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Hans F. Sennholz earned a doctorate under Ludwig von Mises and chaired the Economics Department at Grove City College in Pennsylvania for 36 years. After retiring from Grove City College, he became President of the Foundation for Economic Education, where he served for five years. Sennholz was the recipient of several honors. He was an Honorary Doctor of Universidad Francisco Marroquin in Guatemala; Honorary Doctor of Laws of Culver-Stockton College in Canton, Missouri; and Honorary Doctor of Laws of Grove City College in Grove City, PA. He received the Gary G. Schlarbaum Award for Liberty, and was the recipient of a festschrift with contributions by 36 authors. Sennholz was a prolific writer on economic, social, and political thought and issues, including the economics of money and banking, and the problems of public financing. In more than 1,000 publications, including seventeen books and booklets, he covered nearly every aspect of contemporary thought.

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MANUFACTURED IN THE UNITED STATES OF AMERICA

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FOREWORD

Despite the economic recovery in recent years, many Americans remain pessimistic about the future, and with good reason. They have been through the boom-and-bust cycle before, and their attitude seems to be: if good times are here now, just wait awhile. The economic history of the United States since 1913 has been one of boom and bust, boom and bust. Many Americans think it is unlikely that things have changed much now.

There is a more profound reason for pessimism than the perpetual recurrence of the business cycle. Some Americans have noticed that the cycles of boom and bust seem to be getting more severe. What were regarded as busts just 15 years ago are now regarded as booms, because the busts are now so much worse by comparison. The Reagan administration takes the credit for reducing the rate of price inflation to 4½ percent per year, from 11 percent in 1980 and 1981. But in 1971, an inflation rate of 4½ percent per year prompted President Nixon to impose wage and price controls to stop the intolerable inflation. What was condemned as intolerable in 1971—a 4½ percent inflation rate—is praised as a magnificent achievement in 1985. Why? Because the intervening years saw price inflation at 11 percent per year, something never before seen in our history.

The same is true with regard to interest rates. It is now a tremendous accomplishment to have the prime rate—the interest rate at which the most credit-worthy borrowers can obtain funds—at 9.5 percent, but ten years ago the prime rate was 5 percent, and a 9.5 percent prime rate was regarded as the death knell of capitalism and free enterprise. Why are we so joyful when the prime has fallen to 9.5 percent? Because in the intervening years, the prime rate had reached 21½ percent.

One can make the same point with unemployment. A severe unemployment rate 15 years ago was 6 percent, and a "normal" unemployment rate was 4 percent. Now the government would be delighted to see our unemployment rate *reduced* to 6 percent—that would be a tremendous achievement. After all, unemployment recently reached 9.7 percent. Each turn of the cycle has brought and accustomed us to worse and worse economic conditions, and many think the days of 3 percent and 4 percent interest rates are gone forever. They not only see the cycles, but also recognize that the cycles are becoming more and more severe. And they see no solution to our economic problems.

Other Americans recognize the problems, understand that they are worsening—not improving, and think they know the solution. According to a few, the problem is that we have a private central bank and instead need a government central bank. According to others, the U.S. Treasury, not the Federal Reserve, should print our money; such money would be "debt free" and "interest free." Still others think that gold has to be used in some fashion, perhaps as a reserve for paper money or as a commodity whose price must be kept stable by the Federal Reserve. And a very influential group believes that the government should increase the supply of (paper) money and credit at a constant rate to promote economic growth with no inflation.

None of these groups is interested in financial freedom. All of them wish to use the government to impose their own opinions about the monetary system on the whole country. To the extent that they realize that a major source of our economic problems is the money and banking system, they are entirely correct. But they are mistaken in prescribing more of the same poison—government action and regulation—as the antidote for the poison of government action and regulation that is causing our economic problems.

