paper-ticket dollar has lost something like 98 percent of its purchasing power since the Federal Reserve was formed. Why does anybody think that the last 2 percent is sacrosanct?

Third, there is a whole bunch of—how shall I say—trial balloons being put forth by the media talking about currency depreciation and why it is acceptable. So there was a time roughly about a year ago when Jeffrey Garten—Jeffrey Garten had a minor role in the Nixon Administration, was an Under Secretary of, I think Commerce, in the Clinton Administration, went on to be Dean of the Management School at Yale University, wrote five books, sometimes a publisher of articles in Business Week, member of the Council on Foreign Relations—published an article in the Financial Times, something to the effect of, we have to get ready for a weaker dollar. And he says in the Financial Times, the United States is going to have to camouflage a slow motion default. "Camouflage." In other words, not really explain to the people what they are doing. But there is no question at all that the obligations of this government, of all the local and State governments and all the other debts, these obligations are not going to be met. People's pensions are going to be lost.

Then this was followed up just recently by a professor from Harvard, Professor Rogoff, who published a piece saying that once every 75 years or so we have to have extra inflation, maybe 6, 7 percent, in order to get rid of this debt. And this was legitimatized further by Floyd Norris, senior writer from The New York Times, a very senior guy. He wrote an article, "Sometimes inflation is not evil."

So what they are really doing is setting us up for the depreciation of the dollar. And we know from history that once this gets started, once this gets out of the can, there is no way to put it back in the can.

Other things about this competition and money. It is true that you can make contracts in gold. However, in regular life, if you should have a contractual dispute with somebody and it gets settled in the courts, that judgment is going to come down in the irredeemable paper-ticket money. And it is also noteworthy that the people in the financial sector have gotten the International Monetary Fund—in 1978—to add a provision to the IMF Articles of Agreement—it is like their bylaws—to prohibit member countries from linking currencies to gold and only to gold. These folks have really knocked themselves out to get gold out of the monetary structure and I think part of the response should be that the reason they did that is so that they could garner unearned profits.

I have good evidence to show that. I think I am past my time. I don't know if you want to see some of that evidence.

I am asking you a question. Should I put it up?

Chairman PAUL. Yes.

Mr. PARKS. Thank you. Put up slide number 67, please. I am sorry, 56. Do you have that? 63. It is important. So if you go back to 1980, the money supply in this country, defined by the Federal Reserve at that time, was M3, was something on the order of $2 trillion. And the market capitalization of the stock market was roughly $1 trillion. The financial sector portion of that was roughly

5 percent, roughly $50 billion. You shift ahead to 2007. Now all created flat out of nothing, with no work, now the money supply is something on the order of $13 trillion. The stock market capitalization is approaching $20 trillion and now the value of the financial sector firms is something like $4 trillion. It went from $50 billion to $4 trillion. Forget about the bonuses. Think stock options. These folks have garnered just an incredible amount of money. They don't even know what to do with it. That would not have been possible if we had an honest monetary structure. And the way they got away from an honest monetary structure is they got gold out of the system. And the legal tender laws helped do that. So really you have to get rid of legal tender.

Chairman PAUL. Thank you. I want to move on. I want to yield time to the vice chairman of the committee, the gentleman from North Carolina, Walter Jones.

Mr. JONES. Mr. Chairman, thank you very much. Dr. Parks and Dr. White, thank you very much for your testimony today. I am going to take a little different approach. I am not an expert in financial matters of this magnitude, but I have learned a lot from my good friend Ron Paul, and being part of the Liberty Caucus has at least exposed me to some individuals like yourself who could help me become more interested in the issue of monetary policy.

I am one who is very much concerned, as most Americans are, that we are headed down the road of no return. And when I listened to both of your testimonies—and I listened very carefully—it brings me to a question that the average working American, which I am a part of that group, by the way, when do we know that we get to a monetary point of no return? When that collapse comes, is that something in your opinion that you see happening sooner rather than later? And what should the average person—what will make the average person realize that we are in a collapse as it relates to strength of the dollar?

Mr. WHITE. I think we are getting mixed messages right now. If we look at the exchange value of the U.S. dollar, it has declined precipitously the last couple of years. If we look at the price of gold, of course, that is shooting through the roof. And those are telling us that people don't want to hold their wealth in dollars. They want to move it into something they think is safer. On the other hand, if you look at the inflation indexed bonds or if you look at long-term bonds, those are not signaling the expectation of high inflation. But I am not sure how much we can trust those signals anymore because the Federal Reserve now has a policy of buying 30-year bonds to drive their prices up and drive their yields down. So that signal may be jammed a little bit.

But when we see all those signals indicating that high inflation is coming, then we know we have a big problem on our hands. And of course we don't just have a monetary problem. We also have a fiscal problem. We have a problem of an unsustainable debt going forward. And the two issues are of course related. As Dr. Parks mentioned, there has been talk about how we need inflation in order to relieve our national debt in real terms. But that is nothing more than a default, sort of behind a very thin veil in the form of the value of the dollars being paid back is reduced by half instead of the debt is explicitly cut in half. But it is the same thing. So when that becomes sort of respectable talk, then we have to be very worried.

I am not sure if I can identify exactly a tipping point. But when we see inflation get into double digits, then we will know we are in big trouble.

Mr. PARKS. I would say that collapse can come at any moment. And the amount of leverage in the system is beyond belief. Put up slide number 71, please. This is a slide showing the amount of derivative bets the banks have made all over the planet. It is something north of $600 trillion. This data comes from the Bank for International Settlements, which is sort of like an umbrella organization for all the central banks—it has sovereignty by the way. But one of the things it does, they calculate all these derivative bets.

Slide 71. There you go.

So after the last tie to gold was broken, which was in 1971, as you can see from this chart, basically the only derivative bets you had were things like commodities, corn, soybeans or whatever. But after the last tie to gold was broken you start to have volatility in interest rates, big volatility, and big volatility in foreign exchange rates, and people who are in business and people who trade between countries need to hedge that. Banks have made an incredible number of bets on this. According to the Bank for International Settlements, the amount at risk that can be lost is something like $30 to $40 trillion and this is worldwide. In this country, according to the Office of the Comptroller of the Currency, the amount of derivative bets is something on the order of $200 trillion, and of that, one bank, JPMorgan Chase has something like $80 trillion worth of derivative bets.

These bets, by the way, you have counterparty risk and that is what happened with AIG. That is why they really had to bail out AIG. AIG owed money to a bunch of banks. If you let AIG go down, then those banks' balance sheets become impaired.

But also on this business of inflation, they have changed the methodology of how they compute the CPI multiple times since the Clinton years.

Put up slide 27, please. There is a guy who is a scholar for us. His name is John Williams. He is in retirement now. He used to be an establishment economist with clients like Boeing and IBM. And what he does is he calculates the CPI using the consistent methodology from the 1980s—that is that top blue line—versus what the Bureau of Labor Statistics tells us today. And as you can see, on a consistent methodology basis, inflation is already and has been running 10, 11 percent for like 25 years. The understatement of the CPI, there are innovations such as the hedonic pricing, geometric weighting, substitution. Who knows what these people are talking about? They really lull people into thinking it is not as bad as it is.

I have prepared an analysis. Go to chart number 29, please. These are my health care premiums for Oxford while I had Oxford, and I compare the year-on-year increases with the medical component of the CPI. Next slide, please. With the medical component of the CPI and my insurance premiums—this is everybody in the whole country—they are going up 15 percent a year. But the medical component of the CPI is going up 4 percent a year. So they mislead people on that. And of course people who are seniors, who get Social Security and those benefits are keyed to the CPI. Disabled veterans, people who have cost-of-living escalations and union contracts and of course holders of Treasury inflation protection bonds, these people are all being cheated. But the tipping point comes, you don't know how it is because of the leverage. It is the leverage that always brings you down. And the leverage is beyond belief. As I said, it could happen while I am talking. You don't know when it is going to be.

Mr. JONES. Thank you, Mr. Chairman.

Chairman PAUL. I have a couple of follow-up questions that I would like to ask. I will start with Dr. White.

We have had this system of money since 1971 where there is no connection to gold and the dollar has been used as a reserve currency, to a slightly less degree than it was even a year ago, but it is still the major reserve currency and most of the countries hold dollars. And they pyramid down and inflate their own currencies from this. Have there been many times in history that it has been this significant, this big, this worldwide with the fiat currencies? I know we have had fiat currencies for as long as we can date. People have debased their currency in different manners. But has it ever been this big? Is this a special phenomenon? Or is this something that you can go back in history and say, it was sort of like this 200 years ago or 300 years ago and we worked our way out of it? How do you put this in perspective in history?

Mr. WHITE. As far as the international monetary system goes, the international monetary system was never a fiat system. It was the international silver standard and the international gold standard. And of course there is no potential for runaway inflation when you have a metallic currency. It is only mined to—1, 2 percent of the stock is produced each year. The stock of gold just doesn't grow that fast. And in fact, that makes it possible to have an international monetary system. It is not controlled by any one country. And so countries can join, knowing that it is safe from political devaluation from the interest of any one country undermining the system.

Countries that have adopted the dollar or who fix their own exchange rate to the dollar do so when they think the dollar is the most popular currency in world markets. But as you have mentioned, as the dollar becomes a little shakier, they start to shy away. China, most importantly, has moved from basing their currency entirely on the dollar to now a basket of currencies. So we are starting to see other countries starting to back away from the dollar.

In that sense, I think the move to create the European monetary system provides some real competition to the dollar as an international reserve currency. And we can only hope that that will give the Fed a signal that there is somebody they don't want to inflate faster than. Of course, it seems to be a race to the bottom right now.

Chairman PAUL. If we were successful and had something like we are proposing and we had a competing currency, what would happen with the concept of fractional-reserve banking? Would more laws have to be written? Or would they follow the same pattern that we have today? How do you think that would work?

Mr. WHITE. That is a very good question. If private gold and silver coins begin to be popular, people are going to want to have bank services denominated in gold units or silver units, whatever it is that they find attractive. I am not sure we really have a sort of legal barrier against the Fed controlling that parallel banking system the way they control the current banking system. So it might be necessary to construct some barriers and say, here are the rules for this parallel banking system. It doesn't have deposit insurance. It doesn't have control by the Federal Reserve System as to reserve ratios or investment portfolios. So we would need to think about that if we got to the point where there was a big demand for those services.

Chairman PAUL. I will follow up on that and ask both of you what your opinion is. Of fractional-reserve banking, you know in free market circles, there is a disagreement to a large degree on—I know Rothbard was very adamant, his position of no fractional-reserve banking. What is your opinion about what would be proper? And Larry, you can answer as well, as to whether we should have rules on what the banks declare.

Mr. WHITE. I think the basic should be freedom of contract. And as long as people make informed fractional-reserve contracts with a banker, I have no problem with that. Historically, that seems to have been what was more popular. If you have a fractional reserve then you don't need to pay storage fees to the vault keeper who is keeping your gold and you may even get interest on your account balance. So it is an attractive deal. It doesn't have to be based on hoodwinking the customers. Customers brought their money to fractional-reserve banks because they got a better deal.

The other thing worth noting is that you can't really have circulating paper currency, which is more convenient than carrying around coins for many purposes, unless you have fractional reserve banking. Because if it is a warehouse receipt, the warehouse needs to know who to charge the storage fees to. But if it is an anonymous circulating note, like we are accustomed to, how do they know who to charge the storage fees to? So I don't know of any historical examples of circulating warehouse receipts. But there are plenty of examples of pay to the bearer on demand in gold or silver circulating banknotes.

Chairman PAUL. Do you have an opinion on fractional-reserve banking?

Mr. PARKS. First question, put up slide number 73. This has to do with the size, the amount of fiat money out there. This is an analysis that is put together by McKinsey Global. And in 1980, the amount of financial securities was roughly—I don't know, it looks around $18 trillion. By the end of 2009, it was close to $200 trillion. Last year, it hit something like $212 trillion. I don't know if you can see on that chart, but at the very top it is in red, and that is gold. So all the rest is—it is irredeemable paper-ticket money, U.S. and foreign money, or securities denominated in irredeemable paper-ticket money.

The nice thing about this bill is that it leaves everything in place. It leaves the dollar in place, leaves the Federal Reserve in place, and it really facilitates a transition. And for everyday purposes, it really doesn't make any difference to people whether we use an irredeemable paper-ticket, token, or whatever. They go to work, they get paid, they buy stuff, who cares? Where it becomes important is for future payment for people's pensions, for people's annuities, for people's savings. There they want to know in the future that they are going to have what they have. So in that way, this bill is very important.

For future transactions, people will want gold and we have precedent in this country where this kind of thing was instituted. And that was after the Civil War. You recall the Civil War was financed with greenbacks at one point. The greenbacks were discounted roughly 50 percent against gold. And the way people looked to protect themselves afterwards is they put a gold clause in their contracts. And when they got paid later on they got the same amount of gold they were expecting. When the United States issued Liberty Bonds during the first World War, they had a gold clause in the bonds.

As for fractional-reserve lending, I agree with Dr. White. But I want to add something to that. And that is, it is fractional-reserve lending that got us into trouble from the get-go. And the reason is, the banks have engaged in fraud in their basic banking relationships right from the beginning. And so, for example, banks told people that they were depositors. They are not depositors. They are unsecured creditors. And second, banks told people they could get their money back on demand. In fact and in law, when these people put money into a bank it is not their money anymore. It is the bank's money to do with as the bank wishes. If banks want to do fractional-reserve lending, they need to do what I call full disclosure. They have to tell people right out, we are going to lend this money to somebody else or whatever, that you may not be able to get it back. Some people may want to take that gamble. But my guess is they won't. Ordinary people put money in the bank for security, for safety. They don't want to have it in the mattress. It might be stolen or lost or whatever. They are not interested in making interest on their savings. They just want it to be safe. Those people are not going to be involved in fractional-reserve lending.

As to Murray Rothbard's point of view, Murray was talking always about a gold backed dollar. That is a mistake. Again, you have to go back to what a dollar is. A dollar is the weight of silver. There is no such thing as a gold-backed piece of silver. The trouble with what Murray did is, he didn't go back further than the Coinage Act of 1792 where Hamilton defined the dollar as 371.25 grains of silver. The notion was that if Hamilton could define the dollar one way, we could define it another way. That is not true.

But again, the beauty of this H.R. 1098 bill is that we don't really have to address those issues. I think what will happen is that for long-term transactions, people will start using the gold clause. And over time, there will be a transition. During that period, all the irredeemable paper-ticket money will go away. The Federal Reserve will go away. Again, there is no possibility, in my view, as a practical matter, of having some kind of discontinuity in our monetary system, getting rid of the Fed. But this in fact is really important and we need to bring people up to curve as to why it is.

Chairman PAUL. Congressman Jones?

Mr. JONES. Mr. Chairman, thank you. I want to go a little bit off of your expertise, but I think you will have some very helpful comments. I have said two of the worst votes I ever made since I have been in Congress were the vote to go into Iraq and the repeal of Glass-Steagall. I realize this doesn't deal exactly with monetary issues, but we do have banks. You have made reference to banks many times in your comments about monetary policy.

Do you feel that when Glass-Steagall was repealed by the Congress, it helped the banking world or it created opportunities for greed and for mistakes?

Mr. PARKS. Greed is part of the human condition. Glass-Steagall did not do anything to change that. There is a fellow, his last name was Warburg, he was the son of Paul Warburg, what was his name? One of Franklin Roosevelt's advisors. He wrote a book in the 1930s called, "The Money Muddle," which really led to this business with Glass-Steagall, and what they were complaining about in those days was using bank money to speculate in the securities market. Bank money, it was understood, was money that the bank created out of nothing as opposed to regular money, gold and silver, and so the purpose of Glass-Steagall was really to keep the banks from overleveraging, and when Glass-Steagall was passed, now the banks could overleverage in a big way.

I have charts that I can put up for you that show what happens to the banks. Let me just get those out. Start with chart number 67, please. We will go right through them.

If you go before the last tie to gold was broken, and look at bank revenues, they are tiny. What are banks doing? They are processing payments, they are handling the check clearing system. But after the last tie to gold was broken, look what happened to bank revenues, it went up to something like $800 plus billion. This is just for passing paper around.

Go to the next slide. Look at bank net income after the last tie to gold was broken. It went up to something like, I don't know, $130 billion at its peak. This is after paying compensation to employees.

Go to slide 70, please. Look what happened to bank employee compensation. So the whole notion of all this business of allowing the banks to leverage up, this was enormously beneficial to employees, to the banks themselves. Over the period after the last tie to gold was broken, banks paid out over a trillion dollars in dividends, a trillion dollars in dividends, and just a couple of years ago, it turns out that while bank balance sheets said they had to get, I don't know, $2 trillion from the Federal Reserve, all this money that they paid out in bonuses and what-not, it was not real profits, and the only reason they were able to do that is because they were able to leverage up, and the only reason they were able to leverage up is because we have irredeemable paper ticket electronic money as legal tender. If you had gold and silver money, you would be back on that curve before the last tie to gold was broken, and it is the banks that really have corrupted the system, but again it is probably counterproductive to point fingers. Really what we want to do is have a transition, and again the whole system is going to collapse no matter what. It is urgent that we pass this bill in order to facilitate a transition to an honest monetary structure.

Mr. JONES. I understand. Dr. White, could you comment on Glass-Steagall as well?

Mr. WHITE. I would say the repeal of Glass-Steagall had very little to do with the financial crisis. There would be absolutely no objection to repealing Glass-Steagall; that is, letting commercial banks align or merge with investment banks and insurance companies, if it weren't for deposit insurance and if it weren't for the too-big-to-fail doctrine.

If those had not been in place, then if somebody wants to form a financial supermarket, okay, we will see if that will fly. It is no skin off our nose. But when we begin to guarantee the liabilities of investment banks which are highly leveraged, which are not like commercial banks, which are not even part of the payment system, that is really an invitation to trouble, and when the Federal Reserve Bank of New York intervened in the Bear Stearns failure and took up the bad assets so that JPMorgan Chase would buy the rest, it is not the first sort of too-big-to-fail action, but it is the one that sort of sticks in my craw. That was really bad policy.

Mr. JONES. Right.

Mr. WHITE. And I don't think it had that much to do with the repeal of Glass-Steagall. But if we treat investment banks like they are entitled to too-big-to-fail protection, then we are really asking for trouble, and that is really what needs to be undone.

Mr. JONES. Thank you, sir.

Mr. PARKS. Can I add to that, please? If you have gold and silver as money, gold as money, this too-big-to-fail stuff doesn't even come up. The only reason you have this is because of the irredeemable paper ticket money. You could never have this kind of leverage with gold, and in fact the money-center banks, they have leveraged their balance sheets something like 30 to 1, impossible if you had an honest monetary system. So really one feeds into the other, and this whole business with too-big-to-fail, the lender of last resort, Federal Deposit Insurance—Federal Deposit Insurance is not insurance; it is just a subsidy to the banks, and the reason it came about is that after the banks failed in 1933—they were failing before 1933—people were not putting their money back into the banks, and so they passed that legislation to induce people to put their money back into the banks.

As far as the lender of last resort comes about, again, that is the result of bank leverage, and the only reason you have so much leverage with the banks is because they misrepresented depositors. So if I were to borrow money from you, say I want you to lend me $10,000, what is the first thing that goes through your mind? I would think, what is the collateral? How am I going to get the money back? What are you going to do with the money? But if you loaned it to a bank and they say, well, this is a deposit, now you don't do the counterparty surveillance, so it is really a function of what constitutes the money, and I think you have to go back and realize that what we call our money today, our dollar, this is just a dishonored promissory note. And in fact one of the quotes I have for you, and I will stop right here, is after Franklin Roosevelt closed the banks on March 5th, 1933, a lot of people were caught short, and there was a question of whether they should print script, and here is a quote from William Woodin, Roosevelt's Secretary of the Treasury, he says the Federal Reserve Act lets us print all we need, and it won't frighten the people. Get this line now. It will look like—it won't look like stage money, it will be money that looks like real money. This is the Secretary of the Treasury telling you that this stuff is really, in effect, stage money, but it looks like real money. This is not real money that we have, folks. This is just a piece of paper gussied up with seals and whatnot. It is dishonest, and we need to fix the dishonesty.

Mr. JONES. Thank you, sir.

Chairman PAUL. Thank you. I have one more question for Dr. White. If we moved in to a period of time where we had competing currency, we have one group of people thinking a dollar equals a Federal Reserve note and let's say we or somebody decides that a dollar equals 371 grains of silver, and we use an old silver dollar, that could be competing, but the definitions are obviously completely different. How do you think it would be resolved when it comes to paying your taxes? Because they won't allow—I think this is part of the reason that we allowed the resistance because some people have tried this, paying salaries with old silver dollars, and, oh, that is a dollar, I don't have to pay any taxes on this. But it is a real problem because if they think that anybody—we want to get rid of some of the inhibitions to a competing currency, but if the people who use silver dollars had no taxes to pay, it would be a tremendous advantage. I think we could win that argument. But what do you think the IRS and the tax people are going to say about this? And do you have an idea how that could be resolved?

Mr. WHITE. I am sure the IRS would like the taxes to be paid in the equivalent of what they would be if all the transactions had been done in Federal Reserve notes. It would be an interesting exercise to look at around the world and see if there are other countries that have faced this problem of having taxes denominated in multiple currencies. I really don't know that much about it myself, but it seems like not a very important problem. On tax day, you need to have some exchange rate between the different currencies people might be allowed to pay in or you would require them to convert their own books into whatever the official currency for tax purposes is, but 364 days of the year that shouldn't bother them. It is pretty easy with software these days to convert one column of figures into another column of figures.

Chairman PAUL. It seems like in the computer age we could probably work that out rather well. If I made one dollar of profit and silver was $40, maybe it could be worked out, but of course the more ideal thing would be not to have the income tax, and we wouldn't have to worry about problems like that.

Okay, Walter is gone.

I think that we will conclude. The Chair notes that some members may have additional questions for this panel that they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

This hearing is now adjourned.

[Whereupon, at 3:35 p.m., the hearing was adjourned.]

# A P P E N D I X

September 13, 2011

United State House of Representatives
Committee on Financial Services
Hearing on HR 1098: the Free Competition in Currency Act

Congressman Ron Paul
Statement for the Record

I. The Problem

John Maynard Keynes once stated that "There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose." Such a situation is exactly what faces this country today, as the Federal Reserve seems hell-bent on destroying what little purchasing power remains of the U.S. Dollar.

Money is what allows civilization to flourish. Without money, consumers must barter their goods, hoping to exchange their products for those produced by others, and relying on a double coincidence of wants. Money enables man to rise above barter and makes exchange less burdensome. Once money comes into existence, businessmen can calculate profit and loss, homemakers can compare prices among different grocery stores, and individuals can begin to save and invest.

Money as a medium of exchange should always satisfy certain properties. It should be durable, not wearing out easily; it should be portable, easily carried; it should be divisible into units usable for everyday transactions; it should be recognizable and uniform, so that one unit of money has the same properties as every other unit; it should be scarce, in the economic sense, so that the extant supply does not satisfy the wants of everyone demanding it; it should be reproducible, so that enough units of money can be created to satisfy the needs of exchange; and most importantly, it should be stable, so that the value of its purchasing power does not fluctuate wildly.

Unfortunately, monetary developments over the past century have eroded the stability of the monetary unit. The roots of this instability date back to the mid-19th century, when the government sought to establish a monopoly on the issuance of money. Until that time, gold and silver from numerous countries and private mints circulated as money. At this country's founding, there was no government-controlled national currency. While the Constitution established the Congressional power of minting coins, it was not until 1792 that the US Mint was formally established. In the meantime, Americans made do with foreign gold and silver coins such as the silver Spanish milled dollar, which was understood at the time of the Constitution's drafting to be the basis of our dollar system. Even after the Mint's operations got underway, foreign coins continued to circulate within the United States and did so for many decades. Since the dollar was variously defined as a specific weight of silver (or gold) it was relatively easy to determine the value of non-U.S. currency in dollars. Perhaps more importantly, the Coinage Act of 1792 ensured that the purchasing power of United States currency would remain stable, as debasement of the currency was punishable by death.

As with most monetary malfeasance throughout history, the United States government's drive to monopolize the issuance of money came about during a time of war. In order to fund its military operations during the 1860s, the federal government for the first time in its history issued paper currency which was unbacked by any commodity and was to be accepted at face value as a legal tender. These "greenbacks" quickly declined in value against gold-backed notes, and the government undertook numerous measures to eliminate competition and ensure that individuals would have to accept greenbacks. While some measures, such as banning futures trading in gold, were quickly repealed, other laws that banned the private minting of coinage remain in force today.

Since that time, the government slowly but surely tightened its grip over the issuance of money in this country. Resumption of gold redemption led to gradual acceptance of the federal government's paper currency, and then to Federal Reserve Notes. Once paper currency drove gold out of everyday use, the government was the able to ban private ownership of gold in the 1930s. Eventually the gold window for foreign governments was closed in 1971, thus severing once and for all any link between the dollar and gold. For the past 40 years we have lived in a world in which the issuance of money is completely at the discretion of governments and central banks, and we are reaping the consequences. The fiat money standard has led from one financial crisis to another, as each attempt to inflate out of the previous bubble only sows the seeds for the next crash. Real wages remain stagnant or decrease, while price increases resulting from inflation of the money supply force American households to go ever deeper into debt in order to maintain a constant standard of living.

Economics teaches that monopolies produce fewer goods and sell them at a greater price than in a competitive market. This leads to inefficiency, deadweight losses, and over time complacency on the part of the monopolist. Most mainstream economists fail to extend the theory of monopoly to the market for money. Government monopolization of the issuance of money fails to produce the sound money the market demands. The poor-quality money that is issued continues to lose its value, and the American people must work longer and harder for money that continues to decline in purchasing power. Meanwhile, government agencies and the banking system benefit from the first use of that money, being able to spend it and lend it before it circulates through the rest of the economy and before prices increase in reaction to this inflation.

The only way to counteract this problem is to break the government monopoly on the issuance of money. The Constitution does not grant the federal government this monopoly, a fact which was not in dispute for nearly a century after this country's founding. The federal government has become complacent, forgetting the need for sound money, and the only way to break this complacency is to break the monopoly. HR 1098, the Free Competition in Currency Act, intends to do just that.

II. The Solution

Over millennia of human history, gold and silver have been the two metals that have most often satisfied the market's demand for money and gained the trust of billions of people. Gold and silver are difficult to counterfeit, a property which ensures they will always be accepted in commerce. It is precisely for this reason that gold and silver are anathema to governments. A supply of gold and silver that is limited in supply by nature cannot be inflated, and thus serves as a check on the growth of government. Without the ability to inflate the currency, governments find themselves constrained in their actions, unable to fund either the welfare state or the warfare state.

On the desk in my office I have a sign that says: "Don't steal -- the government hates competition." Indeed, any power a government arrogates to itself, it is loathe to give back to the people. The history of this nation is filled with examples of increasing and unconstitutional centralization of power by the federal government. Militias, letters of marque and reprisal, and declarations of war have gone by the wayside; the postal monopoly drove out private competition; and a market-driven system of competing currencies was suppressed by the creation of a government-supported banking cartel that monopolizes the issuance of currency. In order to return to sound money, it is necessary to undo the legal obstacles that forbid other currencies from competing against the dollar.