In this book, Professor Hans Sennholz argues that the solution to our economic difficulties is not more government, but less; not less freedom, but more. "Sound money and banking are not impossible," he writes, "they are just illegal." What is needed is a program to repeal the laws that have created our present system of monopoly money and a banking cartel. Inflation is possible, he points out, only because legal tender laws force everyone to accept the government's paper currency at face value. Were Americans given a choice, were they free to choose the type of money they would like to use, they would choose a money that has enduring value, not one that has dropped over 50 percent in the last 15 years as the Federal Reserve note has. But this solution appears simplistic to some. "Who will run our banking system? Who will print our money?" they might ask. Until one realizes that these questions are similar to asking, "Who will grow our food? Who will run our shoe factories?" he will favor government involvement in banking and money. Government doesn't grow our food or make our shoes, and we are the best-fed and best-clothed nation in world history. Those societies in which government does grow the food and make the shoes are uniformly hungry and poorly clothed. Americans have understood that freedom and competition can produce the best shoes and clothes; they now must extend that realization to money and banking.

Such a free-enterprise money system is entirely consistent with the Constitution, which reserves the rights to extend credit, issue notes, and mint coins to the American people under the Ninth and Tenth Amendments. Congress is given the power to mint coins, not to print paper money, and that power of the mint is not an exclusive or monopoly power. Competition in currency was the intention of the founding fathers.

Money and Freedom presents the case for extending competition to money and banking. To pessimists of all varieties, it offers hope for the future; however, if we maintain an allegiance to government money and government banks, and turn our back on monetary freedom, there is no way out of the present economic difficulties. Government has caused the problem; only free men can solve it.

Steve Symms

U.S. Senator (Idaho)

PREFACE

In the early weeks of 1973, when the Watergate controversy was swelling into a momentous government scandal, when the U.S. dollar was devalued another ten percent against nearly all the world's major currencies and President Nixon announced yet another phase in his price and wage control program, this writer penned a short essay on Inflation or Gold Standard. It sought to look beyond the tumultuous present to the future, looking ahead the next 10, 20 and 30 years.

More than ten years have passed since then, affording an opportunity to compare the 1973 prognosis with actual conditions and events. The projections of federal deficit spending, the stock of money and the purchasing power of the U.S. dollar were on the mark. The projections for 1993 and 2003 may underestimate the actual course of events, which reveals an ominous trend of financial and economic disintegration. It points at the destruction of the U. S. dollar and a new currency some time during the 1990s.

The essay sought to give support and direction to the budding gold movement. It mapped the road to sound money and outlined three intermediate objectives: (1) individual freedom to own gold, (2) individual freedom to use gold in all economic exchanges, (3) individual freedom to mint coins. Bound and determined, the movement attained all three objectives in the course of a few years. The right to gold ownership was restored on January 1, 1975; the right to write gold contracts and clauses was returned on October 28, 1977; and the right to mint coins was interpreted to mean minting gold medallions, which was implied in the right of gold ownership. Unfortunately, American financial institutions remained enmeshed in a myriad of government regulations and controls designed to safeguard the monopolistic position of government money.

No road is too long for the movement that advances deliberately and patiently. In the knowledge that right makes might, the gold movement of yesteryear has become a "freedom movement" striving to extend basic rights to man's associations and institutions. It opposes any and all attempts of politicians and government officials to assume control over man's financial affairs and establish political monopolies. In particular, it is deeply committed to the abolition of central banking and legal-tender coercion that breed inflation and many other evils. This essay means to sustain the movement by throwing some light on the false roads, wide and popular as they may be, and endeavors to illuminate the narrow path to monetary freedom.

I am indebted to many friends and associates. In particular, I would like to express my gratitude to Messrs. Edward Durell and Raymond S. Sleeper of the Leadership Foundation who convinced me that the essay be written today rather than tomorrow. To Dr. John Robbins of the Leadership Foundation chiefly belongs the credit for the radical rearrangement of the subject matter. What set out to be just another edition of Inflation or Gold Standard became a new creation, Money and Freedom. It was helped along by the invaluable assistance of college librarian, Diane H. GrundyMcKillop. My gratitude is due to my son and his wife, Robert and Lyn, who, as the publishers, are laboring diligently in the vineyard of freedom. My greatest debt is to my wife and partner of life.

Hans F Sennholz
Grove City, PA
September, 1985

INTRODUCTION: LIVING ON BORROWED TIME

Dark clouds have gathered over the world's financial system. Some $500 billion of bad international debts are hanging over American and European banks. Mexico owes $98 billion and cannot even meet interest payments. Argentina owes more than $40 billion and hovers on the brink of bankruptcy. Brazil is in difficulties with $103 billion. The Iron Curtain countries are in the red more than $60 billion. Third-world countries are up to their ears in debts of more than $200 billion.

In the dream world of public finance, all these countries suffer merely from "temporary illiquidity" that will soon be corrected; however, the problem is not a temporary shortage of cash. Seen in the cold light of reality, most of these loans will never be repaid. The money has been squandered by socialistic regimes oppressing their people and repressing economic life. When Mexico was poor and underdeveloped, it could honor its debt. When it struck oil, it went broke in an orgy of political folly. When chaos descended on economic life, the government took over the banks and imposed strangling controls. What else can it perpetrate?

The debt will never be repaid because the willful destruction of the Mexican peso by the Mexican government has multiplied the burden of debt to the borrower. Most foreign debt is dollar denominated and repayable in dollars, but the peso has fallen from four U.S. cents to less than one U.S. cent in the international money markets. Mexican debtors now must pay four times the original number of pesos to service and repay their dollar debt. Few debtors anywhere would be able and willing to make such sacrifices for the benefit of American bankers.

It would be naive to believe that the debtor countries will go bankrupt in the proper sense of the word. Only individuals and small businesses are permitted to fail. Large corporations, great banks, and important countries cannot founder because the U.S. government, acting through its money monopoly, the Federal Reserve System, will come to their rescue. Their failure would precipitate countless other failures in a chain reaction that, in a flash, would spread across national borders. The bankruptcy of Mexico would trigger the failure of numerous American banks, which, in turn, would touch off failures of countless bank depositors.

The big banks in New York, Chicago, Los Angeles and other money centers, which made the bad loans, are the pillars of the American financial system. If they should fall, all economic life could sink into depression and despair; therefore, the Federal Reserve rushed to the rescue of Mexico with billions of dollars, so that it could pay the interest falling due to American banks. The loans are made good, the banks remain open, and the crisis is averted.

In times of tense international crises, interest rates must be expected to soar to crisis levels. After all, the demand for funds is exceptionally great, and the supply is extraordinarily small because of the looming dangers. Yet, interest rates have fallen throughout the worst financial crisis in recent history, which calls for an immediate explanation. The money that is rushing to the rescue of Mexico and other defaulting countries is *new* money, fresh from the Federal Reserve and its printing presses. The international rescue action is international inflation on an unprecedented scale.

To meet future crises and emergencies, the International Monetary Fund established a bail-out fund of $25 billion. Of course, this money, too, was newly created, but how long can it be expected to last, with some $500 billion in shaky loans? If Mexico can be rescued so easily, why should the other debtor countries not be rescued as promptly? One good bailout deserves another, and one burst of inflation brings forth another.

The international financial order is coming undone. Ever larger dressings of new U.S. dollars are needed to hold it together for a while. There is much more inflation to come.

The world is in urgent need of dependable money that facilitates international trade and commerce. Throughout the centuries, gold and silver served as the universal money uniting the world in peaceful cooperation and division of labor. During the nineteenth century, the people of most Western countries were united on a gold standard, settling their payments in gold and making all monetary substitutes, such as bank notes and demand deposits, payable in gold.

With the rise of power politics in its various shapes and colors, governments gradually assumed control over the people's money. The gold coin standard gave way to the gold bullion standard, which in turn yielded to the gold exchange standard, which in time became the gold dollar standard. In 1971, when the U.S. government defaulted in its international gold payment obligations, it paved the way for an international fiat standard. The governments of the world now are marching to the tune of a *fiat dollar standard* that is managed by the Federal Reserve System.

A World Money Standard

There can be no greater financial responsibility than the management of the world monetary standard. Every day assumes a fearful responsibility when we realize that the economic fate of the free world rests on the Federal Reserve. Unfortunately, the Fed is a political institution, born of politics and raised in conflict and strife. The dollar standard itself is the outgrowth of an ideology that places the Federal Reserve in charge of the people's money. It is the handiwork of government and its apparatus of politics. To expect much of such a creation is to invite bitter disappointment.