The first step consists of eliminating legal tender laws. Article I, Section 10 of the Constitution forbids the States from making anything but gold and silver a legal tender in payment of debts. States are not required to enact legal tender laws, but should they choose to, the only acceptable legal tender is gold and silver, the two precious metals that individuals throughout history and across cultures have used as currency. There is nothing in the Constitution that grants Congress the power to enact legal tender laws. Congress has the power to coin money, regulate the value thereof, and of foreign coin, but not to declare a legal tender. Yet, there is a section of US Code, 31 USC 5103, that purports to establish US coins and currency, including Federal Reserve notes, as legal tender.

Historically, legal tender laws have been used by governments to force their citizens to accept debased and devalued currency. Gresham's Law describes this phenomenon, which can be summed up in one phrase: bad money drives out good money. An emperor, a king, or a dictator might mint coins with half an ounce of gold and force merchants, under pain of death, to accept them as though they contained one ounce of gold. Each ounce of the king's gold could now be minted into two coins instead of one, so the king now had twice as much "money" to spend on building castles and raising armies. As these legally overvalued coins circulated, the coins containing the full ounce of gold would be pulled out of circulation and hoarded. This same phenomenon occurred in the United States in the mid-1960s when the US government began to mint subsidiary coinage out of copper and nickel rather than silver. The copper and nickel coins were legally overvalued, the silver coins undervalued in relation, and silver coins vanished from circulation.

These actions also give rise to the most pernicious effects of inflation. Once the public realized that the king debased his currency by 50%, prices would eventually double, as it would now take two coins to purchase what used to require only one. The king who debased his currency spent his new money immediately, before prices rose, and thus gained the benefit of that new money. Most of the merchants and peasants who received the devalued currency felt the full effects of inflation, the rise in prices and the lowered standard of living, before they received any of the new currency. By the time they received the new currency, they had long since had to suffer doubled prices, and the new currency they received would give them no benefit. In the absence of legal tender laws, Gresham's Law no longer holds. If people are free to reject debased currency, and instead demand sound money, sound money will gradually return to use in society.

The second step to legalizing currency competition is to eliminate laws that prohibit the operation of private mints. One private enterprise which attempted to popularize the use of precious metal coins was Liberty Services, the creators of the Liberty Dollar. The government felt threatened by the Liberty Dollar, as Liberty Services had all their precious metal coins seized by the FBI and Secret Service in November of 2007.

The sections of US Code which Liberty Services is accused of violating are categorized as anti-counterfeiting statutes, when in fact their purpose was to shut down private mints that had been operating in California. California was awash in gold in the aftermath of the 1849 gold rush, yet had no US Mint to mint coinage. Even establishment of a US Assay Office failed to provide enough coinage, as the only coins they produced were too large to be used in everyday transactions. Foreign coins filled the void, but even still there was insufficient coinage, and these coins circulated at a value higher than their inherent metal value. The public clamored for smaller denominations of coins, and private mints stepped into the breech to fulfill this demand. The private mints were eventually accused of circulating debased coinage, and with the supposed aim of providing government-sanctioned regulation and a government guarantee of purity, federal laws were enacted which banned private mints from producing their own coins for circulation as currency.

The final step to reestablishing competition in currency is to eliminate capital gains and sales taxes on gold and silver coins. Under current federal law, coins are considered collectibles, and are liable for capital gains taxes. Coins held for less than one year are taxed at the short-term capital gains rate, which is the normal income tax rate, while coins held for more than a year are taxed at the collectibles rate of 28 percent. These taxes on coins actually tax monetary debasement. The purchasing power of gold remains relatively constant, but as the nominal dollar value of gold increases due to the weakening of the dollar by the Federal Reserve, the federal government considers this to be an increase in wealth, and taxes accordingly. Thus, the more the dollar is debased, the more capital gains taxes must be paid on holdings of gold and other precious metals.

Just as pernicious are the sales and use taxes which are assessed on gold and silver at the state level in many states. Imagine having to pay sales tax at the bank every time you change a $10 bill for a roll of quarters to do laundry. Inflation is a pernicious tax on the value of money, but even the official numbers, which are massaged downwards, are only on the order of 3-4% per year. Sales taxes in many states can take away 8% or more on every single transaction in which consumers wish to convert their Federal Reserve Notes into gold or silver coins. Americans should not be penalized through punitive taxation merely for desiring to hold or use one type of currency, nor should they be penalized for exchanging Federal Reserve Notes for US Mint-produced coins.

I hope that this hearing will start a vigorous discussion of currency competition, sound money, and how to return to a sound dollar. HR 1098 is certainly not a panacea, as there remain significant structural problems in our banking and monetary system that still need to be addressed. But allowing for competing currencies will enable Americans to choose a currency that suits their needs, rather than the needs of the government. The prospect of Americans turning away from the dollar towards alternate currencies will provide the necessary impetus to the US government to regain control of the dollar and halt its downward spiral. Restoring soundness to the dollar will remove the government's ability and incentive to inflate the currency, and keep us from launching unconstitutional wars that burden our economy to excess. With a sound currency, everyone is better off, not just those who control the monetary system.

# TESTIMONY BEFORE

# THE U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES

## Subcommittee on Domestic Monetary Policy and Technology

112th Congress

September 13, 2011

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Contents

**Short Bio**

Dr. Lawrence Parks

Lawrence Parks is the Executive Director and Founder of the Foundation of the Advancement of Monetary Education and the host of *The Larry Parks Show*, aired weekly on Time Warner Channel #56, Verizon Channel #34 and RCN Channel #83 in Manhattan. He is a member of the United Association of Labor Educators and UAW 1981, AFL-CIO.

He has broad experience in academia, in business, and in finance. He holds a Ph.D. in Operations Research from the Polytechnic University where for many years he was an adjunct professor teaching at the graduate level.

His writings have appeared in *Pensions & Investments*, *The Economist*, *The Washington Times, The Freeman, The Free Market, The United States Congressional Record, National Review, The Labor Studies Journal, The Houston Chronicle*, and many popular publications.

He is the author of *What Does Mr. Greenspan Really Think?* He has authored and produced more than 200 videos on topics dealing with the U.S. monetary system, more than 50 of which are posted to www.LarryParks.com. He is an active member of many civic and social organizations, and is a frequent speaker on the fight for honest monetary weights and measures.

## Opening Statement:

Thank you for the opportunity to testify in support of H.R. 1098, *The Free Competition in Currency Act of 2011*. I am honored to have been invited.

I know it must sound like hyperbole, but I believe that H.R. 1098 is perhaps the most important piece of legislation to ever come before the Congress, because H.R. 1098 is necessary to make a transition from the certain catastrophic collapse of our unauthorized (by the *Constitution*), dishonest and unstable legal tender irredeemable paper-ticket-electronic monetary system.

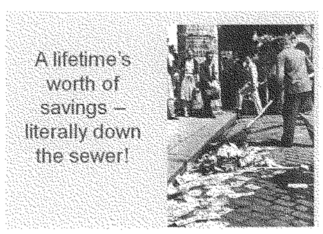
While I suspect that this committee will be most interested in how this bill will affect jobs, debt, economic growth, the capital markets, pensions, and a host of other important and timely topics, I will focus in my opening statement on where we are headed and on the dishonesty of our present system by highlighting some of the many misrepresentations about our money. There are three takeaway points. Our current monetary system is:

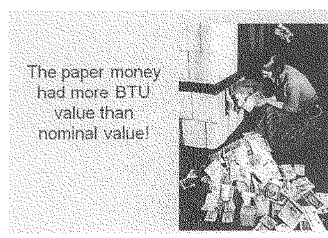
1. Not in conformity with the *Constitution*;
2. Dishonest; and,
3. Unstable and in the process of blowing up, perhaps while I am testifying here today.

One can be certain of a complete collapse because there is no longer any market-based self-correcting mechanism providing negative feedback against increasing the money supply, increasing debt, and increasing leverage. Any system without a self-correcting mechanism is unstable and blows up.

## Where we are headed:

With no exceptions, the history of legal tender irredeemable paper-ticket-electronic money is that its purchasing power always approaches its cost of production: ZERO! Here are some scenes that illustrate this point:



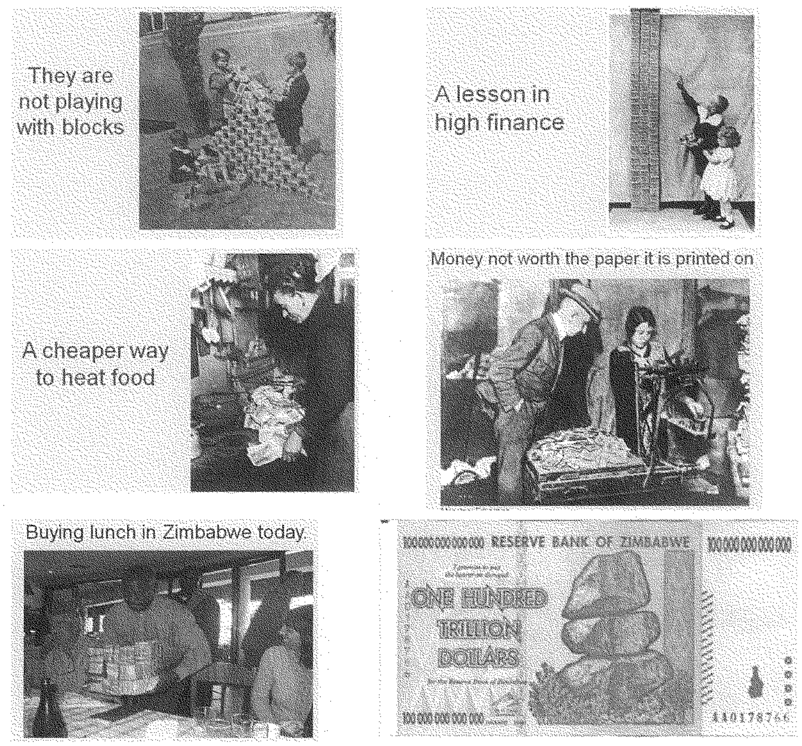



*Exhibit 1*: Scenes relating to currency destruction

## Collapse of the monetary system

With gold-as-money, and without the banking system creating money out of nothing, the amount of financial leverage would be *de minimis* with no possibility of collapse. Because legal tender irredeemable paper-ticket-electronic money can be created without limit, there is no market based self-correcting mechanism to limit financial leverage. Especially at a time when those who engage in leverage do not bear the full risk of loss, but are able pass the risk on to the public through the banking system, whose balance sheet and liabilities are *de facto* guaranteed by the public, financial collapse is a certainty.

This is a scene from Hungary after World War II. That stuff that is being swept down into the sewer is the Hungarian money of the day. Those folks standing about watching are ordinary people who might have been saving the legal tender irredeemable paper-ticket money for later needs.

"A lifetime's worth of savings – literally down the sewer!"

*Exhibit 2*: Sweeping Hungarian money into the sewer circa 1946

While there have been many currency collapses during the $20^{th}$ century, the reason why most countries eventually recovered after a time was that they had an alternate currency: the dollar. Once the dollar is rejected, all those countries that consider dollars as part of their reserves will also experience collapses.

What we define as civilization is the intricate web of understandings that we have about one another and the mutual promises we have made. For example, if I promise to meet you at two o'clock and don't show up, that hurts the relationship. Aside from the mutual promises and understandings we have with family members, the most important promises in society are promises to pay: to pay pensions, salaries, suppliers, annuities, etc.

When money collapses, all promises of future payment are broken, and the enormous intricate web of promises both at home and abroad breaks down. The risks to society cannot be overestimated. A breakdown in national and international currencies is certain. The challenge is to mitigate the damage and lay the groundwork to put into train a monetary system that will not break down and that serves the needs of productive enterprise.

Most important, action must be taken to protect the middle class. As the British are fond of saying, it's the middle class that protects us from the Barbarians.

In 1997, Mr. Greenspan, when he was the Chairman of the Board of Governors of the Federal Reserve, gave a remarkable speech in Belgium where he addressed the issue of leverage and the risk to the financial system.[1] He said:

> "Central bank provision of a mechanism for converting highly illiquid portfolios[2] into liquid ones[3] in extraordinary circumstances has led to a greater degree of leverage in banking than market forces alone would support.[4]

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[1] Remarks by Chairman Alan Greenspan At the Catholic University Leuven, Leuven, Belgium January 14, 1997
[2] "Highly illiquid portfolios" are portfolios that cannot be sold except at a substantial discount to par.
[3] The most "liquid" portfolio consists of cash that the Federal Reserve creates out of nothing.
[4] Private investors would pay less for these assets than would the Fed. In fact, depending upon how "illiquid" these portfolios were, private investors might pay nothing.

Mr. Greenspan was confirming that the "mechanism" or safety net/subsidy/wealth transfer for banks, has led to more leverage than would otherwise occur. For banks, this is great. They can enter into more profitable and riskier bets than they would otherwise because they know that if they lose, i.e., if their bets become "illiquid"—worthless and cannot be sold—the Federal Reserve will "convert" those bets into cash.

And where does the Federal Reserve get the cash? It literally "creates" it out of nothing, thereby diluting the purchasing power of savings and expected pensions of ordinary working people and seniors. In other words, if the banks win their bets they keep their winnings, and if they lose, the Fed—read that ordinary taxpayers—absorb the losses. Fantastic!

> "Traditionally this has been accomplished by making discount or Lombard facilities available, so that individual depositories could turn illiquid assets into liquid resources and not exacerbate unsettled market conditions by the forced selling of such assets or the calling of loans."

What this means is that rather than cause "individual depositories" (banks) to sell "illiquid assets" (loans) which are not good—at a presumed loss—or force borrowers into bankruptcy, the Federal Reserve may buy these loans from the banks, presumably at a discount. Again, if things work out, the banks keep the profits. If the loans cannot be repaid, the Federal Reserve (really taxpayers) makes up the loss.

Is it fair to taxpayers that banks keep the winnings if their bets are successful but that taxpayers make them good if they experience catastrophic losses? Isn't this just blatant wealth transfer? When the Federal Reserve and the Treasury used the "Exchange Stabilization Fund" to bail out Mexico in 1995, the money supplied to Mexico was quickly transferred to the Wall Street firms and banks that had purchased Mexican securities.

Ignoring the fact that every so often the Mexican peso melts, to garner extra yield, U.S. financial institutions bought Mexican securities. When it appeared certain that Mexican debt would default, rather than allow these financial institutions to book a loss, our government—read that ordinary taxpayers—lent money to Mexico so that it could repay U.S. banks and Wall Street firms. Another version of this story was played out by the International Monetary Fund, in part financed by U.S. taxpayers, to bail out banks in South Korea, Indonesia, Malaysia, the Philippines, and elsewhere.

> "More broadly, open market operations, in situations like that which followed the crash of stock markets around the world in 1987, satisfy increased needs for liquidity for the system as a whole that otherwise could feed cumulative, self-reinforcing, contractions across many financial markets."

In this and other speeches, Mr. Greenspan addresses systemic risk. Much more needs to be said about this, but, in sum, the system is perilously close to imploding or blowing up.

Why should ordinary citizens be at risk that our monetary system will implode so that banks and other financial players may reap unearned profits by taking on ever-greater risks?

> "Of course, this same leverage and risk-taking also greatly increase the possibility of bank failures. Without leverage, losses from risk-taking would be absorbed by a bank's owners, virtually eliminating the chance that the bank would be unable to meet its obligations in the case of a 'failure.'"

In other words, without the safety net/subsidy from taxpayers, banks would make bets and take chances while putting their own capital at risk instead of taxpayers' money. This is as it should be, it seems to me. Most important, Mr. Greenspan confirmed that without leverage the possibility that depositors would not get their money back in case of a "failure" would be virtually eliminated. Ordinary working people and seniors would not be at risk.

What an incredible acknowledgment! In other words, we can conclude that if the banks had not been induced by the safety net/subsidy to increase leverage, the banking system would not have collapsed in the 1930's and we would not have experienced the Great Depression. Many think that the Great Depression was a "market failure." Mr. Greenspan has written extremely eloquently that the Great Depression was in fact caused by the Federal Reserve feeding too much credit into the banking system, i.e., enabling the banking system to increase leverage too much.[5]

This raises other important questions: Why should our government empower and induce banks to increase leverage when we know that can lead, and has led, to a catastrophic monetary collapse? Why should ordinary working people and seniors and the rest of us be put at risk of a monetary implosion and the total collapse of our economy?

> "Some failures can be of a bank's own making, resulting, for example, from poor credit judgments. For the most part, these failures are a normal and important part of the market process and provide discipline and information to other participants regarding the level of business risks. However, because of the important roles that banks and other financial intermediaries play in our financial systems, such failures could have large ripple effects that spread throughout business and financial markets at great cost."

The point of this is that it is leading up to the need to suspend normal business rules for banks by not letting them fail on account of "ripple effects."

## Why legal tender irredeemable paper-ticket-electronic money is dishonest:

I wish to focus first on explaining why our monetary system is dishonest. Most importantly, there are myriad misrepresentations and nondisclosure of material information about what we now call a dollar. No amount of regulation or oversight committees will cure dishonesty. The only remedy is honesty.

There was a time after the Revolution when our money, as provided for by the *Constitution*, was gold and silver. There was no legal tender for private transactions. However, the bank notes of the first Bank of the United States were legal tender for payments to the government, e.g., tariff dues.

To illustrate what in my view is the most egregious example of dishonesty, I give an example with silver, although the same principle applies to gold.

It was, and remains, inconvenient to carry around silver dollars, because they are heavy and bulky. So, people deposited their silver dollars, typically in a bank, and received in exchange a promissory note, a.k.a. a banknote or a note, that bore the inscription that so many dollars were deposited and that the note was payable on demand by the bearer in silver.


*Exhibit 2*: United States One Dollar Note

[5] See Greenspan, Alan; "Gold and Economic Freedom;" in Rand, Ayn; *Capitalism the Unknown Ideal*; Signet Books, 1967, pp96-101.

Notice that this is not a dollar. At the top of the bill are the words "United States Note." Under Washington's image, it says "will pay to the bearer on demand one dollar." As put into law by Alexander Hamilton in the *Coinage Act of 1792*, this is a dollar:


*Exhibit 3*: U.S. Silver Dollar

Then, the promise to pay a dollar was defaulted, and the <u>broken promise</u>, the <u>dishonored promissory</u> note, is now represented as being a dollar!


*Exhibit 3*: One dollar Federal Reserve Note

This is a gross misrepresentation and is dishonest. This piece of paper is not even a valid note. The signatures of the Treasurer of the United States and the Secretary of the Treasury are gratuitous and deceptive.

In other words, what we use for money are just dishonored promissory notes that have been misrepresented to be dollars. All of the securities in our capital markets, at home and abroad, are denominated in dishonored promissory notes. This has immense implications for trade, jobs, pensions, military preparedness and almost everything that is important.

People have the notion that the Congress can make the dollar anything the Congress wants it to be and "back" it or not with specie or whatever. This is demonstrably false. The highest law of our country is the *Constitution*, and all laws must be in conformity with it. The word "dollar" is mentioned twice in the *Constitution*, but it is not defined in the *Constitution*.

The word "dollar" appears in connection with the Slave Tax, which is no more. Much more importantly, it is mentioned in the 7th Amendment:

> "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law."[6]

If it were true that Congress could redefine the word "dollar," that would mean that the Congress could redefine the 7th Amendment, which is ridiculous. Further, for the 7th Amendment to have objective meaning, the word "dollar" must have objective meaning. What is the objective meaning of the word "dollar" as used in the *Constitution*?

The word "dollar" in the *Constitution* refers to the Spanish Milled Dollar, a.k.a. a piece of eight.

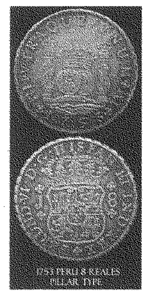



*Exhibit 4*: A Spanish Milled Dollar, a.k.a. a piece of eight or a real

The Spaniards had built mints all over the colonies, and the Spanish Milled Dollar was ubiquitous. In some colonies it was made the unit of account. When independence was declared, the colonies adopted *Articles of Confederation* which gave Congress the power to issue paper money, called "continentals." Here is an example of a continental $30 bill. Notice that it "entitles the Bearer to receive Thirty Spanish milled Dollars or the Value thereof in Gold or Silver."

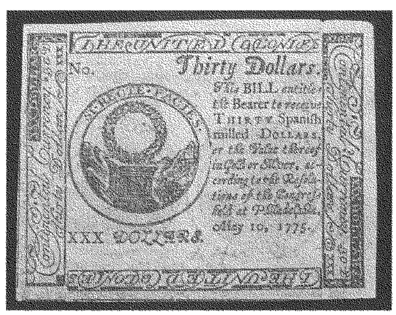



*Exhibit 5*: A $30 bill, issued by the Continental Congress for Thirty Spanish milled Dollars

[6] 7th Amendment to the Constitution.

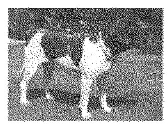
After independence was achieved, and the *Constitution* was adopted, the U.S. did not want to rely on Spanish mints to mint its coins. The U.S. wanted its own mints to mint its own coins, including dollars. To that end, Alexander Hamilton, then Secretary of the Treasury, wrote the *Coinage Act of 1792* wherein he tells us exactly what a dollar is:

> "Dollars or Units—each to be of the value of a Spanish milled dollar as the same is now current, and to contain three hundred and seventy-one grains and four sixteenths parts of a grain of pure, or four hundred and sixteen grains of standard silver."[7]

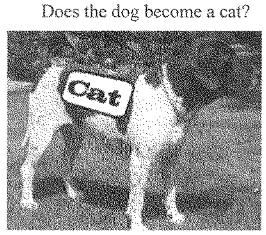
This definition of a dollar, 371.25 grains of fine silver, has never been changed, and cannot be changed. The *Constitution* requires that a dollar be a weight of silver. Some might claim that if Hamilton defined a dollar in this way, perhaps it can be defined in another way. That is not true. Hamilton's definition of a dollar was not arbitrary. All he did was to write into law what was already a fact.

Here is another way of looking at this issue. Suppose we take a sign that says "cat,"

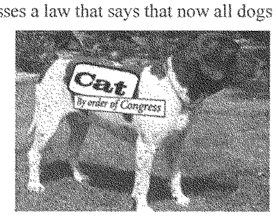

And hang it on a dog,



Does the dog become a cat?




Suppose Congress passes a law that says that now all dogs with cat signs are cats?




Are all dogs with cat signs now legally cats?

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[7] *Coinage Act of 1792*

Conceptually, this is no different than taking a piece of paper, printing the word "dollar" on it, adding seals and signatures and calling it a dollar. This is precisely what has happened to our money. Clearly, there is no easy remedy.

How could such an immense fraud be perpetrated? There are several reasons, but one of the most important, which HR1098 will go a long way to correcting, is that we are coerced into using fraudulent money by the legal tender statutes. By getting rid of legal tender, HR1098 is necessary, and may be sufficient, to help pave the way to an honest monetary system.

Placing images of some of our most revered Founding Fathers on various bills gives bogus money the patina of legitimacy by implying that it had the imprimatur and endorsement of the Founders, when in fact they condemned paper money.

Jefferson, for example, wrote:

> "Paper is poverty,... it is only the ghost of money, and not money itself."[8]
>
> "But that its [paper money's] abuses also are inevitable and, by breaking up the measure of value, makes a lottery of all private property, cannot be denied."[9]
>
> "The trifling economy of paper, as a cheaper medium, or its convenience for transmission, weighs nothing in opposition to the advantages of the precious metals... it is liable to be abused, has been, is, and forever will be abused, in every country in which it is permitted."[10]
>
> "I now deny [the Federal Government's] power of making paper money or anything else a legal tender."[11]

Placing Jefferson's image appear on a legal tender paper $2 irredeemable paper-ticket-dollar misrepresents Jefferson's clear condemnation of legal tender irredeemable paper-ticket-electronic money. It is dishonest.


*Exhibit 6*: A $2 United States Note with Jefferson's image

George Washington was equally clear: in a letter he wrote to Jefferson on August 1, 1786:

> "Other states are falling into very foolish and wicked plans of emitting paper money."[12]

In addition, he wrote:

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[8] Thomas Jefferson to Edward Carrington, 1788. ME 7:36
[9] Thomas Jefferson to Josephus B. Stuart, 1817. ME 15:113
[10] Thomas Jefferson to John W. Eppes, 1813. ME 13:430
[11] Thomas Jefferson to John Taylor, 1798. ME 10:65
[12] Letter to Jefferson on August 1, 1786

"Paper money has had the effect in your state that it will ever have, to ruin commerce, oppress the honest, and open the door to every species of fraud and injustice."

Washington, in his circular letter of June, 1783, to the governors of the several United States, wrote that "honesty will be found on every experiment to be the best and only true policy," being convinced that "arguments deduced from this topic could with pertinency and force be made use of against any attempt to procure a paper currency."

Notice that Washington is not writing from an economic point of view. He is condemning paper money as "wicked," i.e., evil. The perils of paper money were well known. This is very strong language. As with Jefferson, the monetary authorities again misrepresent Washington's heart-felt condemnation of paper money by putting his image on a legal tender irredeemable paper-ticket dollar. That is dishonest.


*Exhibit 7*: $1 Federal Reserve Note

James Madison, the "Father of the *Constitution,*" had an unequivocal view of paper money as well:

"Paper money is unjust; to creditors, if a legal tender; to debtors, if not legal tender, by increasing the difficulty of getting specie. It is unconstitutional, for it affects the rights of property as much as taking away equal value in land." [Emphasis added]

Notice, as with Washington, Madison condemned paper money on moral, not economic, grounds as "unjust." As the principal author of the *Constitution*, who better to opine on it as not permitting paper money than Madison. Again, as with Jefferson and Washington, the monetary authorities misrepresent Madison's strong condemnation of paper money by putting his image on the $5,000 legal tender irredeemable paper-ticket-dollar. That is dishonest.


*Exhibit 8*: $5,000 Federal Reserve Note

Alexander Hamilton, Secretary of the Treasury and presidential aspirant did not condemn paper money *per se*, but he could not have been clearer of what he referred to as "unfunded paper," the kind we have now. In June, 1783, Alexander Hamilton, in resolutions for a new constitution of the United States of America, set forth explicitly:

"To emit an unfunded paper as the sign of value ought not to continue a formal part of the constitution, nor ever hereafter to be employed; being, in its nature, pregnant with abuses, and liable to be made the engine of imposition and fraud; holding out temptations equally pernicious to the integrity of government and to the morals of the people."

By putting Hamilton's image on the $10 legal tender irredeemable paper-ticket-dollar, his clear condemnation of unfunded paper money is also misrepresented. That is dishonest


Exhibit 9: $10 Federal Reserve Note

Consider now the all-important issue of how to get people to accept legal tender irredeemable paper-ticket-electronic money in exchange for their goods and services? Misrepresentation may not be enough. There is a need for coercion, which is provided by the legal tender laws.

## Fraud: nondisclosure of material information and misrepresentations about our monetary system

Commodity money, e.g. gold or silver, is what it is. There is nothing to disclose or misrepresent. Gold or silver is what it purports to be. When gold or silver is minted into coins by the U.S. mint, one can rely on the integrity of the coins because the penalty for malfeasance, e.g., cheating on the weight or the specie content, is punishable by death. Policing the integrity of coins produced by the U.S. mint is done by the U.S. Secret Service. It is very diligent.

*The Free Competition in Currency Act of 2011*, by removing coercion for our monetary system, will signal folks who otherwise would not pay attention to reevaluate the merits of legal tender irredeemable paper-ticket-electronic money.

A full disclosure critical review will tend to reveal:

1. "Dollars" are not redeemable into anything, i.e., they are not valid "notes" that promise to pay something of value to the bearer;
2. "Dollars" have value because people believe that other people, both at home and abroad, will continue to accept them for their goods and services and save them for future needs;
3. In the U.S., people are forced by law [legal tender] to accept "dollars" for all debts public and private;
4. "Dollars" are created out of nothing by the U.S. banking system—mostly by commercial banks;
5. If, in the judgment of the Federal Reserve, there needs to be additional "liquidity" in the system, then the Federal Reserve, on its own authority and without any oversight from

Congress, may create "dollars" without limit. Creating additional "dollars" out of nothing will dilute the purchasing power of "dollars" that have been saved or promised for future payment, such as pensions;

6. Creation of new "dollars" out of thin air has depreciated "dollar" purchasing power by more than 95% since 1950;
7. "Dollars" are in no way obligations of the U.S. Government (the signatures of the Secretary of the Treasury and the Treasurer are gratuitous);
8. "Dollars" are tokens, i.e., a paper tickets or electronic blips in a computer;
9. In 1950, the U.S. broad money supply (M3) was about $150 billion. At the end of 2011, the banking system (commercial banks and the Federal Reserve) has created an additional $14 trillion flat out of nothing; and,
10. What we call a *dollar* today is not in conformity with the word dollar used in the 7th Amendment to the *United States Constitution.*[13] In other words, what we call a dollar is not authorized by the highest law in the land.

For day-to-day transactions, none of this matters. People get paid in legal tender irredeemable paper-ticket-electronic money, and they use that money to buy what they need for daily living. It is, however, *crucially* important for people who save or have securities that are denominated in legal tender irredeemable paper-ticket-electronic money.

A monetary system based on legal tender irredeemable paper-ticket-electronic money is inherently fraudulent. Frauds can be classified in three ways:

1. Frauds in the private sector are generally limited and most times are recognized in a short period.
2. Frauds which have an indirect government imprimatur, — e.g., Madoff, whose fraud continued for three decades largely because many believed that government regulations and Securities and Exchange Commission oversight would prevent such frauds — lull folks into a sense of security and can continue for longer periods.
3. Frauds that have the direct participation of government by virtue of enabling legislation, e.g., the fiat money fraud, can continue for very long periods because people want to believe in their institutions, and, because government is involved, they are coerced — that's what legal tender is about — into participating.

Some misrepresentations about our monetary system are:

4. Pieces of paper gussied up with seals and signatures that have the word "dollar" printed on them are not dollars, as the term is used in our *Constitution* and as defined in the *Coinage Act of 1792*;
5. Federal Reserve Notes are neither in law nor in fact notes — because they have neither a payee nor a due date certain, which are part of the definition and legal requirement for a note to be valid;
6. Legal tender irredeemable paper-ticket-electronic money is not authorized by our *Constitution*. It is misleading to have the signatures of the Secretary of the Treasury and the Treasurer on the bills;

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[13] *7th Amendment*: "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law."

7. Founders such as Washington, Madison, Jefferson and many others condemned paper money on moral grounds. It is misleading to put their images on the legal tender irredeemable paper-ticket-electronic money as if they might have endorsed paper money.

All frauds are eventually found out and collapse.

## Legal tender:

Historically, some commodities were made legal tender, e.g., tobacco in the American colonies. However, there is no need to make gold a legal tender because people readily accept gold-as-money, especially for large transactions. For small transactions, historically people have always accepted silver.

Fiat, irredeemable paper ticket-token or electronic-checkbook money is always made legal tender because otherwise people tend to reject fiat money for their savings or promises of future payment, e.g., annuities, rents, pensions. The biggest hurdle for irredeemable paper-ticket-electronic money to circulate is getting people to accept it in exchange for their goods and services and especially to save it. Legal tender is the coercion in our monetary system.

Legal tender morphed from a concept called "forced tender." When Marco Polo visited China in the middle of the 13th century, he, as well as other observers, noticed that the Chinese Emperor had become fabulously wealthy by issuing paper money. Upon returning home and reporting this to the Europeans, they were incredulous. Why, they asked, would anyone accept a piece of paper, even if gussied up with seals and signatures, in exchange for their goods and services? The answer was that if one didn't accept the Emperor's paper money he would be killed. This was called forced tender.

In 1694, Bank of England (then a private bank) notes were made legal tender by the king. There is no death penalty for not accepting legal tender today. However, if one doesn't accept it, one is not entitled to be paid.[14]

Legal tender was widely used in Colonial America, but opposition didn't crystalize until during the Revolution when the American experience with legal tender was a disaster. The experience of Thomas Jefferson is emblematic. Here is what happened to Jefferson.

Jefferson was married to the daughter of one of the richest men in the colonies, John Wayles. Wayles died in 1773 leaving a huge estate with assets, consisting of slaves and plantations, valued at upwards of 20,000 pounds, and liabilities, consisting of monies owed to British financiers, of about 11,000 pounds. At the time, 100 pounds was a good year's wages for a skilled tradesman, so the net estate was a fortune. Wales had appointed Jefferson along with Jefferson's two brothers-in-law the co-executors of his will.[15]

In those days, and today as well, if an executor distributes the assets of an estate without settling out the liabilities, he becomes personally liable for the liabilities. However, in this instance, since the value of the assets was so much greater than the liabilities, and, besides, Jefferson's in-laws wanted their shares, Jefferson felt comfortable in selling the assets and distributing the proceeds.

At the time in Virginia, folks did not have enough cash for such a large transaction. The remedy was to use what we call today a seller's mortgage or a "purchase money" mortgage, or in the case of goods, vendor financing. In 1773, the procedure was for the buyer to issue a bond to the seller, and amortize the bond, which is what happened. Jefferson offered the estate's British creditors a portion of the bonds to settle their claims, but they wanted specie, i.e., gold or silver. So Jefferson would need to pay off the debts from the amortization of the bond.

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[14] Interestingly, after the French Revolution and the issuance of legal tender irredeemable paper-ticket money, called *Assignats*, eventually the penalty for non-acceptance was death pursuant to a special law called *The Law of the Maximum*.

[15] Sloan, Herbert; *Principle and Interest: Thomas Jefferson and the Problem of Debt*; University of Virginia Press (2001).

But then in 1776 the Revolution started. Virginia issued paper money and made it legal tender. As with all paper money, its purchasing power approached its cost of production — near zero — and Jefferson's debtors paid off the bond with the then worthless money. But Jefferson was still personally liable for the 11,000 pounds to Wayles' creditors in England.

Jefferson was never able to work his way out of that debt and he died a *de facto* bankrupt. Along the way the Congress tried to help him out; it bought his books for $15,000 which became the Library of Congress. After he died, his possessions were auctioned, but they didn't bring enough money to satisfy the debt.

So, when Jefferson said that paper money was a cheat, he wasn't hypothesizing about a theoretical construct. He was cheated big time. And here is the punch line: and so were the other gentry in Virginia including Madison and Washington. Madison, also a large plantation owner, saw the Revolution coming, and he leased his land. The people to whom he leased his land paid him with the worthless legal tender money, and similarly for George Washington.

When the Founders assembled in Philadelphia at the Constitutional Convention (at that time they had gotten Jefferson out of town as our ambassador to France), they were not supposed to write a new constitution. They were to amend the *Articles of Confederation* which were thought to be inadequate because the Articles didn't give the general government the power to tax.

The Framers used the powers granted Congress in the Articles as a template and went down the list transferring what they thought were good provisions to the *Constitution*. When they got to the provision whereby the Articles gave the Congress the power to issue paper money, in those days called "emitting bills of credit," they debated the issue and overwhelmingly voted it down. Madison's notes contain entries to the effect that "we killed paper money," and "we closed the door to paper money."

The principal monetary power of the general government under the *Constitution*, as put forth in Article I Section 8, is "To coin Money, regulate the Value thereof, and of foreign Coin." There is no legal tender power to the general government, and there is no power to issue paper money.[16] That was not an oversight. In addition to the Founders, ordinary people had a miserable experience with legal tender and there was near universal opposition to it. Thomas Paine, sometimes referred to as the Father of the Revolution and the author of "Common Sense," wrote:

> "The laws of a country ought to be the standard of equity and calculated to impress on the minds of the people the moral as well as the legal obligations of political justice. But tender laws, of any kind, operate to destroy morality, and to dissolve by the pretense of law what ought to be the principle of law to support, reciprocal justice between man and man; and the punishment of a member [of Congress] who should move for such a law ought to be DEATH."[17]

What could be clearer than that? Jefferson also confirmed the fact that the general government does not have the power to arbitrarily assign value to something that is valueless by making it "legal tender."

> "The federal government — I deny their power to make paper money a legal tender."[18]

Even John Marshall, the revered chief justice of the Supreme Court condemned legal tender:

> "The inflexible adversary of paper money, detesting it with a hatred almost amounting to a passion, was the chief justice of the United States, John Marshall. While he was on the bench, no case could come before him, in which power was claimed for the

[16] The best reference for the constitutional issues dealing with the U.S. monetary system is Dr. Edwin Vieira's magnificent *Pieces of Eight: The Monetary Powers and Disabilities of the United States Constitution*, Sheridan Books (2002), Edition: 2nd

[17] Bancroft, George; *A Plea For The Constitution Of The United States, Wounded in the House of Its Guardians*; (1884)

[18] Bancroft, George; *A Plea For The Constitution Of The United States, Wounded in the House of Its Guardians*; (1884)

> United States to issue bills of credit; because at that day he and everybody else well understood and willingly acknowledged that the power to emit bills of credit was withheld from the United States, was forbidden by not being granted. But his opinion of the illegality of the issue of bills of credit by the states gave him the opportunity to declare in terms of universal application that the greatest violation of justice was committed when paper money was made a legal tender in payment of debts. But the opportunity to express his opinion, which was never offered to him as a judge, he found as a historian in his life of Washington. He claimed for himself and those with whom he acted, an "unabated zeal for the exact observance of public and private engagements." He rightly insisted that the only ways of relief for pecuniary "distresses" were "industry and frugality;" he condemned "all the wild projects of the moment;" he rejected as a delusion every attempt at relief from pecuniary distresses "by the emission of paper money;" or by "a depreciated medium of commerce." These were his opinions through life. He gave them to the public in 1807, and twenty-four years later in a revised edition of his Life of Washington he confirmed his early convictions by the authority of his maturest life."[19]

Years later, in 1836, legal tender was still being discussed and condemned:

> "Most unquestionably there is no legal tender, and there can be no legal tender, in this country, under the authority of this government or any other, but gold and silver, either the coinage of our own mints, or foreign coins, at rates regulated by congress. This is a constitutional principle, perfectly plain, and of the very highest importance. The states are expressly prohibited from making anything but gold and silver a tender in payment of debts; and although no such express prohibition is applied to congress, yet as congress has no power granted to it, in this respect, but to coin money and to regulate the value of foreign coins, it clearly has no power to substitute paper, or anything else, for coin, as a tender in payment of debts and in discharge of contracts. Congress has exercised this power, fully, in both its branches. It has coined money, and still coins it; it has regulated the value of foreign coins, and still regulates their value. The legal tender, therefore, the constitutional standard of value, is established and cannot be overthrown. To overthrow it, would shake the whole system. The constitutional tender is the thing to be preserved, and it ought to be preserved sacredly, under all circumstances."[20]

Given the U.S. historical record as well as the universal failure of paper money to protect savings and promises of future payment, how did it happen that gold and silver have been "demonetized?"

As with many ill-advised actions of the general government, the assault on honest money gained traction during wartime. The Civil War was a very unpopular war, and Lincoln had trouble financing it. The Morrill Tariff, which was the government's principal source of revenue, was raised to 47%. It didn't bring in enough money.

Lincoln instituted an income tax. For the most part, people rejected paying it, and, in any event, it didn't bring in much money either. In this case, the need for funds was so-great, money could not be borrowed except on terms that would have raised interest rates, some said, to as much as 20% or more. Since bank balance sheets

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[19] Bancroft, George; *A Plea For The Constitution Of The United States, Wounded in the House of Its Guardians*; (1884)
[20] Bancroft, George; *A Plea For The Constitution Of The United States, Wounded in the House of Its Guardians*; (1884); Extract from a speech delivered by Daniel Webster in the Senate of the United States, on the 21st of December, 1836, on the subject of the Specie Circular.

consisted mostly of bonds, had interest rates increased so greatly, the banks would have been bankrupted. So, if one cannot tax or borrow, what does one do?

Lincoln's Secretary of the Treasury, the brilliant lawyer Salmon Chase, who was himself an aspirant to the presidency, agreed to print money, called Greenbacks, because the back of the bills were in green ink. But why would people accept them when they were used to, and were expecting, gold and silver for their goods and services? The answer was that the Greenbacks were made legal tender.


*Exhibit 10*: $1 legal tender Greenback

As one might imagine, this was very controversial. There ensued a great deal of litigation. At its nadir, Greenbacks depreciated nearly 50% against gold. People who had lent gold or were expecting gold in payment felt they were being cheated. After the Civil War, the legal tender cases litigation percolated up to the Supreme Court. Lincoln had appointed Chase Chief Justice, and it was partially up to him to decide if what he had done during the Civil War was in conformity with the *Constitution*.

The first legal tender case, *Hepburn v. Griswold*, was decided in 1870 at a time when there were two vacancies on the Supreme Court. Chase wrote for the majority that there was no legal tender power in the *Constitution*. He wrote, further, that the government had made the Greenbacks legal tender as a war measure, out of necessity. But since the Civil War was over, so was legal tender.

The two open positions on the Supreme Court were filled (some said that the Court was "packed") with justices who were known to be sympathetic to legal tender. The Court quickly took a new case, *Knox v. Lee*, and promptly reversed itself and said there was indeed a legal tender power. However, the affirmative decision relied not on the *Constitution per se*, nor on the legislative history, but, ruled the Court, other countries could create legal tender, and therefore, so could the U.S. In the Court's language, legal tender was a power that accompanied sovereignty.

Chase, now in the minority, wrote in his decision:

> "The legal tender quality [of money] is only valuable for the purposes of dishonesty."

In my view, Chase has this right. Further, it seems clear to me that by not giving the legal tender power to the general government, and limiting legal tender by the states to only gold and silver, mindful that the 10th Amendment to the *Constitution* declares "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people," it means that sovereignty over money is reserved to the people.

In other words, if the people want to increase the money supply, they should mine more gold and silver, and take it to the mint to have in coined. The argument that other countries can impose legal tender and so can we brings to mind when I was a child and was remonstrated for doing something my mother disapproved of. A response from me that "the other kids are doing it" was rejected outright by my mom, and so should have been legal tender.

In defense of this miserable decision, *Knox v. Lee* was decided in 1871. *The Resumption Act* (returning to gold) had been signed into law in 1869 to take effect in 1874, so perhaps the Court believed endorsing legal tender was not that much of an overstep. Also, there was an issue of people who had borrowed Greenbacks during the Civil War who would have had to repay their debts in much more valuable gold if legal tender was rejected.

Chief Justice Chase's strong objection to legal tender and very strong language that it was dishonest, did not stop the monetary authorities from putting his image on the $10,000 legal tender irredeemable paper-ticket-dollar as if he might have endorsed legal tender. This is yet another misrepresentation. It is dishonest.


*Exhibit 11*: $10,000 legal tender Federal Reserve Note bearing the likeness of Salmon Chase.

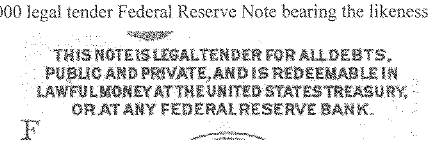


*Exhibit 12*: Blowup of the legal tender wording on the $10,000 Federal Reserve Note

Notice that this legend is somewhat different from the legend that appears today on Federal Reserve Notes because it includes the words that the note is "redeemable in lawful money." The reason for this is that, at the time that the Federal Reserve legislation was passed, it was never anticipated that Federal Reserve Notes would be money *per se*.

Today, all of our money is fiat, not redeemable in "lawful money," and we rely solely on legal tender irredeemable paper-ticket-electronic money, all of which bears the legend:

"This note is legal tender for all debts public and private."

What this means is that if one owes money to any entity and offers payment in Federal Reserve Note(s), if they are not accepted, then one need not pay. In addition, legal disputes settled in money are payable in the legal tender.

The history of how our money became transformed from constitutionally mandated gold and silver to legal tender irredeemable paper-ticket-electronic money is not well understood. Legal tender and other important monetary concepts have been removed from textbooks and, as far as I know, are taught nowhere. Today, I cannot find a textbook that deals with the history of how our legal tender irredeemable paper-ticket-electronic money became legal tender and the controversies that resulted.

While legal tender was a great benefit to those who issued money, at the end of the 19th century, it was the American Federation of Labor that was most vociferous against legal tender.

> "No legal tender law is ever needed to make men take good money; its only use is to make them take bad money. Kick it out!"[21]
>
> "If money is good and would be preferred by the people, then why are legal tender laws necessary? And, if money is not good and would not be preferred by the people, then why in a democracy should they be forced to use it?"[22]
>
> "We [the American Federation of Labor] believe in a financial policy that will neither depreciate our currency at home nor abroad."
>
> "We believe in an honest dollar."

By repealing legal tender, *The Free Competition in Currency Act of 2011*, will facilitate a transition to an honest monetary system, hopefully avoiding a catastrophic collapse.

## The kind of money we use is a moral issue

Commodity money is in conformity with the *Eighth Commandment*: "Thou Shall Not Steal," and *Leviticus* 19:35 & 36, which says that one should not falsify weights and measures. Honesty in business dealings is considered consistent with holiness and with moral law.

Fiat money violates the *Eighth Commandment* and the admonition that one should not tamper with weights and measures. Because it is used for future payment, money is said to serve as a store of value. The generation of fiat money, which is produced without work—how much more work is involved in producing a $100 bill as opposed to a $1 dollar bill?—dilutes that which has been saved and that which has been promised for future payment. It is the same as stealing.

## Property rights and money

Commodity money protects property and is protected by the notion of private property. With fiat money, when money is diluted by the creation of additional money out of nothing, the property rights of savers and those who have been promised future payments, such as pensions, are violated.

James Madison, the Father of the *Constitution* condemned paper money, even that which might have promised redemption, on the grounds that it adversely affected property rights. Repeating the passage cited above, he wrote:

> "Paper money is unjust; to creditors, if a legal tender; to debtors, if not legal tender, by increasing the difficulty of getting specie. It is unconstitutional, for it <u>affects the rights of property</u> as much as taking away equal value in land." [Emphasis added.]

For example, if one works and saves the money one receives in exchange, arguably one has a property right in the money saved. If the money is fiat, then the purchasing power can be decreased by the issuing authority by

[21] Byington, Stephen T. *The American Federationist* September 1895. *The American Federationist* was the official monthly magazine published by the American Federation of Labor.
[22] Ibid.

creating out of nothing, and without work, any amount of additional money. The result will be that one has lost the value of one's work.

The same logic applies to money that has been promised for future payment, e.g., pensions. Arguably, people who have earned and/or contributed to a pension plan have a property right to what they have earned when the plan vests. If a monetary authority creates additional money out-of-nothing, in effect one loses the value of his property. Where is the justice in that?

## Governmental monetary integrity

With commodity money such as gold or silver, the general government tends to be completely honest about money and the monetary system, because there is little for the government to do except to coin money. There is very little "wiggle room."

With legal tender irredeemable paper-ticket-electronic money, because it is inherently fraudulent, the government or its agents, e.g., the Federal Reserve, engage in myriad frauds both at home and abroad.

By delegating to the Federal Reserve a power that Congress does not have under the *Constitution*, the power to create money out of nothing, the Congress has empowered the Federal Reserve to act as a *de facto* agent of the general government. While almost all of what the Federal Reserve does is secret and generally not subject to discovery, occasionally evidence of gross malfeasance and fraud appears.

For example, there came a time circa 1982 when the Federal Reserve helped phony up the balance sheet of the Bank of Mexico. Here are the facts.

After Paul Volcker retired as Chairman of the Board of Governors of the Federal Reserve in 1987, he and Toyoo Gyohten, his former counterpart from the Bank of Japan gave a series of lectures at Princeton. Those lectures became a book, *Changing Fortunes*, in which the following passage appears:

> "So it was a matter of buying time. In an effort to hold things together psychologically, we agreed with considerable unease to extend overnight swap credits once or twice to the Bank of Mexico to bolster the month-end figures for their dollar reserves. *We would transfer the money each month on the day before the reserves were added up, and take it back the next day.* Our unease did not arise from any fear of financial loss, but because the 'window dressing' disguised the full extent of the pressures on Mexico from bank lenders and from the Mexicans themselves." [Emphasis added.]

This is a *prima facie* fraudulent transaction. The phrase "window dressing" is a euphemism for a misrepresentation, which is the indicium of a fraud. The issue that this raised for me is that if the Federal Reserve is willing to engage in this genre of fraudulent transactions, what might be the limit on what the Federal Reserve might or might not do. I conclude that there is no limit.

Further, what possible legislation passed by Congress authorizes this? Some time ago, I submitted to the Federal Reserve a Freedom of Information request for documents dealing with this transaction. My query turned up nothing.

As a small digression, some time ago as part of a larger presentation I showed this to Mr. Ed Ott, then the Executive Director of the New York City Central Labor Council. Mr. Ott connected a dot that I had not considered. He noted that after the Mexican Peso collapsed, when many ordinary Mexicans lost their savings and jobs, in order to survive, many of them illegally migrated to the U.S. to find work. In this way, fiat money has contributed to the problem of illegal immigration that some in the U.S. have complained about.

## The perils of money creation

Prior to August 15, 1971, when President Nixon "temporarily," he said, defaulted on the U.S.' sovereign promise to redeem dollars for foreign governments and foreign central banks at the rate of one ounce of gold for $35 (at the time it was a felony for U.S. citizens to own gold anywhere in the world), the amount of dollars created out of nothing by our banking system was ultimately limited by the amount of gold that could be claimed. After the default, the amount of dollars that could be created out of nothing has no limit. (See *Exhibit 23*)

As Mr. Greenspan confirmed multiple times, the Federal Reserve has the power, on its own authority and without any oversight from Congress, and as recent events have shown, to create money without limit. When money is created out of nothing, it depreciates the purchasing power of money that exists, and more importantly, it depreciates money that has been promised for future payment, e.g., pensions, annuities, etc.

Since 1946, about $14 trillion (M3) has been added to the economy. Where did all of this money come from? How did it get into the society?

As John Kenneth Galbraith explained:

> "The process by which banks create money is so simple that the mind is repelled."[23]

Consider, for example, if one were to take a $300,000 30-year 6% fixed rate mortgage loan from a bank. The interest on the loan will be about $350,000. Where does the bank get the $300,000? Papers are passed back and forth and signed. Then a bank employee goes to a computer and types in a book entry to one's account for $300,000 and that's it! In other words, essentially for passing some paper around and keying six keystrokes, the bank will now reap $350,000 over a 30-year period.

Suppose the loan was for $3,000,000, yielding the bank about $3,500,000 in interest. What extra work does the bank need do to realize the additional $3,150,000? All that need be done is to add an additional zero; one more keystroke. And if the loan was for $30,000,000, yielding the bank almost $35 million in interest, all that need be done is to add two more keystrokes!

Is this genre of money creation possibly in conformity with the *Constitution*? In what way is this related to Congress' power to "coin money?" Is it in conformity with free market principles? Does this kind of "work" justify the lavish salary and bonus compensation paid to bankers? I'll have more to say about this later.

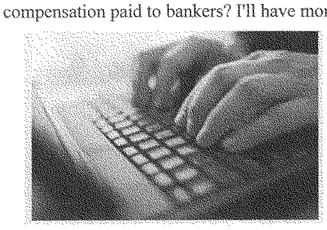

*Exhibit 13*: How banks create money

As unbelievable and outrageous as this appears, the process is explained in official Federal Reserve publications. The Board of Governors and the twelve regional Federal Reserve banks each maintain a Public Information Office. A large number of pamphlets, manuals, reports, videos and other publications purportedly to educate the public on why the Federal Reserve system is so wonderful are available for free or for a nominal sum. This is a great source of reading material if one is having trouble sleeping. The following quote comes from a comic book format directed at children. It explains simply:

> "Money exists simply as a bookkeeping entry at a bank."[24]

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[23] Galbraith, John Kenneth; *Money: Whence it came, where it went*

Here is a more complete explanation from a more erudite publication:

> "If a bank makes a loan, it credits the checking account of the borrower. This creates new money in the form of additional checkable deposits for the borrower."[25]

In effect, the Congress has delegated to the banking system a power that the Congress does not have: the power to create legal tender irredeemable paper-ticket-electronic money out of nothing. What is the response from the financial sector? How can this be justified?

First, they claim that money creation helps the economy and provides jobs by financing factories, real estate, consumer purchases, and so on. While it is true that in some cases money creation is used to build and enhance productive enterprise, mostly it is used for gambling in the capital markets, e.g., proprietary trading. Today, the major money center banks have become *de facto* hedge funds.

Second, they claim that no one coerced another into taking a loan, and presumably the bank is satisfying a customer need while benefiting itself at the same time. In other words, they claim a win-win situation.

But wait, not so fast. The rest of society ultimately pays a huge price for the banking system having the privilege of creating money out of nothing. Consider the effect on the purchasing power of money:

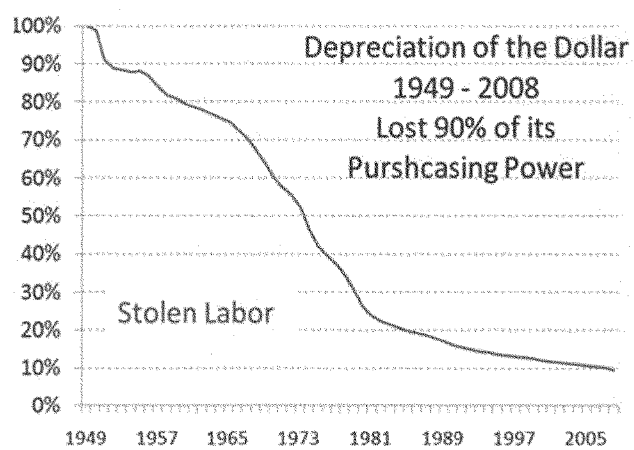


*Exhibit 14*: Depreciation of the dollar 1949 – 2008; Source: Federal Reserve CPI data.

The reason why I call this "stolen labor" is because if one works, one's labor is transformed into money, some of which one saves. If one's savings depreciate, in effect, one has lost his labor. Who benefits? Except for waste, which is unfathomable, the principal beneficiary of legal tender irredeemable paper-ticket-electronic money is the financial sector.