The world dollar standard has created temptations that no government can be expected to resist. The world demand for a reserve currency constitutes an extraordinary demand that tends to support and strengthen its purchasing power. It affords the country of issue a rare opportunity to inflate its currency and export its inflation, without immediately suffering the dire consequences of currency debasement.

In particular, it presents an opportunity to the administration in power to indulge in massive deficit spending, designed to bolster its popularity with the electorate, while its inflation is exported to all corners of the world. The country that provides the world reserve asset can, for a while, live comfortably beyond its means, enjoy massive imports from abroad while it exports its newly created money in payment for imports. In short, it can raise its levels of living at the expense of the rest of the world.

The world dollar standard obviously embodies a fatal flaw that will sweep it away in the end. It allocates income and wealth to some countries and inflicts painful losses on others. After all, the allocation of additional quantities of money by monetary authorities always benefits the early recipients at the expense of all others. Early holders have more money to spend, can command more goods at old prices, and can consume more than others. Latecomers are forced to restrict their consumption because they lack the money to compete with the early holders. They are shortchanged, unless they receive a "fair" proportion of the additional money created by the monetary authority.

On the national scene, the inevitable conflict between beneficiaries and victims of the money allocation is simply stifled by the police powers of government; however, the conflict is audible, at least in free societies, in ardent political debates about economic programs and policies. On the international scene, no police power is capable of hushing the allocation conflict; it is bound to erupt with full force as soon as it is perceived by the victims.

Whatever the money allotment may be, serious conflict must arise about any scheme of dollar distribution by the Federal Reserve System. The less-developed countries may favor distribution based on population; the industrially advanced countries may prefer distribution according to productivity. All would join in opposition if the U.S. government and the American people were made the primary beneficiaries of the system.

During the 1970s, many foreign governments managed to get a substantial share of the new money. Certainly the U.S. government was always an early recipient, followed by the beneficiaries of federal spending, but many foreign governments, ever eager to secure grants and loans, also benefited from the situation. The dollar standard invited massive credit expansion in both the U.S. and the Eurodollar market, and made foreign governments in less developed countries its primary beneficiaries. Foreign central bank reserves, consisting mostly of dollars, expanded from $92 billion to more than $800 billion in 1981. The Eurodollar market recycled the flood of dollars from the United States to the Organization of Petroleum Exporting Countries (OPEC), and from there to commercial banks in Europe and the United States, and to debtors all over the globe; it grew from some $100 billion in 1970 to nearly $2 trillion in 1984. The debt of non-OPEC developing countries alone, consisting of commercial bank loans, multinational organization loans and government loans, soared from $75 billion in 1971 to an estimated $520 billion in 1982. The exposure of commercial banks to these countries, consisting of outstanding loans minus deposits, rose from practically none to more than $200 billion worth in 1984.

Gold and the Growth of International Debt

The Federal Reserve System spearheaded and orchestrated the expansion of international lending. Set free at last from the fetters of the gold standard, it created dollar reserves at dazzling rates. By 1978, dollar crises were seizing the international money markets and prices were soaring at double-digit rates. Most commercial banks welcomed the abundance of credit, which meant more bank loans and higher returns to them. As it is more profitable and convenient to place a few big loans with a few borrowers than to make many small loans to numerous borrowers, the big banks showered their favors on foreign governments all over the world. New York City banks preferred to lend to the governments of Poland, Mexico, Argentina, Brazil, Venezuela, Turkey, Zaire, etc. Eager to make friends and buy allies, the U.S. government encouraged and guided the banks every step of the way.

During the 1970s, the world dollar standard gave comfort and aid to those ideological and political forces that advocate the economic command system and favor redistribution of income and wealth. Unfortunately, neither the command system nor the transfer system is capable of achieving the desired objectives. To come to their rescue with loans and grants is to subsidize poor policies, maintain corrupt governments in power, and sustain the very system that is breeding the poverty.

U.S. grants and loans permitted corrupt governments to indulge in popular transfer programs consuming income and wealth at startling rates. American capital raised the levels of living in debtor countries and boosted the popularity of governments in power. It bailed out administrations that implemented destructive policies, and rewarded them with grants and loans in direct proportion to the evil they inflicted on the people. The Mexican government under Lopez Portillo ruined the peso, drove millions of poor Mexicans across the border and, in the end, confiscated the banks and their deposits, including some $4 billion of American money. This horrid record of willful destruction was set while mope than $80 billion of U.S. loan funds were propping up the Portillo regime.