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[24] *The Story of Money*, 8th Printing, 2005, Federal Reserve Bank of New York, page 17

[25] *The Federal Reserve Today*, 15th Edition, Federal Reserve Bank of Richmond, page 16

Its members, through a combination of fees and stock options, get to transform the legal tender irredeemable paper-ticket-electronic money into real stuff, e.g. 40,000 foot houses in multiple locations around the globe, 200 foot boats, $200 million airplanes, now. Later, when savers and those to whom money has been promised, e.g., pensioners, get their rewards, it turns out that their saved money doesn't have the purchasing power they anticipated. In effect, they have been and will be cheated.

Later, I will show empirical data whereby the financial sector public company market capitalization has increased from 5% of total market capitalization in 1980 to more than 20% in 2007. How could the financial sector, which produces no final products that improve the lives of anyone, have quadrupled its share of market capitalization in one generation? This was just blatant wealth transfer from people who earned it to the financial sector.

These days, the depreciation of the dollar, usually referred to in the press as inflation, as measured by the Consumer Price Index (CPI) is thought to be benign. In my view, and that of anyone who eats food or consumes fuel, the notion that the CPI is benign is false.

John Williams, a Foundation for the Advancement of Monetary Education Foundation Scholar, has had a long career as a professional economist with clients such as Boeing and IBM. Now in retirement, he runs a website service called Shadowstats.com. He claims that the methodology by which the CPI is computed has been modified multiple times since the Clinton years, incorporating "innovations" such as Hedonic Pricing, geometric weighting, substitution, etc. that have had the effect of reducing the CPI from what it would otherwise be had a consistent methodology been used. Here is a plot showing his findings from 1981 through July 2011:

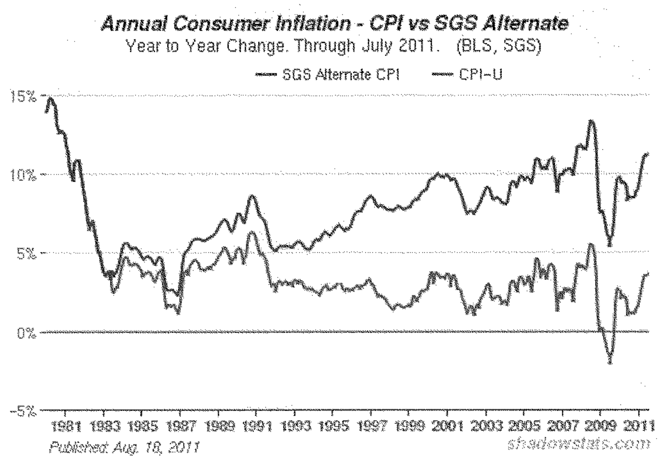


*Exhibit 15*: Annual Consumer Inflation vs. Shadowstat.com computation using a consistent methodology from the early 1980s.

As can be seen, using a consistent methodology, the CPI has been materially understated for almost 25 years.

Here is a real-life example of how the CPI is understated for ordinary people. This graph shows my monthly healthcare premiums to Oxford for the years 2001 through 2007:

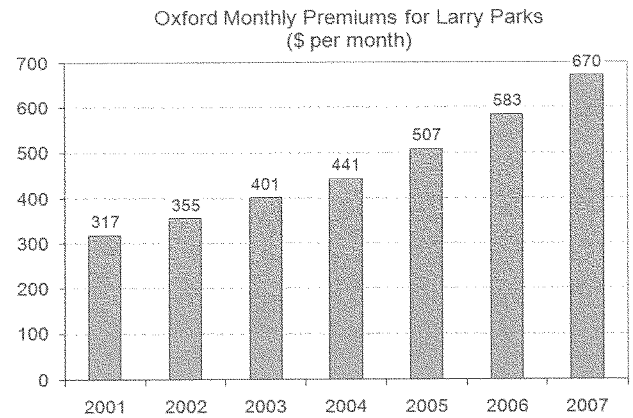


*Exhibit 16*: Oxford Health Plan monthly premiums for Larry Parks 2001 - 2007

On the next graph, I show my year-on-year percentage increased cost (which I believe is representative of the experience of most people who have healthcare insurance) and compare it to the percentage increase in the BLS medical component of the CPI:

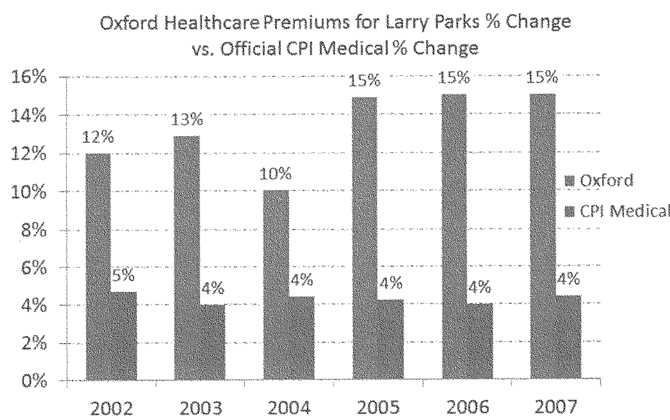


*Exhibit 17*: Medical component of the CPI contrasted with increased premiums charged by Oxford Health Plan; Source: BLS and data from Larry Parks' Oxford bills

Thus, the medical component of the CPI is not in conformity with the experience of virtually the entire population, which has experienced double-digit increases for health care for years.

There is overwhelming empirical evidence that prices are increasing greatly for the inputs to consumer items.

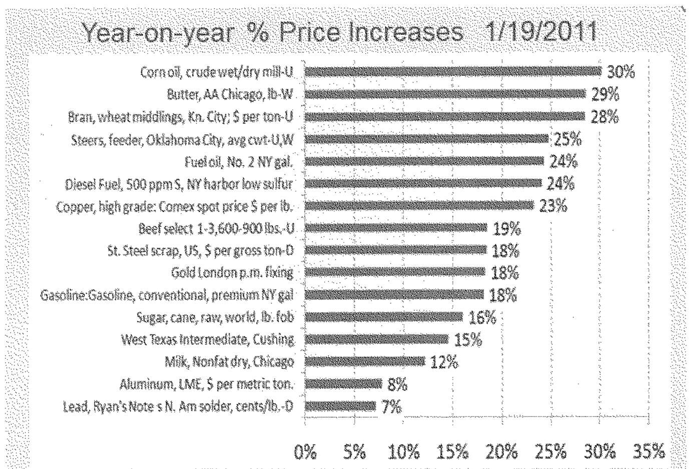


*Exhibit 18*: Year-on-year price increases as at 1/19/2011; Source: *Wall Street Journal*

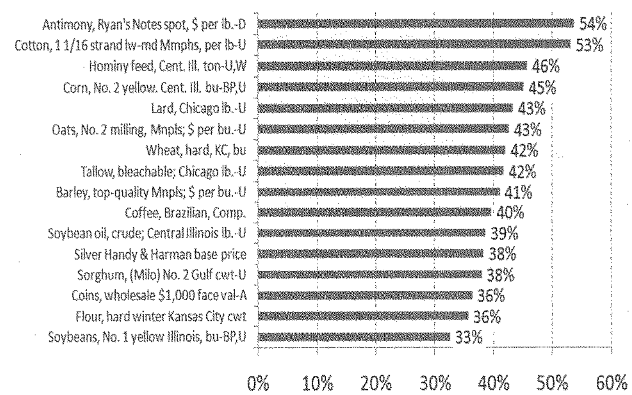


*Exhibit 19*: Year-on-year price increases as at 1/19/2011; Source: *Wall Street Journal*

It's hard to imagine that these large price increases will not at some point be incorporated into consumer products one way or another. For example, the media has reported on many products whose packaging and content sizes have been reduced, while maintaining the prior price per package when it contained more product. In this way, and many others, the effects of currency depreciation are being obfuscated.

These graphs provide support for Mr. Williams' hypothesis that using a consistent methodology the CPI has been seriously understated for almost 25 years. Since retirement schemes such as Social Security, benefits to disabled veterans, and salary increases to those who have COLA clauses (which used to be common in labor contracts) are keyed to increases in the CPI, these beneficiaries along with Treasury Inflation Protection bond holders are being cheated. Why should our government be part of a cheat?

## Boom & bust in the economy

With commodity money, such as gold, and without fractional reserve lending (leverage), a.k.a. the creation of "bank money" by banks, economic activity expands without busts. With increasing amounts of fractional reserve lending, there are periodic booms and busts. A bust results when marginal credit that cannot be serviced is liquidated.

Fiat money tends to create huge bubbles, which, when they collapse—and they always collapse—lead to extended depressions and severe hardship, especially for ordinary working people and seniors.

## Likelihood, duration, and size of wars

Wars are very expensive. Because the only sources of revenues with commodity money are taxes, which people tend to resist, or borrowing, which drives up interest rates, there tend to be fewer and smaller wars. For example, it is less likely that the U.S. would have fought in Vietnam if President Johnson had to finance the war with taxes.

Fiat currency enables politicians to generate revenues with less accountability. They are then able to act without the consent of the citizenry, which, if consulted, would probably allocate their savings differently. Thus, politicians have a freer hand to engage in military adventurism, and they do.

## Military preparedness and the ability to wage war if need be

With commodity money such as gold or silver the country will have a stronger industrial base, which makes for a stronger military. Also, lower interest rates, which are a by-product of commodity money, make for a greater capacity to finance a war.

With legal tender irredeemable paper-ticket-electronic money, there will be a weaker military due to a weaker industrial base. Since purchase power of the money is vulnerable to collapse, there is less of a capacity to finance a war. When a collapse arrives, the military can become fatally weakened. This is an important national security issue.

## Who gets the wealth of society?

With commodity money such as gold or silver, the wealth of society goes to the people who earn it: workers, entrepreneurs, and the producers of goods and services sold in the market in voluntary transactions.

With legal tender irredeemable paper-ticket-electronic money, an inordinate amount of wealth is transferred from those who produce it to banks and financial intermediaries. Large credit-worthy borrowers benefit. Also, politicians tend to profit along with people who are direct beneficiaries of government largesse.

## Social mobility: the ability to improve one's lot in society

With commodity money such as gold or silver, social mobility is high. There are innumerable stories of years gone by about people who came to America with nothing but their willingness to work who built major successes. When the U.S. had sound money, it was known worldwide as "The Land Of Opportunity." These days, there are innumerable stories about folks going back to their original homelands.

With legal tender irredeemable paper-ticket-electronic money, social mobility is low to none. Because improving one's lot requires the accumulation of wealth, and because it is not economic to save fiat currency, the poor tend to stay poor.

## Social engineering (the redistribution of wealth)

With commodity money, such as gold and silver, social engineering is hard to do because it must be done with taxation and people tend to oppose higher taxes. They take a greater interest in where money is spent when it is their own.

With legal tender irredeemable paper-ticket-electronic money, social engineering is easier to attempt by creating money out of nothing and "spending" it, lending it, or guaranteeing loans (where it is known in advance that such guarantees can be met by creating additional money). Contrary to popular opinion, the empirical evidence confirms that most wealth redistribution is from the poor to the rich.

No less an authority than Mr. Greenspan has confirmed that we have subsidies for the banking system. Mindful that bankers are richer than most, this means that poorer people are transferring wealth to richer people. Where is the justice in that? If we had an honest monetary system, the wealth transfer would be apparent to all and would be objected to.

## Unfathomable Waste:

There is a loss that can be even greater than the depreciation of the currency if banks make loans for enterprises that are not long-term viable. Consider the recent residential real estate debacle whereby several million homes face foreclosure, more than a million are vacant and many millions are "underwater."

A house isn't like a rock; it requires constant care and maintenance. If a leak develops, water and mold damage can result in a total loss. When a bank finances a home for which insufficient savings have been accumulated to pay for it, the bank gets upfront fees, called "points." The mortgage broker gets a fee, as does the real estate agent, the appraiser, lawyers . . . a little army of beneficiaries. If the house is a new build, the builder makes a profit as well. My point is that many people get paid.

If the house goes into foreclosure and results in a total loss (there are film clips on the Internet of whole new house divisions being bulldozed), the entire enterprise is for nothing. None of these folks have their compensation clawed back. However, the bank's balance sheet will be replenished one way or another. It is the taxpayer, through additional currency depreciation, who ends up holding the empty bag.

By making a transition to an honest monetary system, when all the facts are on the table without misrepresentations, full disclosure and no coercion, as I will explain further in the section on jobs, prices will again be stable, and savings and promises of future payment will not bear the risk of currency depreciation. *The Free Competition in Currency Act of 2011* will hasten that transition.

## Research & Development and Science Education

Because commodity money has a lower interest rate structure and a longer investment-time-horizon, there tends to be more long-term investment. Research and development tend to be long-term activities. Thus, commodity money results in more scientific activity and the need for more science education.

Because fiat currency results in a higher interest rate structure and a shorter investment-time-horizon, there tends to be less long-term investment. If interest rates are high enough, as in Mexico or Brazil, there may be no long-term investment at all and little research and development, and less demand for science education.

## Manufacturing jobs and employment:

With commodity money such as gold or silver, there is more investment in productive ventures; there are more and higher-paying jobs than otherwise. Because manufacturing is capital intensive, there are also more manufacturing jobs. With fiat, irredeemable paper ticket-token or electronic-checkbook money, there is less investment in long-term productive enterprise, there are fewer and lower-paying jobs.

This is because fiat currencies cause higher interest rates and a shorter investment-time-horizon, causing a decrease in manufacturing activity. Generally, there is an increase in the so-called service sector because it has a much shorter investment-time-horizon. Near zero interest rates today are not a market-driven event. It is blatant market manipulation by the Federal Reserve creating additional money out of nothing to buy bonds.

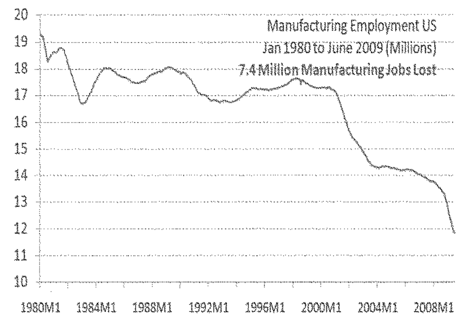


*Exhibit 20*: U.S. Manufacturing Employment January 1980 to June 2009; Source: BLS

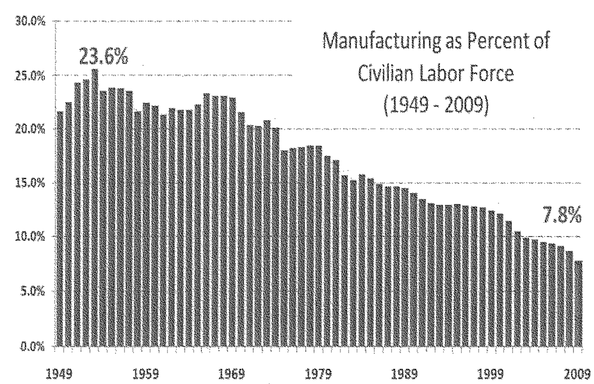


Exhibit 21: Manufacturing as a percent of the civilian labor force 1949 – 2009; Source: BLS

With commodity money, job security is impacted mostly by increases in productivity, which tends to destroy some jobs and create others. Decreasing prices help offset the negative effects associated with the destruction of jobs resulting from productivity (labor saving) improvements.

With fiat money, job security is impacted by rapidly changing interest and foreign exchange rates, and less of a propensity to save and invest for the long term.

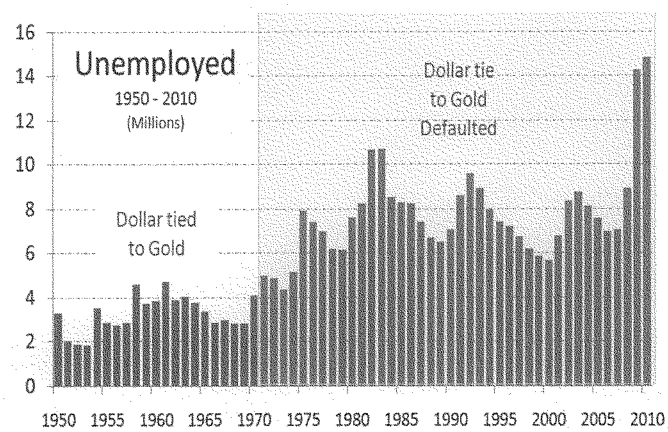


*Exhibit 22*: Unemployed persons series U; Source: BLS

*The Free Competition in Currency Act of 2011*, by speeding a transition to an honest monetary system, will help to create more and better job opportunities in the U.S.

Except for those workers who do manual work without tools, e.g., picking vegetables, or who are professionals who work in a knowledge-based industry, well-paying jobs require tools, or more generally, plant and equipment. The more sophisticated the tool, the more investment in research and development is required over longer periods. The source of investment is always accumulated savings, i.e., that which is not consumed from one's production.

While legal tender irredeemable paper-ticket-electronic money created out of nothing by the banking system may at first blush appear to be an alternate source of funding separate from savings, in fact it dilutes the purchasing power of that which has been saved or has been promised for future payment. The only thing that gives fiat money value is that some people save it. If a country issued paper money in a country that had no accumulated savings, that money would depreciate quickly and would, in effect, be rejected.

Part of the human condition is that people must save (or someone must save on their behalf, e.g., a pension plan) for a time when they can no longer work. Labor songster, the late Joe Glazer wrote a song commemorating this at the time that Walter Reuther was negotiating the Chrysler pension plan circa 1954. The refrain is "Too old to work, too young to die, how am I going to get by?"

Ordinary people are very security conscious and tend to allocate their savings to what they perceive to be the least risky (from the vernacular, not the financial definition) allocation. Most times, they allocate to U.S.

Government bonds (in Europe, German bonds are considered safe). Ideally, however, society is best off when savings are allocated to productive enterprise.

Recently, David Malpass, former senior economist for Bear Stearns, wrote an insightful OpEd piece in the *Wall Street Journal* in which he observed:

> "Treasury bond yields have been at near-record lows and gold prices at record highs, attracting millions of investors into idle assets through coins, exchange-traded funds, and even warehousing facilities." And,
>
> "It means people would rather buy gold than hire workers or start businesses -- that they don't trust the central bank to maintain the value of their money."[26]

Thus, if people don't trust the efficacy of currency, they make a "flight-to-safety" rather than invest in productive enterprise. So far, there is substantial residual faith in the fiat dollar, as evidenced by the unsustainably low interest rates on U.S. Government securities. That could change very quickly. The bottom line is that industrialization requires sound money, not money that a central bank can create, in Mr. Greenspan's exact words "without limit."

But there is another, and more toxic effect of legal tender irredeemable paper-ticket-electronic money on jobs. As the banking system increases the money supply, as mentioned previously, the purchasing power of money that exists depreciates. This is called inflation as measured by the CPI.

Here is a long-term chart of M3, the so-called broad money supply, from official sources until March 2006, at which time the Federal Reserve stopped publishing this metric. The components of M3 are known, so some have constructed a proxy to continue the series. For our purposes, that proxy is meaningful. Here is a plot showing the M3 money supply from 1946 through 2008.

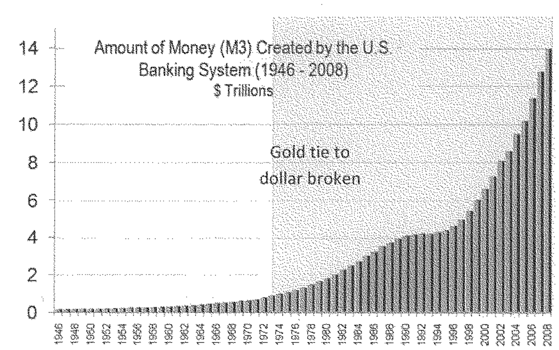


*Exhibit 23:* The broad money supply (M3) from 1946 to 2008. Source: Federal Reserve until March 2006 when the Fed stopped reporting this metric. From April 2006 to December 2008 the data reflects estimates of various observers based on known components of M3.

[26] "Beyond the Gold and Bond Bubbles Shouldn't the Fed Try to Improve Incentives to Invest in Growing Businesses?" by David Malpass, *The Wall Street Journal*, August 31, 2011.

In 1946, M3 was approximately $150 billion. By 2008, it had ballooned to $14 trillion. Contrary to what most people understand, all of our money is created by the banking system. Specifically, when a bank makes a loan it creates the deposit with a simple book entry. The jargon for money creation is called "fractional reserve lending."

Notice how the money supply accelerated after the last tie to gold was broken on August 15, 1971. A great deal of the increase in the money supply went into the capital markets, thereby increasing the nominal valuations of equities. Wall Street called this "wealth creation." In fact, on account of the fees that went to financial sector participants and stock options that went to those who manage publicly-traded companies, it was mostly wealth transfer. I will have more to say about this in the section on Wall Street and the Banks.

Again, creating all of this new money out of nothing increased the price level. The effect on jobs has been an unmitigated disaster and from many points of view.

Consider the price level of the United States from 1800 to 2006:

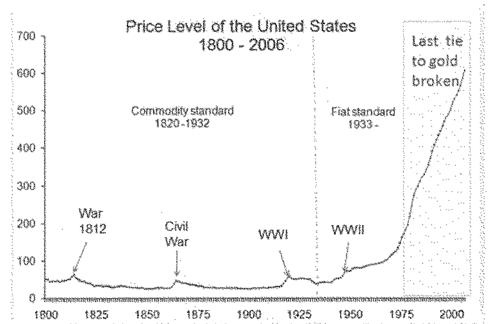


*Exhibit 24*: Price Level of the United States 1800 – 2006. Source: Federal Reserve Bank of Dallas.

Notice that the U.S. price level was stable for about 125 years. There were little blips at the time of the War of 1812, the Civil War, WWI and WWII, but at the end of the period prices were nearly what they were in the year 1800. During the period, there were enormous improvements in manufacturing as more and better products were produced. The standard of living at the end of the period was many times greater than that of the year 1800 with innovations such as the steam engine, railroads, telegraph and many others. Further, the growing industrial strength made the U.S. the envy of the planet. At one point it appeared that a large part of the world's population wanted to migrate to the "Land of Opportunity," also called the "Land of the Free."

It is significant that after FDR seized all of the monetary gold owned by U.S. citizens and made it a felony for U.S. citizens to own monetary gold anywhere in the world, the price level began to increase, especially on account of financing the Vietnam War with legal tender irredeemable paper-ticket-electronic money.

At the time that president Nixon defaulted on the last promise to redeem dollars for gold to foreign countries and foreign central banks, not only did money creation accelerate, but so did the price level.

What does this have to do with jobs? As the price level increased, nominal wages increased, and along with some other effects, especially taxes (which are not part of the CPI calculation), the U.S. became uncompetitive with other locales. I recall up until the last tie to gold was broken the New York City metropolitan area where I live had a large garment center manufacturing presence. Because it was cheaper to manufacture in other countries, e.g., Japan, garment manufacturing, and most labor-intensive manufacturing left the U.S.

Shortly thereafter, whole industries migrated, such as shoe manufacturing. I have been told that there is only one large shoe manufacturer left in the U.S., Allen and Edmonds. As time went on the television industry, microwave ovens and myriad other industries took their jobs overseas.

The spin from Wall Street was that we would be doing the creative work (we would think, and the Asians would sweat) and everyone would benefit. Forgetting the effect of legal tender irredeemable paper-ticket-electronic money in financing "trade," so-called globalization was the new mantra to an improved standard of living for all. What was wrong with that argument?

The fallacy with globalization is that it wasn't trade, unless one wants to think of it as trading jobs for consumer electronics. When Ricardo postulated that comparative advantage and free trade would benefit all, England was on a gold standard, and trade meant an exchange of value for value and work for work. With a legal tender irredeemable paper-ticket-electronic monetary system, money is created without work. How much more work does it take to create a $100 bill as opposed to a $1 bill? None at all. And the amount of work it takes to create a $1 bill is about two cents. In this light, globalization is not trade. It is wealth transfer.

### Money creation effects on state and local taxes:

Commodity money tends to facilitate lower tax rates and less taxation, since citizens see how much is being extracted from them. As fiat money is created out of nothing, there tends to be inflation and ordinary working people are pushed into higher tax brackets. People pay a larger percentage of their income to taxes.

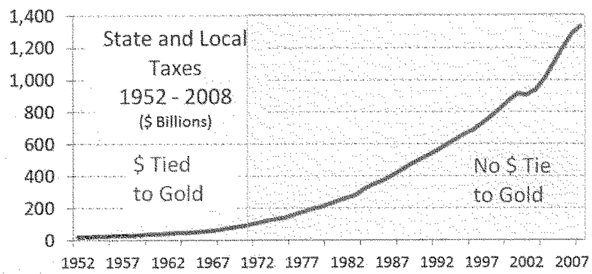


*Exhibit 25*: State and Local Taxes 1952 – 2008; Source: government data

After the last tie to gold was broken in 1971, concomitant with money creation, state and local taxes increased greatly. Until recently, except for a very slight decrease in year 2003, tax collections were clearly in a long-term uptrend. Few made the connection between legal tender irredeemable paper-ticket-electronic money and tax revenues. The apparent prosperity generating the increased tax revenues was a mirage based on fiat money.

The result was that state and local politicians were induced to expand public services and to make promises, such as pensions and benefits, to public employees that they should not have made and which cannot be kept. One can well understand the fury of those who have been promised pensions and benefits, having worked their entire careers in anticipation of receiving them and then being told that these promises cannot be kept. Reality must be confronted in a way that will minimize the damage and pave the way for an honest monetary system that will provide genuine prosperity going forward.

The alternative of increased money creation along with so-called "inflation targeting," while kicking the can down the road, will compound the catastrophe. The money issue needs to be addressed now. *The Free Competition in Currency Act of 2011* provides a clear path.

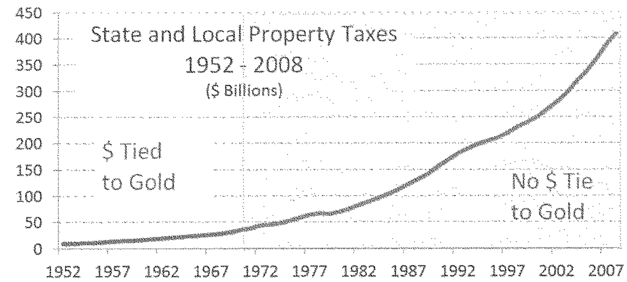


*Exhibit 26*: State and Local Property Taxes 1952 – 2008; Source: Government data

A great deal of legal tender irredeemable paper-ticket-electronic money created out of nothing found its way to financing real estate. As a result, real estate values increased greatly and so did concomitant real estate taxes. One effect was that seniors whose income was fixed, and also on account of other increasing costs such as fuel, insurance, medical care etc., got squeezed out of their homes. Some, not being mindful of money creation and anticipating ever-increasing values of their homes, took out additional mortgages. Everyone knows how that turned out. Few have connected the dots to legal tender irredeemable paper-ticket-electronic money.

But legal tender irredeemable paper-ticket-electronic money is responsible for another and in my view more insidious effect. While bankers, Wall Street firms, mortgage brokers, real estate brokers and a small army of support personnel profited and walked off stage with major fortunes, manufacturers whose products were marginally profitable had to abandon their businesses and fire their employees.

For example, a couple of years ago *The New York Times* ran a story about Bartlett Manufacturing Company in Cary, Illinois, which had to close its printed circuit board factory because the property taxes were no longer affordable. As can be seen from the photo, this was a machine-intensive business.[27]

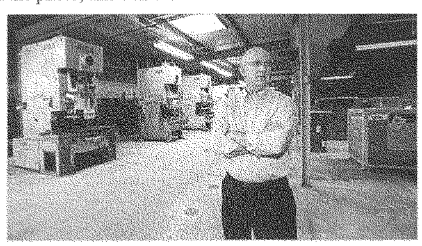

*Exhibit 27*: Bartlett Manufacturing Company shutdown on account of property taxes

After he closed the business he was quoted as saying: "I am going to tear down the building and sit on the land, and hopefully sell it after the recession when land prices hopefully rise." As can be seen, this is a perfectly serviceable building.

[27] Uchitelle, Louis; "Obama's Strategy to Reverse Manufacturing's Fall"; *The New York Times*, 7/21/09

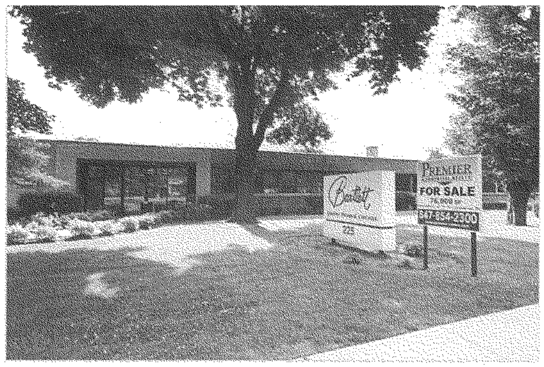


*Exhibit 28*: Bartlett Manufacturing Company teardown on account of property taxes

The bottom line is that legal tender irredeemable paper-ticket-electronic money has myriad adverse effects, one of which, by causing taxes to increase at the state and local level, is contributing to the destruction of industry and jobs.

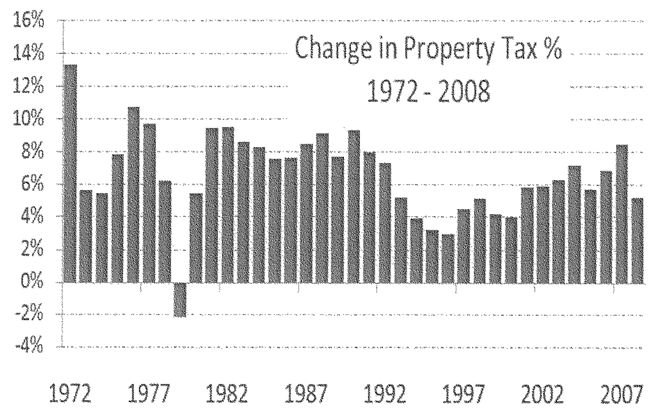


*Exhibit 29*: year-on-year percentage change in property taxes; Source: government data

Small digression: property taxes are not included in the CPI calculation. In addition to property taxes there are many other fees and charges that increase on account of money creation.

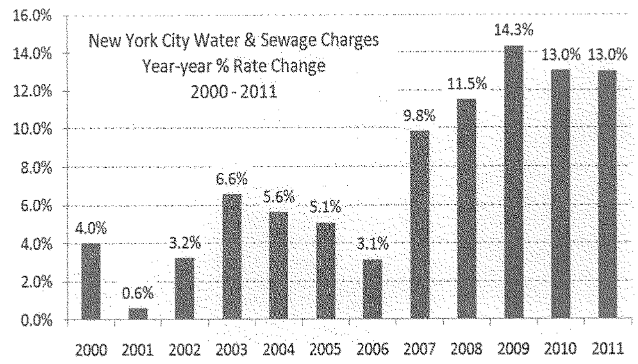


*Exhibit 30*: New York City Water & Sewage Charges year-on-year change 2000 – 2001; Source: New York City Government

## Real Wages

With commodity money, real wages tend to increase, as does the standard of living. With fiat money, real wages tend either to stagnate or decrease, as does the standard of living. This is confirmed by the empirical data.

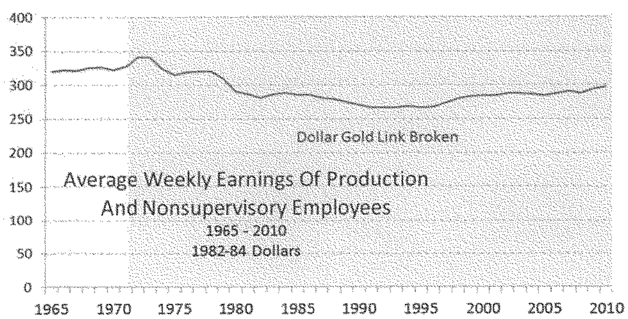


*Exhibit 31*: Average Weekly Earnings Of Production And Nonsupervisory Employees, 1982-84 Dollars; Source: BLS

The tipoff that legal tender irredeemable paper-ticket-electronic money adversely affects wages is the use of the adjective "real." Without the modifier are wages imaginary? Yes they are. Even with the modifier, with fiat money wages are denominated not in dollars as the term is used in the *Constitution*, but in dishonored promissory notes, i.e., broken promises to pay dollars (see the section: Why legal tender irredeemable paper-ticket-electronic money is dishonest).

Common usage is for "real" to mean "adjusted for inflation" as measured by the CPI. As explained in the section: The perils of money creation, this adjustment understates the depreciation of the currency, and so real wages have suffered even more than shown in Exhibit 31. While there was a link to gold and our dollar was more stable, real wages had been increasing.

At the inception of the Labor Movement in America, circa 1830, working people were very mindful of the perils of paper money, which, while not legal tender, was redeemable into specie on demand. The problem from Labor's point of view was that redemption had to take place at the bank of issue, which was not always geographically convenient. As a result, workers paid with paper money most times suffered a redemption cost when they redeemed it for specie.

Gold and silver as money, a.k.a. sound money (because it made a sound) or honest money, was one of the three issues that motivated men to join unions. The other two were the ten-hour workday and education for workers. Eli Moore, then president of the Typographers' Union in 1832, was the first union official to win a seat in Congress. He was a staunch supporter of Andrew Jackson who got rid of the Second Bank of the United States by vetoing its renewal charter and who was an outspoken supporter of gold.

## Propensity to Save

Commodity money is very savable because it doesn't obsolesce or deteriorate and is difficult to counterfeit. Purchasing power is not diminished. Fiat money is less savable and can discourage long-term savings altogether, since its future value is always in doubt. Why save a depreciating asset? This is confirmed by the empirical data.

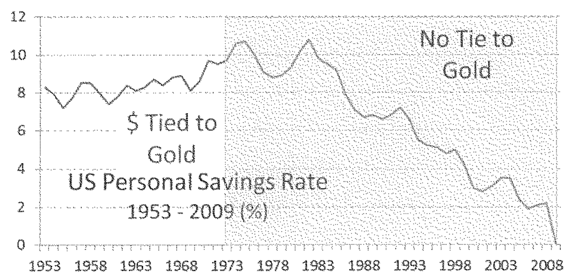


Exhibit 32: U.S. Personal Savings Rate; source: http://www.bea.gov/national/nipaweb/SelectTable.asp#S5

The only way to build a rich society and improve everyone's standard of living is to save and invest. Provided one invests in a society that respects property rights and one can reasonably expect to enjoy positive results of an investment, should there be any, then one tends to risk a portion of one's accumulated savings by investing in productive enterprise. Otherwise, one might just as well spend and enjoy one's income. That is precisely what the empirical data confirms.

It is invested capital, both physical and intellectual, that are a precondition for high-wage jobs. The lack of accumulated capital in most of Africa is the principal reason why wages are so low in that region. Because legal tender irredeemable paper-ticket-electronic money always depreciates, especially for long-term investments, the eventual chance that one will enjoy a positive result from risking one's savings is less than it would otherwise be, and so there is less of it.

Most important, since legal tender irredeemable paper-ticket-electronic money always depreciates, less of it is saved than otherwise. One deceptive escape hatch for some people is to allocate their savings to the equity markets and hope for the best. As will be shown, the capital markets benefit mostly those who get fees for facilitating transactions.

## Pensions in peril

Pension assets in physical gold are safe and secure. There is no counterparty risk. Because the amount of new gold produced each year is a tiny fraction, generally less than 2%, of the gold above ground, prices denominated in gold remain stable over time. Because it takes work to mine and produce gold, the amount of gold above ground cannot be increased by whim.

With legal tender irredeemable paper-ticket-electronic money, pension assets are vulnerable to volatility in interest rates, rate-of-return and discount rate assumptions by those charged with contributing to defined benefit plans, whether they be private or political entities. Because fiat money can be created out of nothing without limit, the purchasing power of pensions is vulnerable to severe depreciation.

*The Free Competition in Currency Act of 2011*, by speeding a transition to an honest monetary system, will make pensions more secure and more valuable for the putative beneficiaries.

With our current legal tender irredeemable paper-ticket-electronic monetary system, the real beneficiaries of pension plans are financial sector firms, especially banks, brokerage firms, and the army of professionals who service them. If retirees receive their promised pensions and benefits, it will be a happy accident. Already, millions of steel workers, textile workers, airline workers and many others have lost promised pensions and benefits which they have earned.

The short explanation is that financial sector firms get fees now in money that still has purchasing power, while pensioners are looking forward to getting their payments later. When later arrives, the money they receive will at best be worth a lot less than what they are expecting, and at worst will be worth nothing at all. In many ways, this is similar to the classic Ponzi scheme in that some people get paid sooner; when later arrives, folks are left with an empty bag.

An important way in which real assets are improperly transferred to the financial sector has to do with the manner in which assets are allocated to various financial vehicles.

Today, U.S. private and state and local pension funds have approximately $9 trillion in assets.

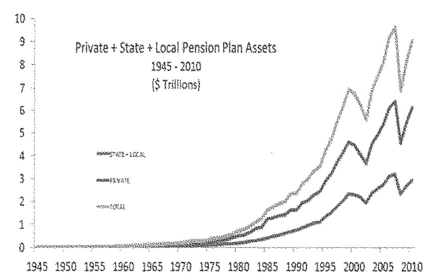


*Exhibit 33*: U.S. private and state and local pension assets. Source: Federal Reserve Flow of Funds

Pension assets, while supposedly under the control and by law the fiduciary responsibility of pension plan trustees, are *de facto* under the control of consultants and Wall Street money managers from whom trustees take their marching orders. Order of magnitude, all factors considered, I estimate that fees and overhead for these funds is about one percent of assets, $100 billion per year. This structure is enshrined in major legislation including *The Employee Retirement Income Security Act* (ERISA) and *The Pension Protection Act Of 2006* (PPA) which require trustees to be "prudent."

In case something goes horribly wrong and pension assets are dissipated, virtually everyone has been given a "safe harbor" if they rely upon "standard industry practice." In effect, what this means is that no one will be held liable if they diversified the allocation of assets and relied upon "experts." The experts, however, have a conflict of interests with the beneficiaries, because their compensation is derived from fees which they have an incentive to maximize, and the diversification of assets is based on demonstrably phony methodologies.

Over the years, along with academic "experts" whom the financial sector has compromised through endowed chairs, prizes[28], honorariums, research grants, consulting work, and who knows what else, demonstrably bogus methodologies have been conferred legitimacy that enhance fees to the detriment of pension plan beneficiaries.

The ranks of those who might become experts is highly restricted because journals that an academic must publish in to qualify for tenure and to move up the academic food chain are, for the most part, edited by folks who are present or former employees of the banking system, and especially the Federal Reserve.

> "One critical way the Fed exerts control on academic economists is through its relationships with the field's gatekeepers. For instance, at the *Journal of Monetary Economics*, a must-publish venue for rising economists, more than half of the editorial board members are currently on the Fed payroll -- and the rest have been in the past."[29]

These editors act as gatekeepers and do not publish anything that challenges fundamental assumptions nor the legitimacy or honesty of central banking and the legal tender irredeemable paper-ticket-electronic monetary system.

Here is another example of how the Federal Reserve has compromised the Academy: In 1994, Mr. Stephen Davies wrote an article citing evidence collected by then Chairman of the House Banking Committee Henry Gonzalez showing that the Fed has spent millions hiring economics faculty members as "consultants." The article quotes Mr. Gonzalez:

> "The Federal Reserve employs hundreds of researchers in their [sic] research departments, but inexplicably also spends millions to pay hundreds of outside economic consultants. . . *The Fed is simply buying off potential critics by* holding *out contracts that offer academics extra money* and use of the Fed's facilities. No agency that has to justify its spending would dream of this kind of extravagance and waste." [Emphasis added.]

More telling, the article continues:

> "Moreover, the *Bond Buyer* has learned that in the case of the Federal Reserve Board, all contractors are required to sign a non-disclosure statement... broadly worded *to prohibit the release of any information relating to past, present or future activities that can be considered damaging to the Board.*"[30] [Emphasis added.]

The bogus methodologies, e.g., Modern Portfolio Theory (MPT) and the Capital Asset Pricing Model (CAPM), which work to generate fees, would not be applicable if we had an honest monetary system without legal tender irredeemable paper-ticket-electronic money.

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[28] The Nobel Prize in Economics, for example, is not one of the prizes that was endowed by Alfred Nobel in 1895. It came in 1968, and the endower is the Central Bank of Sweden. The real name of the prize is Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel. It is a bank prize, and it is not given to anyone who might challenge the honesty or legitimacy of central banking.

[29] "Priceless: How The Federal Reserve Bought The Economics Profession" by Ryan Grim, 9-7-09, http://www.huffingtonpost.com/2009/09/07/priceless-how-the-federal_n_278805.html

30 Davies, Stephen A.; "Some Lawmakers Claim Fed Keeps Critics at Bay With Jobs", *The American Banker*Bond Buyer*, December 2, 1994 page 3.

Allow me to explain. Modern portfolio theory is a theory of investment which attempts to:

1. Maximize portfolio expected return for a given amount of portfolio risk; or equivalently,
2. Minimize risk for a given level of expected return, by carefully choosing the proportions of various assets.

Notice the reference to "risk." The meaning of "risk" in this context is crucial, because there needs to be some standard against which to measure risk. For MPT asset allocation, the standard is called the "riskless rate-of-return," i.e., the rate of return on an asset allocation with zero risk over a period. In practice, the USD 3-month Treasury bill is considered to be a (near) riskless asset. But what about the risk that the dollar will lose purchasing power? That risk is not considered.

Furthermore, in the financial sector, the word "risk" has yet another meaning: it means "volatility." The risk of the dollar losing purchasing power is also not considered. As price volatility increases, "risk" is said to increase. This special and limited definition gives birth to concepts such as the "risk-adjusted rate-of-return." Thus, an allocation to gold might have a lower risk-adjusted rate-of-return than, say, an allocation to equities or real estate, despite the fact that an allocation to gold increased by about 18% per year since 2001 and <u>without any down years</u>!

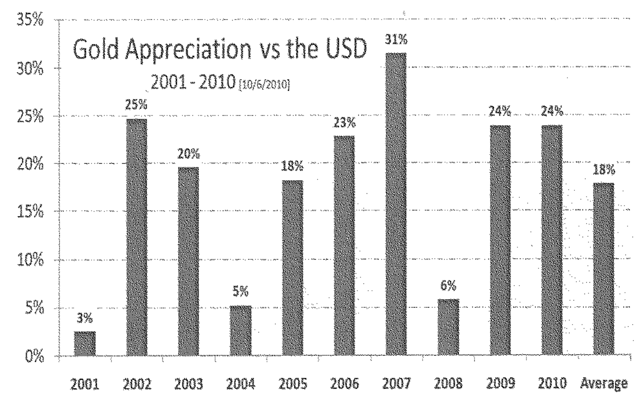
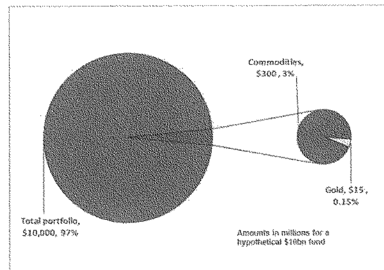



*Exhibit 34*: Gold appreciation vs. the dollar 2001 - 2010

But using standard industry practice, except for a unit of the Texas Teachers' Retirement Fund and a few others, U.S. pension funds are believed to have less than $20 billion of their assets in gold out of their approximately $10 trillion.[31]

[31] An allocation to gold might pay a fee at the time of purchase, but then the fee stream stops.

Gold holdings at U.S. pension funds are negligible...




Source: TRS

*Exhibit 35*: Estimated gold holdings at U.S. pension funds; Source: Texas Teacher's Retirement Fund

From here, the story gets worse. Much worse. For almost everyone who is not in the financial sector or providing services to it, risk, according to the *Oxford English Dictionary*, means "(Exposure to) the possibility of loss, injury, or other adverse or unwelcome circumstance."

What could be a more adverse or unwelcome circumstance than having one's hard-earned savings, allocated to sovereign debt (either U.S. or some other country) and having it redeemed in currency whose purchasing power has greatly depreciated? How do the ratings agencies treat this risk in assigning ratings to various fixed income securities? This is important, because at home and abroad many pension funds are restricted by law to allocate to only "investment grade" securities.

To check this out, I queried the major ratings agencies (Fitch Ratings, Moody's, and Standard and Poor's):

> "If the purchasing power of a sovereign's currency, e.g., in the U.S. that would be the dollar, were to fall to zero, and all of the outstanding sovereign's debt was paid down with worthless currency, would that or would that not constitute a default in the opinion of [rating agency]?"

Eduardo Barker, Communications Strategist, Sovereign and Latin America Moody's sent me a sheet with its explanation of sovereign ratings that did not appear to address the question along with a statement "we would not comment beyond that."

Fitch Ratings was more forthcoming. Brian D. Bertsch, Director, Corporate Communications, wrote me: "It is very hypothetical but most likely it would not be considered a default."

Standard and Poor's was the most straight forward. John Piecuch, Director, Standard & Poor's Communications, wrote me: "In terms of your question, even in the case of hyperinflation, a currency's purchasing power is still not zero (if it were zero, it would cease to be a currency). Even in that case, as long as the issuer were honoring the original terms of the contract (even if repaying with much cheaper currency than originally borrowed), this would not be a default."

Thus, through the use of Modern Portfolio Theory and ratings from government-endorsed ratings agencies, pension plan assets are not being allocated to the one asset that would give beneficiaries the most protection against a decrease in the dollar's purchasing power.

Empirical evidence, in the U.S. and elsewhere, is incontrovertible that currency depreciation is a material risk. Consider again the depreciation of the dollar from 1949, according to official CPI data:

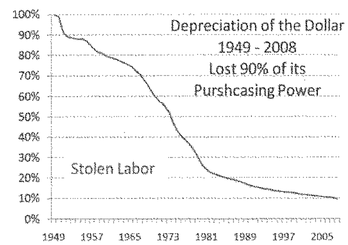



*Exhibit 36*: Depreciation of the Dollar 1949 – 2008; Source: CPI data, BLS

## Balance of Trade

With commodity money such as gold or silver trade balances because one is always trading work for work, and value for value. With gold-as-money, exports pay for imports and balance of trade deficits are small or nonexistent.

With fiat, irredeemable paper ticket-token or electronic-checkbook money, and provided that foreigners, especially foreign central banks, continue to save legal tender irredeemable paper-ticket-electronic dollars, which, by the way, are legal tender only in the U.S., as history shows, enormous trade deficits are possible. Not only are foreigners going to end up with an empty bag, along the way these huge trade deficits represent lost employment at home.

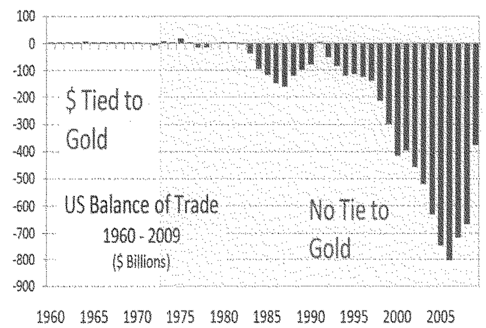



*Exhibit 37*: U.S. Balance of Trade 1960 – 2009: Source: Government data

This is a really ugly chart. It provides empirical evidence that after the last tie to gold was broken in 1971, partly as a result of many U.S.-based industries moving production overseas, the U.S. began to experience enormous trade deficits. Leaving aside the trillions of dollars that have accumulated as reserves in the other countries, especially China, Japan, South Korea, etc., this also reflects a huge transfer of good-paying manufacturing jobs to other locales.

While the Business Roundtable, along with the AFL-CIO and others were complaining about "currency manipulators," and while Wall Street embraced the process, now called "globalization" and was cheerleading the globalization as concomitant to "wealth creation," overlooked was the fact that the dollars accumulating overseas weren't really dollars at all. It was, as Jefferson called it, "only the ghost of money, and not money itself."

When the legal tender irredeemable paper-ticket-electronic dollar meets its fate, in addition to folks at home, there are going to be some very unhappy and angry people overseas. Are foreigners going to continue to sell us oil along with the myriad other products we now depend on from imports to keep our society functioning? This is a risk factor policy makers need to address.

## Federal Taxes and Spending

With commodity money such as gold or silver, as government spending increases, taxes or borrowing (delayed taxation) must increase, because there is no other source of funding. People tend to resist higher taxes, thereby limiting government spending.

With fiat, irredeemable paper ticket-token or electronic-checkbook money, since government has easy access to money created out of nothing, it does not need to increase tax rates. In effect, it can borrow by so-called monetizing debt. In time, money is depreciated, which causes prices, including the price of labor, to increase in nominal terms, along with concomitant tax collections.

However, because of the delay in tax collections, spending almost always exceeds revenues. Eventually the purchasing power of the legal tender irredeemable paper-ticket-electronic money approaches its cost of production —near zero— there is a regime change and the party ends.

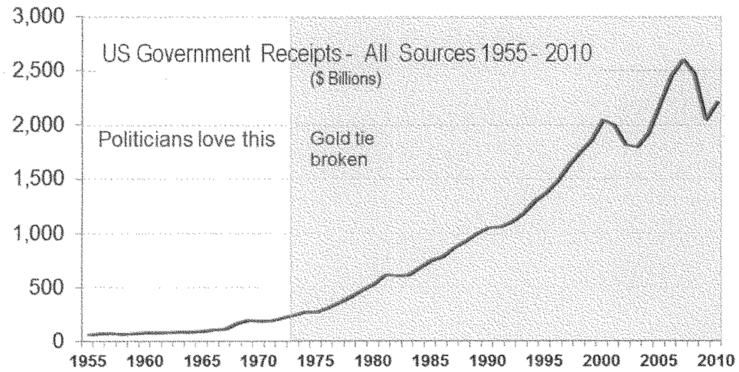



*Exhibit 38*: U.S. Government Receipts: 2955 – 2010; Source: U.S. Department of Treasury: Monthly Treasury Statement - Table 1; FRB 1.39 (for historical fills)

Notice that after the last tie to gold was broken tax collections accelerated greatly. Even before the gold link was defaulted, to fund the Vietnam War, there was material money creation. As some of that money leaked overseas to U.S.' major trading partners, Great Britain, France, Japan and Germany, both Britain and France, recognizing that too many dollars were being created for the U.S. to maintain its sovereign promise to redeem dollars for gold at the rate of one ounce of gold for $35, began redeeming dollars in ever-increasing amounts. At the time when President Nixon defaulted, "temporarily," he said, it was clear that had he not defaulted all of the U.S. gold would have been gone anyway.

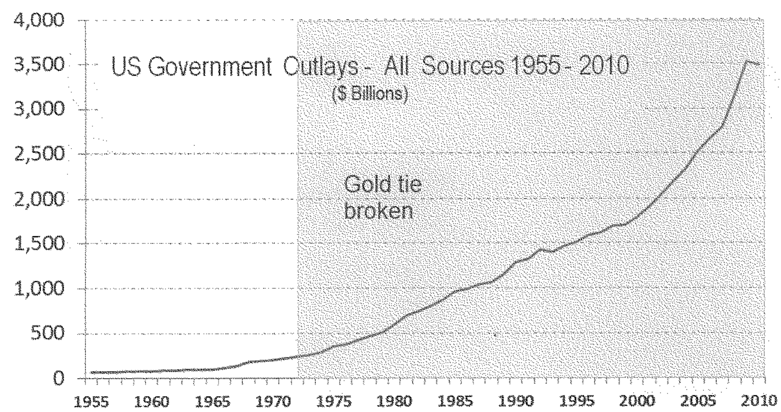



*Exhibit 39*: U.S. Government Outlays 1955 – 2010; Source: U.S. Department of Treasury: Monthly Treasury Statement - Table 1; FRB 1.39 (for historical fills)

As federal government receipts continued to increase year-after-year, politicians bought into the notion that this was the result of our growing economy. They were not mindful that the nominal numbers were being driven by ever-increasing money creation. True, there were some wakeup calls along the way, especially when inflation began to pick up at the end of the 1970s, but high interest rates, imposed by Mr. Volcker, appointed by President Carter, were thought to have "broken the back of inflation."

On April 19, 1993 Mr. Greenspan gave a speech using the word "inflation" an incredible 58 times, in which he stated that "it is going away; it is not coming back; it is not a problem; it is diminished; it is nonrecurring; it is subdued; there's no resurgence; we've learned our lesson." Pronouncements such as these also diverted people's attention from the amounts of money being created out of nothing. In addition, much of the newly-created money accumulated in the capital markets. The equity and real estate markets spiraled upwards. Investors were euphoric. The CPI was reformulated to take lesser account of the increase in housing prices, and so the monetary authorities could then claim that inflation was benign.

Because so much of the newly-created money found its way to the fixed income market, people who should have known better adopted the view that "deficits don't matter." President after president greatly increased spending. This would not have been possible if we had an honest monetary system.

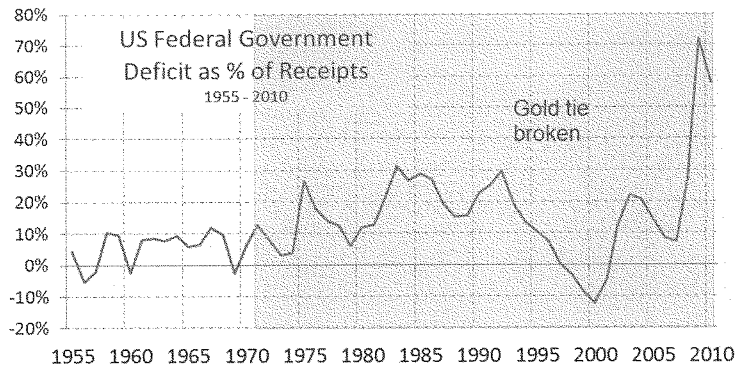



*Exhibit 40*: U.S. Federal Deficit as a % of receipts; Source: U.S. Government

In an attempt to put the government deficit into perspective, most economists compare it to GDP. This is a grave error, in my view. The GDP, a specious metric to begin with, is not available to the government to service and, if was honestly incurred, repay its debt while meeting its promised obligations. For any entity, the money to service and repay debt must come from receipts.

As shown above for the period 1955 to 1970, prior to defaulting on the last promise to redeem dollars for gold, the federal deficit as a percentage of receipts was almost always less than 10%. These days, it is painfully clear that the deficit is completely out-of-control. Theoretically spending could be reduced to bring it in line with receipts. However, that would mean defaulting on benefit promises. It is difficult to imagine how that could happen.

Meanwhile, many trial balloons are appearing in the major media forecasting and endorsing currency debasement.

> "Washington will therefore have little choice but to take the time-honoured course for big-time debtors: print more dollars, devalue the currency and service debt in ever cheaper greenbacks. In other words, the US will have to camouflage a slow-motion default because politically it is the easiest way out."[32]

> "Any inflation above 2 per cent may seem anathema to those who still remember the anti-inflation wars of the 1970s and 1980s, but a once-in-75-year crisis calls for outside-the-box measures."[33]

> "In the future, central banks will have to realize that debt-financed expansions in asset prices can be a threat. For now, it would be nice if they would at least recognize that major deflations in asset prices can be much more important than the relatively small gains in commodities that show up in the Consumer Price Index."[34]

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[32] Garten, Jeffrey, *Financial Times*, November 30, 2009; "We must get ready for a weak-dollar world"
[33] Rogoff, Kenneth; "The bullets yet to be fired to stop the crisis"; *Financial Times* 8/9/2011
[34] Norris, Floyd; "Sometimes, Inflation Is Not Evil"; *The New York Times*, August 11, 2011

## Government deficits

It is difficult to sustain government deficits with commodity money because they would have to be funded by borrowing. Since a commodity money supply cannot arbitrarily be expanded, interest rates would increase if government increased borrowing. Manufacturers and others would then object to higher interest rates, causing government to reduce spending, and thereby causing deficits to decrease.

With legal tender irredeemable paper-ticket-electronic money, as long as someone, such as the Bank of Japan, the Bank of China, the Federal Reserve, or banks, will purchase government securities by creating money out of nothing (called "monetizing debt"), deficits can be funded without greatly increasing interest rates, and deficits can grow without limit (in theory). Also, government debt can be financed by pension plans and other institutions. Eventually, the debts are defaulted.

The empirical evidence confirms that government deficits are facilitated by legal tender irredeemable paper-ticket-electronic money.

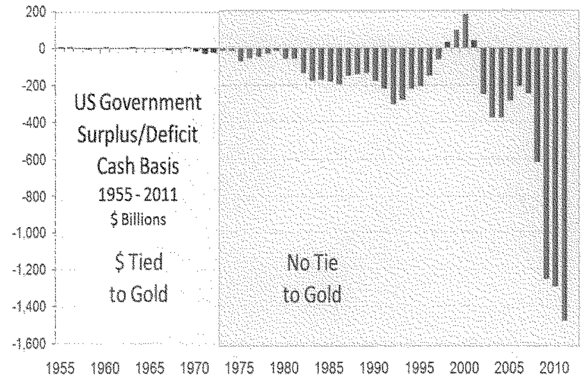


*Exhibit 41*: U.S. Government Surplus/Deficit Cash Basis 1955 – 2011; Source: BLS

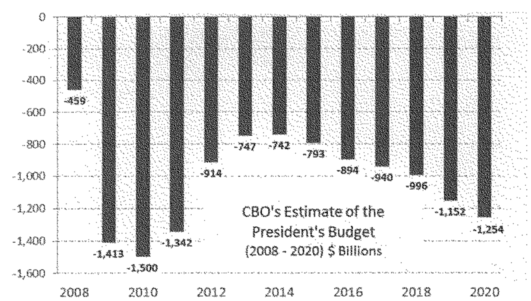


*Exhibit 42*: Recent CBO Estimate of forecasted deficits; Source: Congressional Budget Office; Office of Management and Budget.

The data shows conclusively that while the dollar had a link to gold, government deficits were small. After the last tie to gold was broken, the deficits and resulting government debt accelerated greatly. Also, these deficits use the cash method of accounting.

If one factors in the present value of promises, e.g., Social Security, Medicare, Medicaid, etc., then the deficits are much greater. Some estimate that the accumulated obligations are on the order of $100 to $200 trillion! Because politicians cannot renege outright on their promises, especially if they want to be reelected, there will be motivation to continue to inflate the currency until it collapses. I don't see any alternative.

That's why *The Free Competition in Currency Act of 2011* is important. It provides a way to mitigate the damage and prepare our country for an honest monetary system.

## Financial market instability and the best argument against gold

Absent fraud and coercion, a monetary system based on gold-as-money is stable. With Legal tender irredeemable paper-ticket-electronic monetary systems, because there is no market-based mechanism that provides negative feedback to increasing the money supply, total debt and leverage will necessarily blow up.

The strongest argument against linking the dollar to gold, sometimes referred to as the "gold standard," is that financial markets are *inherently* unstable. Because almost all other markets depend on the financial sector for payment processing, there needs to be a lender-of-last-resort. If the dollar is tied to gold, the lender-of-last-resort may not be able to function. Therefore, it is claimed, modern financial markets require a "properly managed" (to quote William Niskanen, former Chairman of the CATO Institute) fiat monetary system.

While it is true that over the last two centuries financial markets have been unstable, they are not inherently unstable. Misrepresentations and nondisclosure about our monetary system and about basic banking customer relationships enable financial sector firms to over-leverage. This is the root cause of financial instability. Remedies being put forth, such as a global lender of last resort, will be counterproductive and will result in greater instability. The solution is to the change the structure of the world's monetary systems to remove the cause of such instability: the ability of banking systems to create money out of nothing.

In the U.S. during the 19th and 20th centuries, there were numerous boom/bust periods in which financial markets soared and then collapsed. How come this malady wasn't common to other markets, such as the ice cream market or the automobile market? What is it about financial markets that they tend to boom and bust? Also, it is essential to understand that because financial markets are interrelated with other markets, a financial market collapse can also result in a systemic collapse.

A distinguishing characteristic of financial markets that is absent from other markets is *excessive* leverage. On the futures exchanges, various commodities are leveraged, but no one would suggest that the markets for, say, copper or soybeans are inherently unstable. Clearly there is something different about financial markets. That difference is inadequate counterparty surveillance. And that inadequacy is the result of misrepresentations and nondisclosure, which is the indicia of fraud, on the part of key financial players: banks.

From inception, banks made fundamental misrepresentations to their customers regarding the basic banking relationship in two areas. First, banks told customers that they were "depositors." At best, this was misleading. In fact and in law, depositors were, and continue to be, unsecured creditors of banks. Most depositors, especially small ones, put their money in banks for safe keeping; they were not heedful of the risks they were taking.

Second, banks told customers that they could get "their" money back "on demand." However, in fact and in law, when people "deposit" money in a bank, it becomes the bank's money to do with as the bank pleases. The bank may loan that money to someone else, invest it in whatever, including illiquid investments, or gamble with it. Further, what banks should have told depositors was that they could get their money back on demand provided: not too many of them wanted to do so at the same time; the money had not been invested in something that was illiquid and that could not quickly, and without much loss, be converted back into cash; and, finally, that the bank had not lost the money in some venture.

Third, when banks make a loan, they create the deposit with a book entry.

These misrepresentations lulled depositors into acquiescing to nondisclosure on the part of banks as to what they were doing with depositors' money and the amount of leverage banks were employing. If banks told depositors the truth about the basic relationship, depositors would have exerted more counterparty surveillance over banks, excessive leverage would never have occurred, and there would never have been anything approaching systemic failure, as almost occurred in 1907 and as did occur in 1932.

In his book, *Soros on Soros*, Mr. George Soros correctly observes that a lender of last resort and the gold standard are incompatible. What made the lender of last resort bailout facility necessary were banking misrepresentations and nondisclosures.

By abandoning the gold standard, banks enhanced their ability to, in effect, create money out of nothing. Whereas under the gold standard they were able to create money, called "fractional reserve lending," there were some (clearly inadequate) limitations on the amount of money they could create. First and foremost, since all of the newly created money, called banknotes, which were legally promissory notes, were redeemable on demand in gold, there was a physical limit beyond which market forces would close a bank that created money greatly in excess of its capital and its reserves, thereby curtailing additional money creation.

Second, with some limitations, bank officers and directors were personally liable to depositors. These two factors led many banks to keep something on the order of 40% of their reserves in gold, just in case. If those reserves could be reduced, then banks could garner more profits, and first some, and then many banks sought to do so. The notion that banks were acting improperly was well understood by some market participants.

> "Perhaps Hugh McCulloch, our first Comptroller of the Currency, may have been somewhat over the edge, in this regard, when in 1863 he proposed that the National Bank Act 'be so amended that the failure of a national bank be declared prima facie fraudulent, and that the officers and directors, under whose administration such insolvency shall occur, be made personally liable for the debts of the bank, and be punished criminally, unless it shall appear, upon investigation, that its affairs were honestly administered.' So much for moral hazard. And surely, here we observe the intellectual origins of prompt corrective action." [Speech by Federal Reserve Chairman Alan Greenspan before the American Bankers Association, Washington, D.C., September 18, 2000]

After the Panic of 1907, which J. P. Morgan alleviated with a huge gold loan to banks so that they could meet the demands of depositors who were then withdrawing their funds, there were four words that terrified the banking community: "What if he [Morgan] dies.?" The answer was a government entity that would provide "liquidity" when the banks got caught short. Further, the formation of the Federal Reserve enabled bank reserves to be aggregated so that there would be a need for less of them, and the banks could leverage even more than before.

The banking system was thus able to finance World War I. Without such financing, and had there been full disclosure at that time about the causes of bank panics, some suggest that the War would have been over in just a couple of months with no Treaty of Versailles, no destruction of the German and Austrian currencies, no Hitler, no Lenin, no Stalin, no World War II, and the murder of 150 million, excluding those who died during wars during the Twentieth Century, would not have occurred.

No amount of regulation will eliminate the moral hazard issue. Further, the system, with moral hazard, is inherently unstable, and the moral hazard issue means that there will necessarily be wealth transfer from ordinary working people to those who benefit from the moral hazard: the financial sector. Not only is this unfair, it will not stand the light of day if ordinary people come to understand what is transpiring.

The solution is gold-as-money. There are compelling reasons why free men and free markets choose precious metals as money. In a nutshell, because of its physical attributes, precious metal as money is the most efficient medium of exchange—in terms of minimizing transaction costs—for transmitting value over time.

## Levels of debt

Because with commodity money prices tend to decrease, it becomes harder to service and pay down debt, and debt is discouraged. With fiat, irredeemable paper ticket-token or electronic-checkbook money, because debt gets serviced and repaid with cheaper money, increases in debt are encouraged. This also works to decrease the purchasing power of savings and future payments, the majority of which constitute pension funds. Today, booked debt (public and private), exclusive of the present value of promised "entitlements," is more than $52 trillion.

Exhibits 43, 44, 45, and 46 confirm that after the last tie to gold was defaulted, "temporarily" promised President Nixon, on August 15, 1971, debt levels in the U.S. greatly increased.

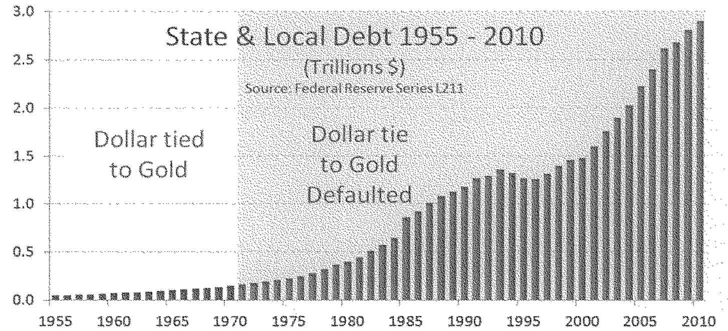


*Exhibit 43*: State and Local Debt 1955 – 2010: Source: Federal Reserve Flow of Funds

The level of debt at the state and local level does not include the present value of promised pensions and benefits to public employees. Because of the misallocation of pension assets, also largely the result of legal tender irredeemable paper-ticket-electronic money as I have explained, state and local finances will be under ever increasing pressure to increase taxes and/or to reduce services in order to meet obligations.

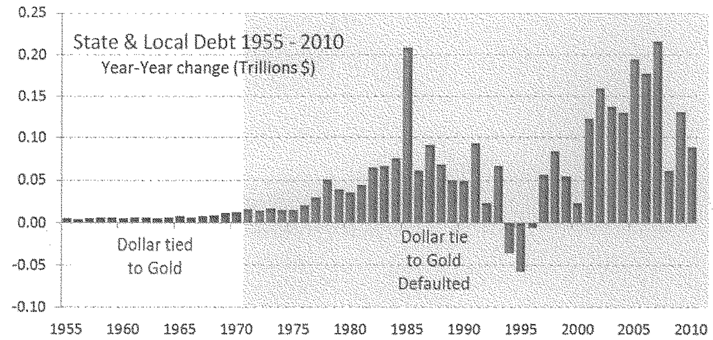


*Exhibit 44*: State and Local Debt 1955 – 2010 year-on-year changes; Source: Federal Reserve Flow of Funds

The effects of fiat money on state and local debt are even more dramatic when one looks at the year-on-year change the state and local debt. Notice how much state debt accelerated after the last tie to gold was broken.

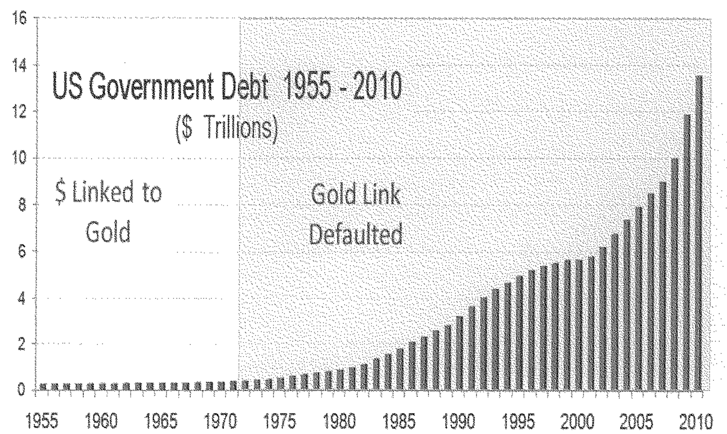


*Exhibit 45*: U.S. Government debt 1955 – 2010: Source: Federal Reserve Flow of Funds

It is now clear to many observers that U.S. Government debt is completely out-of-control. In my view, because there is neither the intention nor the ability to ever repay this debt with money of similar purchasing power at the time that the debt was incurred, this is fraudulent debt. The big losers will be ordinary people who have followed the rules, worked hard, and allocated their retirement savings to U.S. Government securities, which they have been told are the safest in the world.

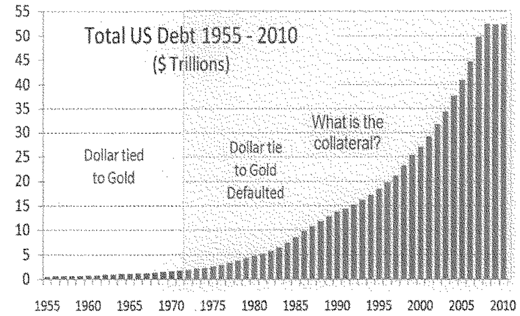


*Exhibit 46*: Total U.S. Debt 1955 – 2010; Source: Federal Reserve Flow of Funds

Total booked debt, exclusive of the present value of government and corporate promises for entitlements and pensions is now more than $52 trillion. What is the collateral of $52 trillion in debt instruments? Aside from government debt, the collateral is mostly residential and commercial mortgages along with car loans, credit card loans, etc. That collateral is melting away. This means that there are going to be material defaults, most likely through the ongoing depreciation of the currency. Every dollar of debt is somebody's asset, e.g., retirement savings. If we had an honest monetary system, these obscene debt levels would not have been possible.

## Long-term interest rates

With commodity money, long-term interest rates have historically been about four percent; just equal to the time-value of money. There is good data from Great Britain going back almost 200 years attesting to this. With fiat money, interest rates include not only the time-value of money but also an additional increment—the so-called "inflation premium"—to compensate for the loss of purchasing power due to the actual and expected creation of additional money. Interest rates are much higher than with commodity money.

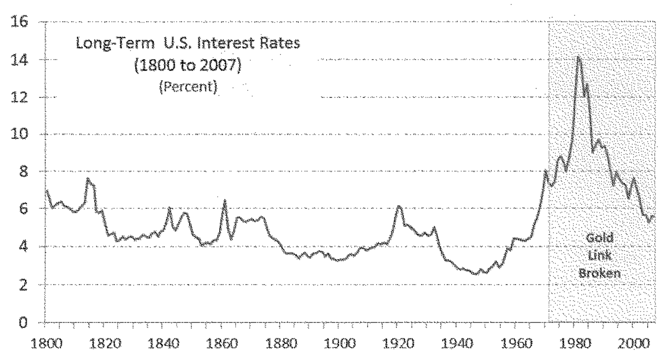


*Exhibit 47*: Long term U.S. interest rates 1800 – 2007; Source: http://www.measuringworth.org/datasets/interestrates/result.php

Notice that, from year 1800 almost until 1970, except for times of war, e.g., the War of 1812, the Civil War, and World War I, long-term interest rates hovered about 4%. It was only when the last link to gold was broken in 1971 that interest rates began to increase to unheard of levels. Is it any wonder that the price of gold accelerated greatly reaching $850 per ounce in intraday trading circa 1981? Many thought the monetary system was collapsing at that time.

Low and stable long-term interest rates are necessary for long-term investment. As interest rates increase, the present value of a future payoff decreases, and activities for which the payoff is in the distant future are curtailed. For example, when I began my working career at IBM in 1964, IBM, along with Bell Labs, had one of the world's premier research and development facilities, the Watson Research Center. In those days, IBM was engaged in research at the molecular level where a commercial product was not expected well into the 21st century.

After long-term interest rates began to increase greatly the present value of future payoffs was reduced to a tiny fraction of what was originally anticipated. As a direct result, Bell Labs and almost all of IBM's pure research efforts were disbanded. If the U.S. can achieve an honest monetary system as discussed above, long-term research and development will increase greatly. This is a vital ingredient not only to increase our standard of living, but also for military preparedness.

## Interest rate and foreign exchange rate volatility

With commodity money, such as gold or silver, there is very little interest rate or foreign exchange volatility. With fiat money, there is inherent high volatility, which tends to be hedged by derivatives, and which adds additional cost to financing. Financial sector participants benefit. Workers, manufacturers, entrepreneurs and consumers pay the cost.

Almost everyone who is not a participant or supplier to the financial sector wants monetary stability. Manufacturers want low and stable interest rates so they can make long-term investments in plant, equipment, and research and development. Ordinary people want low stable interest rates so they can plan their futures, buy homes and have some idea what their return will be on assets they have saved for retirement. Those involved in international trade want stable foreign exchange rates to facilitate payment for goods to be delivered far into the future, e.g., airliners, and so on.

The financial sector does not want monetary stability. Because so much of its profits derive from trading, the financial sector wants volatility. Tragically, the financial sector has been left in charge of the monetary structure, and it has rigged that structure for its own benefit (really the benefit of top management) and to the detriment of everyone else. That is why the financial sector champions legal tender irredeemable paper-ticket-electronic money. The empirical evidence confirms that legal tender irredeemable paper-ticket-electronic money results in interest rate volatility:

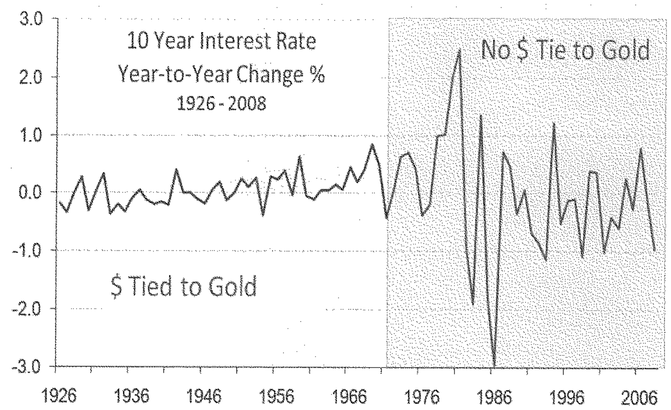


*Exhibit 48*: U.S. 10-year bond year-on-year interest rate change; Source: Federal Reserve

Prior to the last link to gold being broken by President Nixon in 1971, going back almost 200 years in Britain, and for a lesser period in the U.S., interest rates were relatively stable, very rarely moving plus or minus 20 basis points in any year. After the last link to gold was broken, year-on-year volatility reached 200 basis points and even higher.

One shocking result was that interest rate volatility played havoc with defined benefit pension plans (DBPPs). The added risks to companies led many to replace DBPPs with defined contribution pension plans, which transfer the risk of the value of pension plan benefits to workers.

DBPPs allocate their investments to the fixed income and equity markets. Using General Accepted Accounting Principles (GAAP), because DBPP liabilities are discounted by interest rates, interest rate volatility resulted in volatility for pension plan liabilities. In the 1980s, in addition to interest rate volatility, there was also volatility in the equity markets. Changes in pension plan assets and liabilities flowed through to the income statements of the companies affected. Thus, volatility in pension assets and liabilities resulted in volatility in reported earnings.

Investors want earnings stability. Companies with great profit volatility are penalized with lower stock prices than they would otherwise enjoy. For company management, lower stock prices meant that they would be less likely to reap a benefit from their stock options. What was their remedy?

Corporate management appealed to their accountants who lobbied to change GAAP to allow management to smooth interest rates and changes in equity valuations on the theory that since pensions would not be due for many years, it was unfair to pay such close attention to yearly interest rate and equity fluctuations. This led to abominations called the expected rate-of-return and a smoothed discount rate. Accountants and actuaries did the calculations for the smoothing. Management hired and paid them.

Since contributions to a pension fund are considered a cost, in an effort to reduce costs, it is to management's benefit to have the assumed rate-of-return and the discount rate to be high as possible. The result is that, depending upon whom one listens to, public pension funds are underfunded by as much as $3 trillion, and the DBPPs that remain in the private sector are underfunded by about $½ trillion.

There was another wrinkle to this that adversely affected pension plan beneficiaries. Because pension fund liabilities are discounted by the "discount rate," the higher the discount rate, the less the present value of the liabilities. In the 1980s, on account of high interest rates, some DBPPs became "over-funded."

Then ensued a great deal of merger and acquisition activity whereby, if a firm could be liquidated, the pension plan could be frozen, and any "overfunding" could be recaptured. Recall the movie *Wall Street* whereby rationale for liquidating the airline Blue Star was its overfunded pension plan.

Working people who are depending on their DBPPs for retirement are not going to receive pensions and benefits they are expecting. None of this would have occurred if we had an honest monetary system. By passing *The Free Competition in Currency Act of 2011*, an anticipated new monetary system based on gold-as-money will avoid this kind of malfeasance.

For those who are engaged in international trade, stable exchange rates are essential. Foreign exchange rate volatility results in lower profit, or even losses. It reduces the international division of labor and our and our trading partners' standard of living. Consider volatility between the U.S. dollar and the Canadian dollar:

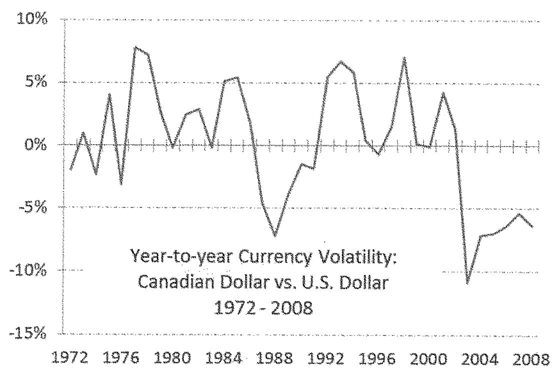


*Exhibit 49*: Year-to-year currency volatility: Canadian dollar vs. U.S. dollar 1972 - 2008

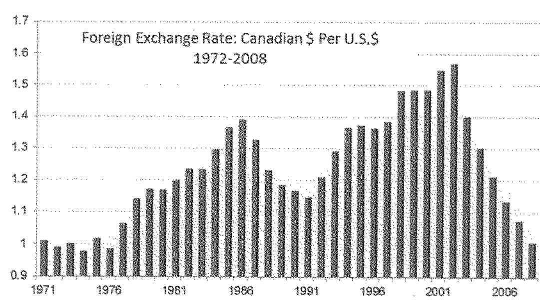


*Exhibit 50*: Foreign Exchange Rate: Canadian dollar per U.S. dollar

With our European trading partners foreign exchange rate volatility is even more extreme. To protect themselves from catastrophic foreign exchange losses, firms buy derivative contracts from banks. This cost is a benefit to financial sector firms. As Mr. Paul Volcker has noted numerous times, "a global economy requires a global currency." The open issue is what is the global currency going to be?

If the global currency is gold, then there is no foreign exchange volatility. Of course, that will mean an end to a material profit stream for financial sector firms. Is that a contributing reason why the International Monetary Fund changed its *Articles of Agreement* in 1978 to prohibit member countries from linking their currencies to gold and only to gold?[35] What might be the public policy justification of that prohibition?

## Wall Street and the banks

With commodity money, such as gold and silver, Wall Street, while important, plays a minor role. Its primary function is to help asset allocation on a much-reduced scale. With fiat, legal tender irredeemable paper-ticket-electronic money, Wall Street, because it has easy access to money created out of nothing, plays a dominant role in society.

Consider the growth of the financial sector after the last link to gold was broken in 1971.

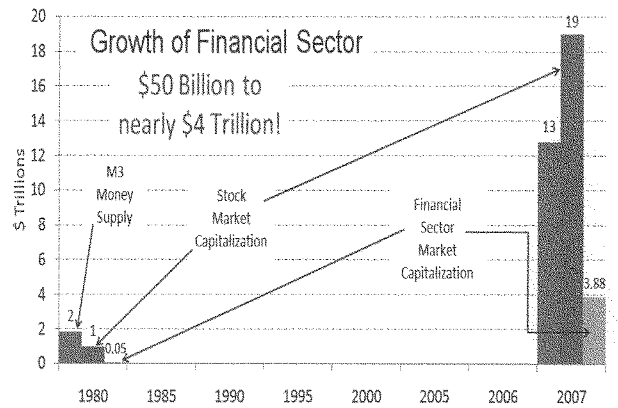


*Exhibit 51*: Growth of the Financial Sector

In 1980, the broad money supply (M3) as reported by the Federal Reserve was slightly less than $2 trillion. The U.S. stock market capitalization was about $1 trillion, and financial sector firms accounted for about 5% of the total, about $50 billion. On the plot above, one can barely see the valuation of the financial sector.

By 2007, the money supply, all created flat out of nothing, had zoomed to about $13 trillion, but now the market capitalization of the equity markets was about $19 trillion, and about $4 trillion of that was from financial sector firms.

[35] IMF *Articles of Agreement Section* 4-2b

Forget about the multi-million dollar bonuses and salaries. That was chickenfeed compared to the value of stock options. Some folks in the financial sector garnered so much money they didn't know what to do with it. The extravagances are legend: 40,000 foot houses in multiple locations around the world, 200 foot boats, $200 million airplanes with another $100 million to outfit them. Some extreme excesses made the major media.

For instance, on February 26, 2002 it was reported that six investment bankers went out for dinner and spent $60,000 for a meal! The media is fond of reporting financial sector management taking home tens of millions. Frank Raines, at one time a government employee earning government scale wages, is reported to have left Fannie Mae with more than $100 million. The question that needs to be addressed is exactly what do these folks provide to society that they should be rewarded like this?

Here is another way of looking at the data:

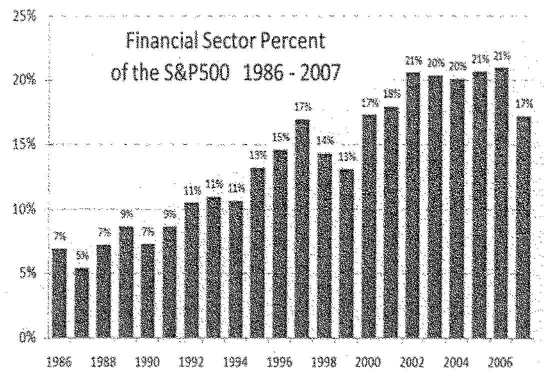


*Exhibit 52*: Financial Sector as percent of S&P500; Source: Standard & Poor's

The growth of the financial sector, while noticed, was not criticized greatly because on the back of obscene money creation, equity valuations greatly increased, too. What's to say if one's Goldman Sachs or Merrill Lynch account is growing at double digits? When the equity markets lost nearly half their value almost overnight, for some people it was a wakeup call that something is seriously wrong.[36]

[36] For Bear Stearns employees, the decline was over a weekend. They went to sleep on a Friday night when their stock had a book value of about $85 per share. When they awoke Monday morning, the stock was trading for $2. There was a clean certificate from the accountants, an investment-grade rating from the rating agencies, and no malfeasance. Again, there's something wrong with a system that can destroy accumulated savings in this manner. That something is our dishonest monetary system.

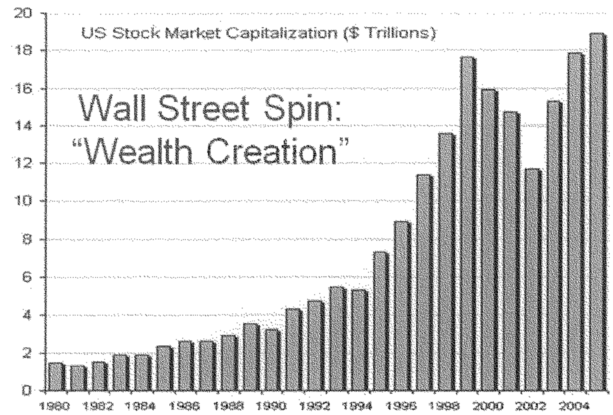


*Exhibit 53*: U.S. Stock Market Capitalization 1980 - 2005

Wall Street firm revenues, again, just for moving paper around, took off as well:

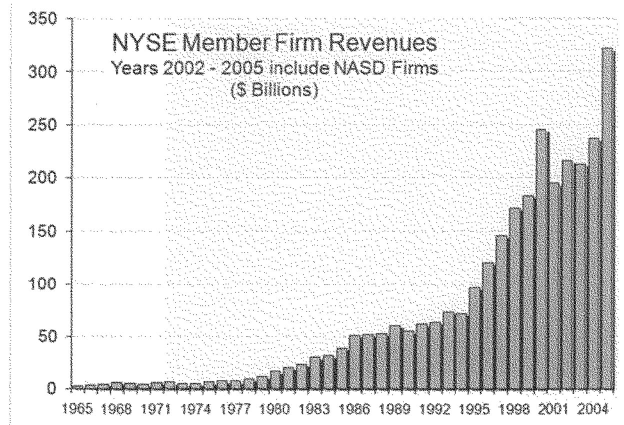


*Exhibit 54*: NYSE Member Firm Revenues 1965 – 2005; Source: SIFMA

Twenty-something-year-old youngsters, fresh out of college began taking down multimillion dollar salaries. Again, what was the product or service that they were providing to society that they should have received that level of compensation? Did they invent anything that improved the lives of anyone? Did they cure some dread disease? Did they produce a useful product? No, no, and no. They were the fortunate beneficiaries of legal tender irredeemable paper-ticket-electronic money creation.

And look what happened to bank revenues after the last link to gold was broken:

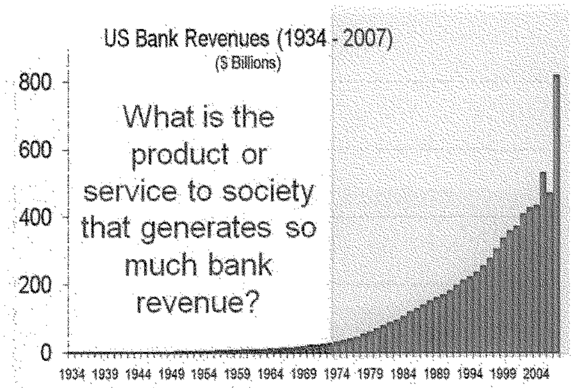


*Exhibit 55*: U.S. Bank Revenues 1934 – 2007; Source: FDIC

And after paying out multimillion dollar salaries to "talent," look at how bank net income increased after the last tie to gold was broken:

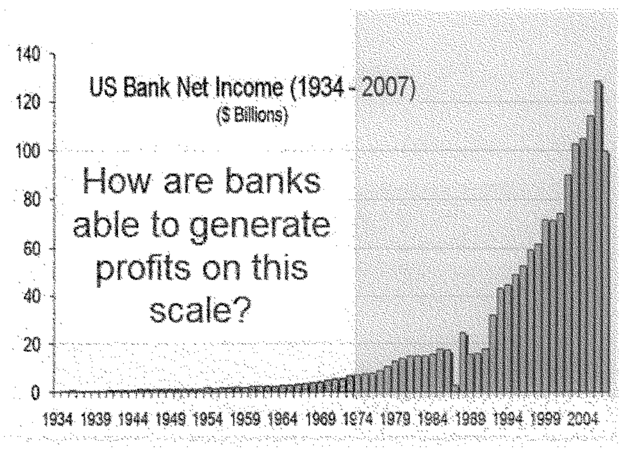


*Exhibit 56*: U.S. Bank Net Income 1934 – 2007; Source: FDIC

Consider the tradeoffs between commodity money and legal tender irredeemable paper-ticket-electronic money for banks. With commodity money, such as gold or silver, the role of bankers is limited to: (1) storing money for safekeeping; (2) acting as intermediaries between savers and credit-worthy borrowers; and (3) facilitating the payments transfer system. with legal tender irredeemable paper-ticket-electronic money, bankers have a greatly expanded role: they sell instruments to hedge interest rate and foreign exchange volatility; and they create fiat money (in the form of credit) for which they get the interest and fees. In effect, banks' traditional role as intermediaries between savers and borrowers decrease, and the banks become the equivalent of hedge funds whose downside is guaranteed and subsidized by ordinary working people. The euphemisms for these guarantees are called the "lender of last resort" bailout facility at the Federal Reserve, and so-called Federal Deposit Insurance, which is not insurance.

Again, focusing on stock options, look at what happened to Citibank stock as a result of money creation:

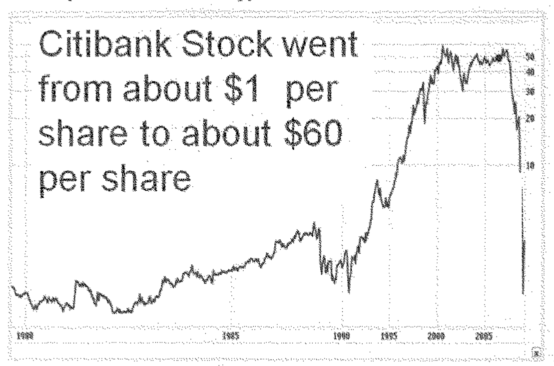


*Exhibit 57*: Citibank stock from about 1979 to about 2009

One can well imagine the amount of wealth garnered by executives fortunate enough to have stock options with long durations.

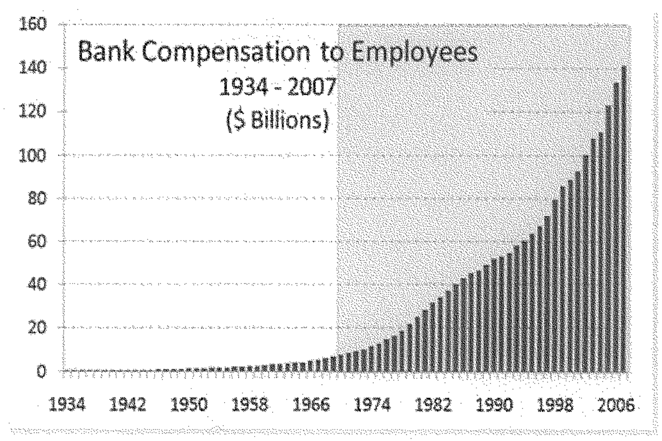


*Exhibit 58*: Bank Compensation to Employees 1934 – 2007; Source: FDIC

While financial sector compensation appears excessive by any standard, it is important to note that these folks have done nothing wrong. George Soros once said: "I'm just playing by the rules, and I didn't make up the rules." There is something seriously wrong with the rules. It is not a lack of regulation. It is our dishonest monetary structure. That needs to be changed. *The Free Competition in Currency Act of 2011* is necessary to get that done.

## Special privileges for banks and other financial players

With commodity money such as gold or silver, banks and other financial players receive no special privileges.

Because of the instability of fiat-based monetary regimes, to "protect" the efficacy of the payment transfer systems, there is a need for a "safety net" for the financial sector. This "safety net," as Mr. Greenspan has pointed out, is a subsidy to the financial sector. It constitutes wealth transfer from ordinary taxpayers to the financial sector. While regulators are charged with monitoring the financial sector to reduce or make less likely massive wealth transfer, the financial sector has a history of compromising politicians who are nominally in charge of the regulators. At the end of the day, in all cases, regulation fails and the fiat system collapses.

## Taxes on money

When used as money, gold and silver *per se* is not taxed. When not used as money, and partially in an effort to suppress its use as money, the U.S. general government has arbitrarily classified gold and silver bullion, coins, and securities representing gold and silver as "collectibles" and subject to taxation at a much increased level as compared to capital gains for financial securities. Local jurisdictions also apply taxes, e.g., sales taxes, on transactions in gold or silver.

When used as money, fiat money per se is not taxed. However, taxes do apply for transactions whereby U.S. legal tender irredeemable paper-ticket-electronic money is converted to another country's legal tender irredeemable paper-ticket-electronic money.

Another benefit of *The Free Competition in Currency Act of 2011* is that it abolishes taxation on gold and silver, the money mandated by the *Constitution*. Part of the human condition is that people must save for a time when they become too old or incapacitated to work. Ordinary people seek a medium that is the most secure form of savings.

Today, on account of coercion, misrepresentation and nondisclosure of material information, few are saving silver or any gold. Were they to convert their labor into gold instead of legal tender irredeemable paper-ticket-electronic money or securities denominated in legal tender irredeemable paper-ticket-electronic money, why should they have to give up a portion of their savings when the legal tender irredeemable paper-ticket-electronic money depreciates? That strikes one as blatantly unjust.

For example, if one works and allocates his earnings that are not consumed into gold, and the Federal Reserve, in Mr. Greenspan's exact words, creates money "without limit," thereby depreciating the purchasing power of legal tender irredeemable paper-ticket-electronic money, why should one be penalized for having saved gold or silver by having to pay income or other taxes on the appreciation of his gold or silver relative to the legal tender irredeemable paper-ticket-electronic money?

Without the ability to save gold or silver, ordinary people are defenseless against the loss of their savings on account of our unconstitutional and dishonest monetary system. Current taxing schemes whereby the IRS has misclassified gold and silver as "collectibles" subject to a 28% tax on appreciation against legal tender irredeemable paper-ticket-electronic money provide a great disincentive for such saving. Justice cries out to get rid of this and other pernicious taxing schemes.

## Summary and Recommendations

As I hope this testimony makes clear, in every area of our economy that is important, whether it be jobs, pensions, wages, debt levels, government fiscal responsibility at all levels, etc. legal tender irredeemable paper-ticket-electronic money works to the disadvantage of ordinary people and to our nation. For all of history, there have been no successes with paper money. Every one of them has resulted in a disaster. The U.S. experience is vulnerable to being qualitatively different in three critical areas.

First, in every country where the paper currency collapsed in the last century, there was always an alternate currency in which some people had saved. That alternate currency was almost always the dollar. In other words, there was always some accumulated wealth that could be used to rebuild. Because the dollar is the so-called "reserve currency of the world," when the dollar collapses, most of the planet will be caught empty handed. This has the potential to almost destroy the division of labor for a long time, plunging the U.S. and much of the world into poverty.

Second, the U.S. is different in a very important aspect from every other country sans Switzerland. The U.S. is an armed country. There are more than 200 million guns in the hands of the public. When the dollar collapses and people lose their savings, their pensions, their annuities, and their jobs, it's hard to say what action they will take. There is the potential for serious unrest.

Third, there is a contingency plan, although when I questioned authorities such as Paul Volcker, Larry Summers, and many others, they did not want to speak of it. The contingency plan, as set forth in myriad legislation and Executive Orders, is martial law. That was what Henry Paulson was talking about when he was attempting to steamroll passing the TARP legislation. We could have a regime change that will set us back possibly for generations. That's why it is crucial to pass *The Free Competition in Currency Act of 2011* in order to mitigate the damage and prepare for an honest monetary system.

Mindful that our current monetary system is well on its way to blowing up, I hope that Congress will act quickly and decisively to set things right. For the American people to accept what will be perceived as drastic changes in the monetary structure, those changes will need the imprimatur of being in conformity with the *Constitution*. Fortunately, that is indeed the case.

While Congress is certainly culpable for allowing the monetary system to become unauthorized and dishonest, it was not this Congress. All of the malfeasance was set in train a long time ago, some as far back as 100 years ago when the Federal Reserve legislation was passed.

As a practical matter, absent the debacle of a complete collapse, there can be no abrupt changes to our monetary system. That is another reason why *The Free Competition in Currency Act of 2011* is so important and so timely. It leaves everything in place: the Federal Reserve, the irredeemable paper-ticket-electronic dollar (which will cease to be legal tender), and all of the mutual promises based on it.

For day-to-day transactions, eliminating legal tender is irrelevant. People work, they get paid, and they exchange their pay for daily needs: food, shelter, fuel, etc. Why would anyone care if the dollar is depreciating at the Federal Reserve's hoped-for rate of 2% or thereabout? I doubt they will.

But there are situations where some people will care: making sure that future payment will be made at a value that one is anticipating. Fortunately, we have precedent in the U.S. to guide us to how those situations will most likely be dealt with.

After the Civil War experience with Greenbacks, to protect against the depreciation of paper money, for long-term transactions, e.g., real property leases, long-term loans, bond issues, people inserted a "gold clause" in their contracts.[37] This provided that future payments should be made in gold at the same weight and fineness as were current at the time that contracts were entered into.

In this way, provided there is no discontinuity in the purchasing power of the dollar and it continues to depreciate slowly, in time we will make a transition to a gold-as-money monetary system. Our country will then reap the benefits of a sound system that will encourage savings, capital investment, high paying jobs, and all the other benefits described above in this testimony.

Agreements for future payment in gold cannot be accomplished if there are taxes on the money itself. Thus, the provisions in *The Free Competition in Currency Act of 2011* to eliminate any taxes on gold and silver are also essential.

In addition, we need a way to get gold into the hands of the population at large. Thus, as envisioned by Alexander Hamilton, the mints should be opened for free coinage; people should be able to bring gold or silver to the mint to have it coined. While it would be helpful to allow private mints, they will certainly do no harm and may provide extra needed capacity, it's not clear to me that the death penalty could apply to a private mint that cheated on its coinage, as the penalty does apply for anyone who counterfeits coins from the U.S. mint.

Other recommendations that are not addressed by the proposed Act:

1. The U.S. supposedly has in the treasury about 288 million ounces of gold. (This gold reserve has not been audited since the Eisenhower years. It's time for an audit.) It would be helpful if that gold was coined and distributed per capita to every American citizen, perhaps a 25 gram coin each.
    a. On the theory that they cannot replenish their savings when the legal tender irredeemable paper-ticket-electronic dollar collapses, perhaps older people should get extra and infants none at all on the theory that their parents would take care of them.
2. Relief could be brought to the real estate market by the president declaring real estate taxes (now under the jurisdiction of state and local governments) as against public policy. Eliminating real estate taxes will boost real estate valuation by a factor of about twenty times the eliminated tax. Nationwide, real estate taxes are about $400 billion per year. Thus, order of magnitude, real estate valuations would increase by about $8 trillion. That would give relief to almost all those whose mortgages are "underwater." Revenue from lost real estate taxes could be compensated by increasing sales taxes.

[37] When the U.S. Government sold Liberty Bonds to help finance World War I, the bonds had a gold clause. The promise of gold redemption was defaulted when President Roosevelt seized the nation's gold and made it a felony for American citizens to own monetary gold anywhere in the world.

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TESTIMONY

# STATEMENT ON HR 1098, THE FREE COMPETITION IN CURRENCY ACT OF 2011
## SEPTEMBER 13, 2011

Lawrence H. White
Professor of Economics, George Mason University

House Committee on Financial Services
Subcommittee on Domestic Monetary Policy and Technology

Chairman Paul, Ranking Member Clay, and members of the subcommittee: Thank you for the opportunity to discuss my views on HR 1098, the Free Competition in Currency Act of 2011 (hereafter "the Act"). As an economist specializing in monetary systems I have studied and written for many years about the role of free competition in currency. Indeed the second book of my three books on the topic, published in 1989 by New York University Press, was entitled *Competition and Currency*.

THE BENEFITS OF CURRENCY COMPETITION

It is widely understood that competition among private enterprises gives us technological improvements in all kinds of products, delivering higher quality at lower cost. For example, the competition of FedEx and UPS with the U.S. Postal Service in package delivery has been of great benefit to American consumers. Currency users also benefits from competition. My research indicates that currency has been better provided by competing private enterprises than by government monopoly. For example, private gold and silver mints during the American gold rushes provided trustworthy coins until they were suppressed by legislation. Scientific appraisals have found that the privately minted coins were produced even more precisely than the coins of the U.S. Mint. Private bank-issued currency was the most popular form of money around the world until government-sponsored central banks, with few exceptions, gained exclusive note-issuing privileges.

We do not rely on the Treasury or the Federal Reserve, but rather private financial institutions, to provide our checking accounts, credit cards, and traveler's checks. The consumer benefits from the competition in payment services among banks. Consumers would likewise benefit from free and fair competition among coin issuers. Although Federal Reserve Notes and Treasury coins should of course be protected from counterfeiting, there is no good case for them to enjoy monopoly privileges in the market for currency.

HR 1098 would give currency competition a chance. It would not remove the Federal Reserve from the currency market, but it would give the Fed a stronger incentive to deliver the kind of trustworthy money that consumers want. The dollar already faces salutary international competition from gold, silver, the euro, the Swiss Franc, and other stores of value. HR 1098 would allow salutary domestic competition between the Federal Reserve Note and other media of exchange. The Fed will have little to fear from competition so long as it provides the highest quality product on the market. Continuing to ban competition from the domestic U.S. currency market, or keeping it at a legal disadvantage, limits the options of American consumers who use money to their disadvantage.

What sort of competition might we see if currency were free from legislated restrictions? Here is one example. In 1998 a non-profit organization launched the "American Liberty Currency," a private silver-based currency intended to compete with Federal Reserve currency. In the year 2000 I wrote an article about the project, entitled "A Competitor for the Fed?," published by The Foundation for Economic Education's magazine *The Freeman* (vol. 50, July 2000). I was skeptical that the project would attract many users, absent high inflation in the dollar. But I noted then, and I reiterate today, that in a high-inflation environment "silver-backed currency with widespread acceptance would provide a useful alternative to the Federal Reserve's product. Then, if you don't like the way the federal government manages (or mismanages) the value of the fiat dollar, you aren't limited to complaining. You can switch to the private alternative." If double-digit inflation should unfortunately return to the United States, then the American public, as I wrote, would "find a very practical advantage in a silver-backed alternative to the free-falling Federal Reserve note."

The Act offers three reforms. I will comment on them in turn.

SECTION 2

Section 2 of the Act repeals 31 USC, §5103, which presently declares that "US coins and currency (including Federal Reserve notes ...) are legal tender for all debts, public charges, taxes, and dues."

What are the likely economic consequences of removing legal tender status from US Treasury coins and Federal Reserve notes? The immediate consequences would be minimal. New forms of currency will not be introduced into the market any faster than the public is prepared to accept them. The longer-run consequence will be to enable a more level playing field for competition in the issue of currency.

Legal tender status is more limited in its scope than is sometimes believed. That Federal Reserve notes and Treasure coins have "legal tender" status does not mean that they are the only legal way to pay. Any seller or creditor may (of course) voluntarily accept payment by transfer of bank-account balances, that is, by ordinary bank check, debit-card transfer, direct deposit, or wire transfer. Traveler's checks or cashier's checks may be accepted. The seller or creditor may even accept foreign currency or barter. Measured by dollar volume, payments in Federal Reserve notes or coin are a tiny share of all final payments in the United States (less than 20% of consumer payments, nearly 0% of business-to-business and financial payments). The great bulk of payments are electronic transfers of non-legal-tender bank balances.

Nor does legal-tender status mean that acceptance is mandatory when offered at a point of sale in a spot transaction. Large-denomination Federal Reserve notes are refused at many points of sale, and lawfully so. Vending machines refuse pennies. Mail-order sellers may refuse cash of any denomination. Millions of legal-tender one-dollar coins are piling up in the Federal Reserve's vault in Baltimore because nobody wants them.

Legal tender relates to the discharge of debts. The phrase "Legal tender for all debts" in 31 USC, §5103, quoted above, means that if Smith owes Jones $125, then Smith's offering Jones $125 in US coins or Federal Reserve notes legally extinguishes the debt, even if Jones would prefer payment in some other form (say, a check). In other words, the creditor is barred from refusing payment in legal tender notes or coins.

There is already an important exception, however. Debts in gold-clause contracts, made since 1977, are *not* unilaterally discharged by offer of US coin or Federal Reserve notes. 31 U.S.C. §5118(d)(2) reads: "An obligation issued containing a gold clause or governed by a gold clause is discharged on payment (dollar for dollar) in United States coin or currency that is legal tender at the time of payment. This paragraph *does not apply* to an obligation issued after October 27, 1977." [emphasis added] That is, the holder of a gold-clause bond is free to insist on receiving payments in gold, or in an amount of dollars indexed to the price of gold, whichever the bond contract specifies.

Removing legal-tender status from U.S. Treasury coins and Federal Reserve notes generally, as Section 2 of the Act does, essentially broadens the gold-clause exception to allow contractual obligations to specify payment in, or indexed to, any medium that is an alternative to Treasury coins and Federal Reserve notes. It opens the competition not just to private checks and banknotes, but also to gold units, silver units, units of foreign currency, Consumer Price Index bundles, wholesale commodity bundles, Bitcoins, and whatever else a lender and a borrower might agree upon. If they prefer a unit for denominating their debt contract other than the Fed or Treasury dollar, they would be free to write a specifically enforceable contract in the unit of their choice.

Hand-to-hand currency does not need legal tender status to make it circulate easily. In jurisdictions where private commercial banks may issue circulating currency notes or "banknotes" (found today in Scotland, Northern Ireland, and Hong Kong), banknotes have the same legal status as checks. That is, they do not have legal tender status. Any creditor *might* refuse them if he preferred to be paid in another medium. (In Scotland and Northern Ireland, only pound sterling coins are legal tender.) I have spent a fair amount of time in Northern Ireland, visiting the Finance Department at the Queen's University of Belfast, and have observed the circulation of banknotes there first-hand. There are four private banks that issue notes, and all of their notes are universally accepted. Legal tender status is clearly not necessary to have currency that circulates widely and is commonly accepted for payment of debts. Currency notes do not need legal tender status any more than credit cards, checks, debit cards, or traveler's checks.

SECTION 3

Section 3 of the Act rules out federal or state taxes on precious-metal coins, whether minted by a foreign government or by a private firm. This section would allow precious-metal coins to compete with the US Treasury's token coins (made of base metals, and denominated in fiat US dollars) without tax disadvantages (sales taxes on acquisition and capital gains taxes on holding, from which Federal Reserve Notes are exempt), and thereby a level playing field for competition among monetary standards.

SECTION 4

Section 4 of the Act repeals Title 18 §486 (relating to uttering or passing coins of gold, silver, or other metal) and §489 (making or possessing likeness of coins).

Section 486 is a relic of the Civil War, part of an effort to bolster the use of the wartime paper "greenback" currency by banning competition from the private gold coins I previously mentioned. The repeal of §486, combined with the previous section, would allow silver and gold coins to compete with the Treasury and the Fed on a level playing field.

I previously mentioned the American Liberty Currency project. The mover of that project, Bernard von Not Haus, was convicted in March 2011 of violating §486, and presently awaits sentencing, for the victimless crime of producing one-ounce silver coins, of original design, that he hoped would compete with the Federal Reserve's currency. Regarding this case I commend to your attention the article by Seth Lipsky, "When Private Money Becomes a Felony Offense," *Wall St. Journal*, 31 March 2011.

The repeal of §486 would avoid a repeat of the injustice done to Mr. von Not Haus. I share Mr. Lipky's view that "it's a loser's game to suppress private money that is sound in order to protect government-issued money that is unsound."

Title 18 §489 of current law outlaws making or possessing "any token, disk, or device in the likeness or similitude as to design, color, or the inscription thereon of any of the coins of the United States or of any foreign country issued as money, either under the authority of the United States or under the authority of any foreign government". Von NotHaus was also charged with violating this section. In my view §489 is redundant at best and over-reaching at worst. It is redundant at best because if there is any fraudulent intent in making or passing such a device, it is already outlawed under §485, which bans the counterfeiting of US coins. To outlaw "likeness or similitude as to design, color, *or* the inscription" [emphasis added] in cases where it is not counterfeiting and has no fraudulent intent, is far too sweeping. Taken literally, §489 outlaws all commemorative silver medallions—and if you go on eBay, you'll find that there are thousands of them for sale—because it says that you are in violation of the law if you make or own any disk that merely has a color similar to that of a US quarter.

CONCLUSION

Competition in general creates incentives to provide a high quality product by taking business away from low-quality producers. Competition in currency is a practical idea that offers sizable benefits to the public when the quality of the incumbent currency becomes doubtful. In particular, US citizens would benefit from freedom of choice among monetary alternatives though the removal of current legal restrictions and obstacles against currencies that could compete with Federal Reserve Notes and US Treasury coins. HR 1098 would give currency competition a chance.

Responses to Questions for the Record from Chairman Ron Paul (TX-14)
Subcommittee on Domestic Monetary Policy and Technology
Committee on Financial Services, U.S. House of Representatives

Hearing held on September 13, 2011, entitled
"Road Map to Sound Money: A Legislative Hearing on H.R.1098 and Restoring the Dollar."
Witness: Dr. Lawrence M. Parks

**Question # 1of 2**: Part of the purpose in discussing H.R.1098 and holding this hearing was to initiate a discussion on how we begin to achieve sound money. Your Foundation for the Advancement of Monetary Education has been educating people for more than 17 years about the benefits of an honest monetary system and the perils of, what you call in your testimony, legal tender irredeemable paper-ticket-electronic money. From your experience, what are your suggestions to expedite implementing an honest monetary system that is in conformity with the Constitution?

For the reasons outlined in my written testimony, it is urgent that the United States begin a transition to an honest monetary system to replace our current legal tender irredeemable paper-ticket-electronic monetary system before it completely collapses.

Here is what needs to be done.

<u>Preconditions</u>:

Before the problem of how to change our monetary system can be addressed, there must be widespread recognition that there is a problem. While the symptoms of our dysfunctional and dishonest monetary system are well recognized and complained about, few have traced the cause back to legal tender irredeemable paper-ticket-electronic money.

The parameters of the problem need to be stated and legitimatized. That is the role of intellectuals. As a precondition for implementation, those intellectuals who help establish credibility and build support for an honest monetary system must be paid. As I outline the steps, please keep in mind that all of this will need to be financed.

Because of the almost 100 years of misinformation and disinformation about our monetary system, putting what I call the money issue on the national agenda in a manner that its importance becomes widely recognized is a large task. Here are some of the steps that are usually taken to affect social change and which can be employed:

1. Engage "academic cover." Teaching about the perils of legal tender irredeemable paper-ticket-electronic money and the benefits of an honest monetary system will require some combination of:
    a. Endowed chair(s);
        i. There are not many candidates for an endowed chair who are knowledgeable about the perils of legal tender irredeemable paper-ticket-electronic money and the benefits of an honest monetary system. Professor Richard Ebeling, the former von Mises Professor of Economics at Hillsdale College comes to mind. An endowment requires several million dollars. It should be named after a famous person to give the chair the imprimatur of legitimacy. Best if the school is well respected. The holder of an endowed chair many times becomes head of department, which would give one some control of the curriculum, the selection of textbooks, the hiring of additional staff, and a say in awarding tenure appointments.

b. Academic prizes;

   i. Prizes help confer the mantel of being an expert on a prize holder. This is a common technique to legitimatize concepts. For example, the so-called *Nobel Prize in Economics* is not one of those prizes that Alfred Nobel established in 1895. The Economics prize came in 1968 and is endowed not by the Nobel Foundation but by the Central Bank of Sweden. It is a *bank* prize, and its real name is the *Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel*. This prize is never awarded anyone who even hints at the dishonesty of legal tender irredeemable paper-ticket-electronic money or questions the legitimacy of central banking.

   ii. Prizes help spur research and books. For example, the Gilder-Lehrman Institute for the past 12 years has awarded a $25,000 book prize about Frederick Douglass, an important historical figure, but certainly not one that most people have heard of. If memory serves, at this year's award ceremony it was mentioned that there were 63 books submitted for consideration. Imagine all of the study, articles, academic courses and other activities resulting from this kind of prize.

c. Honorariums for lectures/presentations;

   i. Academics, just like everyone else, are quick to respond to financial incentives. In industry, to establish the *bona fides* of concepts, products, etc. it is common to hold events where leading academics make a presentation. Wall Street does this all the time. It is only natural for someone who is being paid, say $50,000 (not an unheard of amount), to be the keynote speaker at a conference to understand what one is expected to say.

d. Research grants.

   i. Later in the process for achieving social change, e.g., getting legislation passed, there will be legislative hearings. Witnesses will be called (who might be the witnesses today to support getting rid of legal tender irredeemable paper-ticket-electronic money?), and evidence will need to be introduced. Lawmakers will require "cover" as well. Research findings will be necessary. Today, the Federal Reserve, for example, sponsors hundreds, maybe thousands, of reports, studies, etc. in support of the current system. Those who back an honest monetary system will need intellectual ammunition and their own expert witnesses to counter these.

2. Engage think tanks. There is a worldwide network of think tanks that conduct research and engage in advocacy. They staff recognized experts in almost every area.

   a. Think tanks produce research reports (which will be needed to support proposed legislation), their experts write op-eds and articles which are published in the general media, they hold conferences and other events that are attended by media people, and they arrange for their experts to appear in the major media. Think-tank sponsored conferences are another distribution channel for imparting legitimacy to ideas.

   b. Also, when journalists and researchers want information about a topic, they most times approach those who are considered to be "expert." As with prize winners, heads of department in the Academy and authors, think tanks are many times the source of expert opinion. Think tanks help establish credibility for and legitimatize ideas.

   c. To attract attendees when a business enterprise holds an industry conference, it many times arranges for "entertainment." A top intellectual from a well-known think tank not only adds the prestige of being a scholar, but also provides name recognition of the think tank that the scholar represents.

   d. As with other distribution channels, radio and television programs also seek to have "experts" appear. Think tanks many times are sources of authorities.

   e. It may be beneficial to sponsor new think tanks to address the money issue.

3. Engage a public relations firm.

   a. Public relations firms typically provide a distribution channel to the major media. While they many times also help devise a media strategy for introducing concepts and ideas to the general public, their most important function is to get publicity for content. To do that, public relations firms are generally staffed by former editors, television producers, and others who have relationships with the major media. That's how many op-eds, articles and television program specials get placed. Public relations firms expedite media appearances and conference participation.

4. Make use of Internet technology.

   a. New innovations, e.g., Facebook, Twitter, mobile device apps, email marketing, etc. should be used to help distribute intellectual ammunition highlighting the perils of legal tender irredeemable paper-ticket-electronic money and the benefits of an honest monetary system.

5. Engage lobbyists.

   a. Legislation will be required to make a transition to an honest monetary system. I think it is fair to say that no important legislation gets passed in the U.S. without significant lobbying. A key issue is: who will pay the lobbyists? (More about this follows.)

6. Management: An umbrella organization will be needed to oversee and manage this process.

Rebut stated objections to eliminating paper money

The principal objections to transitioning from paper money must be addressed (that will be the task of experts who will need to present convincing and truthful research). It is not my purpose to counter these objections here except to say that they are all easily addressed with empirical evidence and logical reasoning.

1. The proposition that financial markets are inherently unstable.

   a. The argument is that since financial markets interconnect all other markets, and since financial markets have historically gone through periods of boom and bust[1], there must be some mechanism, called the "lender-of-last-resort," to rescue financial markets when they become vulnerable to collapse. Otherwise, the argument goes, society could collapse. If we don't have paper money, i.e., if we have gold-as-money or money that is somehow linked to, redeemable into, or otherwise connected with gold, there may not be enough gold to go around. Therefore, it is claimed, we must rely on paper money and associated institutions, e.g., central banks.

2. Need for safety nets.

   a. Sometimes, even without a systemic collapse, such as occurred in the 1930s, there come times when there are severe economic dislocations and high unemployment, as we have now. The

[1] Famed economist John Maynard Keynes hypothesized that financial excesses are driven by "animal spirits." I interpret this to mean that every now and then something in folks' pituitary gland causes them to go off the rails financially. In my view, this is nonsense, and, to paraphrase Keynes, "nonsense on stilts."

argument is that this requires safety nets, e.g., unemployment benefits. If politicians don't have easy access to legal tender irredeemable paper-ticket-electronic money, then it may not be possible to finance the safety nets. Also, it is further argued that it may be necessary for government to provide "stimuli" in the form of government-sponsored "investments," say in infrastructure or whatever, to "get the economy moving." If we don't have a monetary system that includes legal tender irredeemable paper-ticket-electronic money, such government action may not be possible.

3. Not enough gold for government to honor entitlement promises, especially Medicare.
    a. Regardless of whether our legal tender irredeemable paper-ticket-electronic monetary system is maintained, Medicare and Medicaid promises cannot be met. Current legislation aimed at reducing payments to providers and limiting coverage is just another way of defaulting. The solution, regardless of the monetary system, is to eliminate the monopoly that doctors have on the delivery of healthcare and the stranglehold that the FDA has on approval of new drugs and devices. It is well-known that whenever there is a monopoly prices increase and the level of service goes down. What is the mystery that this principle should not apply to healthcare?
    b. Social Security can easily be made solvent by increasing the retirement age and other adjustments, as should have been made long ago, again, regardless of the monetary system.
4. Not enough gold to fund defense.
    a. The argument is that historically, when countries were on the gold standard, which system is not being recommended, the ability to redeem gold certificates for gold was frequently suspended in order to finance war with legal tender irredeemable paper-ticket-money. However, it was always understood that after war was over convertibility would be resumed. In fact, there is always enough gold and accumulated wealth to finance wars that have the support of the people. It is only wars of adventure and the stationing of troops all over the world that will have difficulty being financed.
5. Without paper money, the ability of politicians to manage the economy would be severely constrained.
    a. This is true. However, for those engaged in producing goods and final services that improve the lives of ordinary people, as opposed to those who profit from moving paper around, the ability of politicians to manage the economy should be constrained, if not totally eliminated.
6. Limits to the amount of gold to support a growing economy.
    a. The argument is that as an economy grows, there needs to be more money to fund that growth. With gold or other commodity money there may not be enough and growth will be unnecessarily constrained.

Unstated Objections to eliminating paper money

Whenever legislation is proposed or opposed, there is a stated agenda, usually positioned that the legislation will be good or bad for the country (whenever possible, legislation is also positioned as being good or bad for children). There is also almost always an unstated agenda that the proposed legislation will help or hurt a particular special interest. Proposals to change the monetary system away from legal tender irredeemable paper-ticket-electronic money are vulnerable to very material unstated objections. The reason they are unstated is that, because few would agree that the objections are valid if they were openly acknowledged.

1. Eliminating legal tender irredeemable paper-ticket-electronic money limits politicians' ability to extract "campaign contributions" for granting special privileges and protecting suppose interests. Fewer "campaign contributions" impair politicians' tenure in office.
2. The most important unstated objection to eliminating legal tender irredeemable paper-ticket-electronic money is that it limits financial leverage and profits to the financial sector. For example, today there is something north of $60 trillion under professional management generating a fee stream on the order of $500 billion (no typo) per year. Additional hundreds of billions are garnered from transaction fees. This fee stream would almost totally evaporate if we don't continue with legal tender irredeemable paper-ticket-electronic money. Those who profit from the current system will mount a spirited defense of it and will denigrate any proposed monetary system based on gold.

Who should decide the parameters of a new monetary system?

On March 11th, 2009, the *Financial Times* ran a large article about who would be called upon to fix the financial debacle[2]. Of the 50 names put forth, only three were from the productive (the article called them "industrialists") sector. The corpus consisted of central bankers, bankers, economists whom they have coopted, financial sector regulators, financial sector investors, heads of financial sector institutions, and politicians whose allegiance that the financial sector has bought off with what are euphemistically referred to as "campaign contributions." If in fact these folks should come up with a plan, I think it fair to say that "the fix would be in."

Ideally, the monetary system should serve the needs of ordinary people and those who produce products and final services. Thus, those who should be responsible for determining the structure, i.e., what the money should be, of the monetary system are manufacturers, farmers, end-product service providers (as opposed to intermediaries), private sector organized labor, small countries, savers, seniors, and our trading partners. There may be others, but the point is to exclude financial sector participants for reasons which shall be stated shortly. Others should include the same categories of participants from Canada, Mexico, Germany, the UK, China, France, South Korea, Japan, etc.

The reasons why financial sector participants should be excluded from shaping new monetary system specifications are:

1. Financial sector participants do not produce any final service or product. At best, they are intermediaries facilitating production or services. In other words, while their services are necessary, their services are analogous to friction which costs should be minimized; and,
2. They have a conflict of interest with everyone else. What producers of products and services want is a monetary system that will minimize the cost of transferring wealth over time along with monetary, foreign exchange, interest rate, and balance sheet stability. The costs which producers want to minimize are revenues to the financial sector. Moreover, because the financial sector garners so much of its profits from trading, it does not want stability. It wants volatility. For the past 100 years at least, the *structure* of the monetary system has been largely left in the hands of financial sector participants. They have rigged that *structure* to their benefit and to the detriment of everyone else.

Those in the public sector, especially politicians, should also not provide input to the monetary structure. Once the parameters are determined by end users, it will be up to the politicians to accept or reject the recommendations.

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[2]Lionel Barber, "Fifty who will frame a way forward", March 11 2009, *The Financial Times*, http://www.ft.com/intl/cms/s/0/5b91ddbc-0ddb-11de-8ea3-0000779fd2ac.html#axzz1dt45VHCO

Implementation

There needs to be broad support from those who have a real and legitimate stake in defining a new monetary system. Fortunately, there is precedent whereby the major beneficiaries of a proposed system have gotten together on a worldwide basis to design a new system. The model which could easily be emulated is the highly successful Global XML Initiative.

The Global XML Initiative was a joint effort by many of the world's largest companies (cross-industry and cross-geography), especially those engaged in international trade, to develop a set of protocols whereby they could communicate with one another and their suppliers over the Internet to send purchase orders, acknowledgements, etc. and to eliminate, or at least greatly reduce, paper processing. Think of the result as akin to the ability of any bank to send wire transfers to any other bank worldwide across all industries.

The Global XML Initiative, after joint study and conferences, set up protocols that all companies subscribed to. I propose a Global Currency Initiative using a similar methodology.

Who will finance the Global Currency Initiative (the "GCI")?

It is anticipated that funding will come from three principal sources:

1. Gold sector participants (gold producers, gold funds, and hedge funds that have allocated significant assets to gold) on the theory that the conclusion of the GCI will be gold-as-money. In that event, gold sector participants can expect material relative asset valuation increases;
2. Large industrial enterprises on the theory that the new monetary system will eliminate, or at least greatly reduce, foreign exchange, interest rate and balance sheet volatility. While the costs of foreign exchange and interest rate volatility are not reflected in company financials, revenues to the financial sector are borne largely by productive sector businesses. I estimate those revenues, and the concomitant amounts that will fall to the bottom line for companies in the productive sector to be more than a trillion dollars per year. In addition, current systemic instability introduces enterprise risk for major businesses, i.e., the careful accumulation of productive capital over generations could be obliterated in the blink of an eye; and,
3. Foundations and other charities whose mission includes increasing the standard of living for all people and helping to ensure peace and stability.

The Global Currency Initiative

The primary purpose of the GCI will be to establish criteria for a new monetary system. Then GCI participants will mobilize their already-on-retainer lobbyists to lobby elected representatives to legislate a new system. To signal that the GCI should be considered seriously and to attract high-level participants, someone who has earned worldwide respect in industry should lend his/her name to the project, e.g., Andy Grove or Bill Gates.

It is proposed that the criteria for a new monetary system be consistent with three guiding principles:

1. Full disclosure of all relevant information;
2. No misrepresentations; and,
3. No coercion, i.e., people should be free to accept or reject any particular form of money. The jargon for monetary coercion is legal tender, a power not authorized to the United States Government by the U.S. *Constitution*.

Possible criteria for the new monetary system to be considered should include (but not be limited to):

1. Low and stable interest rates;
2. Stable foreign exchange rates;

3. Price stability;
4. Balance sheet stability;
5. Conformity with the U.S. *Constitution*;
6. Conformity with the teachings of the major religions about money;
7. No special privileges for any sector or government (thus eliminating moral hazard);
8. Minimize the cost of transferring wealth over time.

After there is agreement on the criteria for the new monetary system, proposals for particulars will be evaluated on the basis of how well they meet the desired criteria. My research indicates that the system that best meets the criteria is gold-as-money. However, it is proposed that the GCI participants reach their own conclusions.

Gold-as-money monetary system

After the GCI has been consummated, I anticipate that the new monetary system will be the one system that has been the choice of free people whenever gold (and/or silver) was available: a monetary system that uses gold-as-money.

To make the switch-over in the least painful way, mindful that pain is unavoidable as the current legal tender irredeemable paper-ticket-electronic monetary systems implodes, is to leave everything in place: the so-called "dollar," the Federal Reserve, the "lender-of-last-resort," the International Monetary Fund, the World Bank, the euro, the yen, the yuan and all central banks and banking institutions worldwide. Any government or company or person who wishes to continue to use and save irredeemable paper-ticket-electronic money should be free to do so.

However, the coercion associated with irredeemable paper-ticket-electronic money, legal tender laws, should be repealed worldwide. Further, there should be no taxes of any kind (sales taxes, income taxes, VAT taxes, etc.) levied against gold or silver. In addition, at least in the U.S., the gold that supposedly resides in Fort Knox and other depositories should be distributed per capita to citizens, and perhaps the same worldwide, and mints should be opened to free coinage. Gold and silver coins should be denominated by weight.

It is anticipated that as irredeemable paper-ticket-electronic money continues to depreciate, transactions for future settlement will more and more be denominated in gold by weight, not dollars or any other paper money. In this way, it is hoped that a monetary transition, as opposed to a monetary discontinuity/collapse, can be made over time.

> **Question # 2 of 2**: In your testimony, you suggest that H.R.1098 is necessary to implement an honest monetary system in conformity with the Constitution in part because H.R.1098 repeals legal tender laws. However, it would appear that existing legislation already empowers one to contract for payment in gold and compel specific performance. If this is correct, please explain further why you believe H.R.1098 is essential legislation.

In my testimony I highlight how the Founders abhorred legal tender, especially Thomas Jefferson and Tom Paine. I also quote from Justice John Marshall and Daniel Webster who also opposed legal tender. I explain how it came to be that the Supreme Court legitimatized legal tender in what today (and at the time when the decisions came down) prominent legal scholars called the decisions questionable at best. As Judge Bork once put it:

> "[t]his Nation has grown up in ways that do not comport with the intentions of the people who wrote the Constitution -- the commerce clause is one example -- and it is simply too late to go

back and tear that up. I cite to you the legal tender cases. These are extreme examples admittedly. Scholarship suggests that the Framers intended to prohibit paper money."[3]

I also emphasize that Chief Justice Salmon Chase dissent in *Knox vs. Lee* declared: "The legal tender quality [of money] is only valuable for the purposes of dishonesty." A clearer condemnation is not possible, in my view. One would hope that our government would stop being a party to something that is *prima facie* dishonest.

Professor Lawrence White, while endorsing competition in currency, makes the valid point that there is already an exception to the "Legal Tender Statute," 31 USC, §5103 in that since 1977 one may insert a "gold clause" in contracts and insist on receiving payments in gold, or in an amount of dollars indexed to the price of gold.

Because gold (with a minor exception being silver, and which is irrelevant) is the only commodity for which there is more than a year's worth of production above ground that could easily be brought to market—there is in fact more than 65 years' worth of gold production above ground—gold is the only commodity when used as money that could provide price stability for future payments. Thus, if price stability is to be a criterion for a new monetary system, with full disclosure and absent coercion and misrepresentations, gold-as-money will be a principal candidate.

One might conclude, therefore, that on account of the 1977 exception for gold, HR1098's repealing legal tender is not necessary, and that if one wants to transact with gold-as-money one could and would do so now. In my view, this is wrong and HR1098 is necessary and essential if we are going to transition away from legal tender irredeemable paper-ticket-electronic money for the following reasons:

1. Hardly anyone knows that contracts payable in gold are now legal and supposedly enforceable. All over the world, gold has been "demonetized." The International Monetary Fund, for example, modified in 1978 its *Articles of Agreement*, Section 4-2b, to prohibit member countries from linking their currencies to gold and only to gold. Irredeemable paper-ticket-electronic money is legal tender in every country, as far as I know. Thus, absent a clear repudiation by the world's leading monetary power, the United States, legal tender will remain an impediment for using gold-as-money for international transactions as well as domestic transactions.
2. U.S. Gold Eagles, authorized by the *Gold Bullion Coin Act of 1985*, have a nominal face value of $50 and are themselves "legal tender." The market value of the gold content in Gold Eagles is almost 38 times their face value. Gains on the dollar value of gold using U.S. Gold Eagles for transactions is considered income by the IRS and are subject to special additional income taxes, because the IRS has categorized gold as a "collectible." In some locales gold and/or bullion coins are subject to sales taxes. These factors alone stymie anyone attempting to switch away from legal tender irredeemable paper-ticket-electronic dollars to gold-as-money.
3. As a practical matter, a gold clause requiring payment in gold in contracts is, in my view, a deal killer. For example, how could a debtor have any confidence that he could perform? Further, if one promised gold as payment, where might one reliably get gold at the time that payment is due? Today, on information and belief, commodity exchanges provide that contracts for gold bought for future delivery may be settled in cash, i.e., paper money. In addition, there is material counterparty risk that any arrangements that a debtor makes to pay in gold could be frustrated. Why would a debtor or creditor undertake the risk of payment in gold? Further, to acquire U.S. Gold Eagles, the most reliable form of gold-as-money for use in commercial transactions, one must pay a 3% premium on the dollar market value of the coins, which is charged by the U.S. Mint, plus a commission to a selling dealer which is generally in the range of one to two percent of the dollar market value of the coins. I am aware of no commercial transactions that use gold-as-money in the form of U.S. Gold

[3] Hearings Before Senate Comm. on the Judiciary 100th Cong., 1st Sess. Nomination of Robert H. Bork to be Associate Justice of the Supreme Court of the United States: art 1 at 84-85 (1987), as referenced by: http://www.law.duke.edu/boylesite/bork.htm#N_60_

Eagles or any other form of physical gold for future payment. In other words, the exception to the Legal Tender Statue cited by Professor White is of no practical significance.

4. The notion of fiat money, i.e., arbitrary money whereby a politician(s), under the color of law, designates something that is inherently worthless (such as a piece of paper) gussied up with seals and signatures as having value as money has historically been repugnant to the American sense. These days, in part because the concept of fiat money has been removed from course curricula in almost all government schools, few have any knowledge of the history or threats of fiat money to their economic and political well-being. This was not the case as recently as 1933. Then, ordinary people understood what fiat money was and would not have tolerated it. Evidence for this is that on March 5th, 1933, President Roosevelt, relying on a dubious interpretation of a long-ago lapsed *Trading With the Enemy Act of 1917*, froze all transaction in gold. Seven days later, on March 12th, in the first of his famous Fireside Chats, when he spoke to the nation over radio during which time he explained his actions, he made it a point to declare about [Federal] Reserve Banks issuing currency: "This currency is not fiat currency." Even in the depths of the Great Depression, the American public would have rejected fiat money, and President Roosevelt knew it. Fiat money became a worldwide phenomenon when on August 15th, 1971 the United States defaulted on its sovereign promise to redeem the dollar, which is widely said to be the world's "reserve currency," held by foreign governments and foreign central banks for gold at the rate of one ounce of gold for $35. The result is that the entire planet is now awash in legal tender irredeemable paper-ticket-electronic money.
5. Despite the provisions in U.S. law referred to above, those who are at the pinnacle of the monetary authority understand full well that legal tender is necessary to coerce people into using fiat money. No less authority than Alan Greenspan, then Chairman of the Board of Governors of the Federal Reserve System wrote to Congressman Dr. Ron Paul on November 20, 2003, a copy of which letter is appended hereto, in which Mr. Greenspan states unequivocally: "So long as we issue fiat currency, I see no alternative to a legal tender law."
6. The notion that one can enforce payment in gold by a court is a bad joke. As a practical matter today, non-"small claims" disputes of less than say $50,000 cannot be adjudicated mostly on account of the monopoly that lawyers have on access to the court system and the monopoly fees that they charge. Larger transactions, where it may be economic to retain an attorney, are at risk because U.S. courts cannot be relied upon to enforce the law as written. There's a long history in the U.S. whereby the courts, including the Supreme Court, don't enforce legally binding contracts calling for payment in gold.
    a. For example, pursuant to an Act by Congress of September 24, 1917, the United States issued Liberty Bonds to help finance World War I. These bonds had a gold clause which stated that "The principal and interest hereof are payable in United States gold coin of the present standard of value." *The Emergency Banking Relief Act of March 9, 1933* empowered the President to regulate or prohibit transactions in gold. Subsequently, in a Joint Resolution of June 5, 1933, Congress nullified all gold clause obligations of the United States. An action on this matter reached the Supreme Court: *Perry v. United States*, 294 U.S. 330 (1935). The Supreme Court decided that the Government, on the theory that it is sovereign, has the power under the *Constitution* to renege on its promises. The explanation was couched in legal gobbledygook, e.g., that since gold ownership had been outlawed, while the plaintiff had a right, there was no remedy. It should be noted that Justice James Clark McReynolds in dissent stated: "The *Constitution* is gone."[4]

[4] Henry Mark Holzer, *The Gold Clause*, 1980, ISBN # 0595139671, p65

b. It has long been held by the courts that "as a legal medium there could be no distinction between notes and gold." [5] An example is given of dispute over a contract drawn on June 17, 1862 providing payment "'in the current gold coin of the United States, in full tale and count, without regard to any legal tender that may be established or declared by any law of Congress' was held satisfied by payments in the nominal value in any legal tender money. The court said that it was not a contract to be paid in bullion, or in so many pounds or ounces of gold, but in a certain number of dollars, in coin. The transaction did not regard gold as a commodity but as money. The Legal Tender Act had made Treasury notes of like value with gold. As a legal medium there could be no distinction between notes and gold."[6]

c. "The theory of the suit brought on contracts payable in specific chattels is that the court's judgment is not for payment in articles in kind, but for the damages resulting to the creditor in consequences of breach of contract, and this judgment can be paid off and satisfied in whatever money the law has clothed with the attributes of legal tender. Although it was a notorious fact for purposes of trade and in commercial transactions a difference was made between Treasury notes and specie coin, whatever fluctuations might arise from extraneous causes, the debtor's right to pay in whatever medium he chooses could not be affected. In administering the law, it was necessary that gold and Treasury notes should be considered equal. (Appel v. Woltman (1860) 38 Mo. 194.) A note payable "in gold" was held enforceable only for the face value of the note payable in any lawful money, and a judgment for a premium on gold in addition was declared invalid. (Henderson v. McPike (1864) 35 Mo. 255.)"[7]

d. "In New York, the words "in specie, gold, and silver coin" were held not to affect the right to discharge an obligation, for the payment of a certain number of dollars, by paying in legal tender notes. (Murray v. Harrison (1867) 47 Barb, 484, affirmed (1868) 52 Barb. 427.) So also a bill of exchange payable "in specie or its equivalent" could be paid in legal tender notes called greenbacks." (Jones v. Smith (1867) 48 Barb. 552.)[8]

7. Rather than quote more extensively from the reference cited, suffice it to say that there are myriad examples of courts denying plaintiffs the right to be paid in gold as provided by contract.

Without doubt, Mr. Greenspan has it right. If the U.S. is to transition away from legal tender irredeemable paper-ticket-electronic money, legal tender must be repealed.

[5] George Cyrus Thorpe, "Contracts Payable in Gold"; United States Senate Document #43, 73rd Congress, 1st Session.
[6] ibid
[7] ibid
[8] ibid

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

November 20, 2003

The Honorable Ron Paul
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Thank you for your letter dated October 27, 2003, regarding legal tender laws. You asked me for a more detailed explanation of the Federal Reserve's position on the economic effects of and justification for legal tender laws and for my position on your Honest Money Act (H.R. 2779), which would repeal 31 U.S.C. § 5103, the "Legal Tender Statute."

As I indicated in my letter of September 2, 2003, the Legal Tender Statute specifies those items that, when transferred to a creditor, constitute a legal tender for a preexisting debt. Thus, a person who owes a debt to a creditor can provide United States coins and currency to the creditor in an amount equal to the debt and subsequently conduct his or her business with the knowledge that the creditor cannot successfully sue for further payment. The statute provides legal certainty to the final settlement of debts required for the efficient functioning of the nation's financial system. So long as we issue fiat currency, I see no alternative to a legal tender law.

I hope these comments are useful. Please let me know if I can be of further assistance.

Sincerely,