Building Socialism with American Money

Throughout the world, U.S. funds were building socialism. American dollars provided by the U.S. government or commercial banks strengthened the position and authority of socialistic governments. American dollars financed the takeover of agriculture and industry by foreign governments; American dollars supported government enterprises that were hampering private enterprise. While American money built or rebuilt roads, railroads, public utilities and other government enterprises, socialism claimed the credit. With every new government project, people were led to believe: socialism is working, our glorious leaders are pointing the way.

Despite massive foreign aid, the Third World now languishes in depression and crisis. Having wasted billions of dollars on grandiose schemes to glorify government and make socialism work, dozens of governments are in default or are pleading for debt rescheduling. The shock of default is signaling an end to the wealth-transfer process from creditors to debtors, from capitalistic countries to socialistic and communistic countries. It is also signaling a new approach to money allocation under the dollar standard.

The Balance-of-Trade Deficit

Since the Mexican default and the payment rescheduling of loans to more than 50 countries, the new money created by the Federal Reserve has been made to benefit primarily the U.S. government and the American people. As the first recipients of new money, they have more funds than the rest of the world. They can indulge in massive deficit spending and withdraw more goods from the world market than they did before. Foreigners restricting their consumption must earn their share of the new money through exports to the United States. While Americans are enjoying huge balance-of-payment deficits, other countries, especially industrial countries in Europe and Asia, are suffering from chronic balance-of-payment surpluses. The imbalance signals the flow of dollar-standard money from the world monetary authority, the Federal Reserve System, to all corners of the world. That is the real meaning of the trade deficit.

Millions of Americans now are reaping the allocation gains of the world dollar standard. They are enjoying not only vast selections of foreign goods at bargain prices, but also the investment of surplus funds earned by foreigners. Foreign producers are earning dollar funds by shipping their goods to this country and investing the funds in anything striking their fancy, from U.S. Treasury bills to Texas ranches. After all, the action is here, the world money is printed here.

As consumers, most Americans are benefiting from the dollar standard; as producers and workers, many, unfortunately, are made to feel some painful effects. They are victimized by the cost and price structures of the system that prices them out of the market. Many Americans are unemployed because they fail to compete with foreign producers rushing their goods to American markets to earn U.S. dollars. No matter what other causes may contribute to their plight, the paper dollar standard is an important factor in our industrial depression and economic disintegration.

The greatest losses by far are suffered by the inhabitants of the "surplus" countries that faithfully continue, year after year, to ship the goods and receive the dollars. They are sitting on huge piles of depreciating dollars. In recent years, they have managed to invest them advantageously in U.S. markets, but no situation remains advantageous forever; American investments, too, may fail and inflict losses.

Massive foreign investments in the United States raise the question of American ability to pay; this creates no problems as long as foreigners are willing to accept more dollars, but what are we to do if they insist upon interest and capital repayment in the form of goods and services? What are they to do with dollar claims that are depreciating continually? The victims are under pressure to cut their losses and salvage what they can. The temptation to dump the dollars is getting stronger with every day of dollar depreciation. This is why this decade may see the end of the world dollar standard. Too many people have suffered grievous losses as a result of the dollar standard.

There are no world banking authorities that can prevent the conflict, nor can we expect the International Monetary Fund's system of Special Drawing Rights (SDRs), based on a collection of paper currencies and the monetary powers of several governments, to prevent the inevitable. In fact, such a composite currency would aggravate the world situation. A deep distrust of monetary authorities is spreading throughout the world. People are learning to distrust sweeping political promises that government will exert more discipline in its fiscal affairs in the future. That's why they are demanding real money, untouched by government and its agents.

Competing Currencies

Many economists favor an early separation of government and money. They advocate a "parallel standard" that would allow the free use of both government money (without legal tender quality) and gold, silver, or any other commodity. They work diligently to free all financial institutions from their present restrictions on the use of gold or silver in contracts, as media of payment, as financial assets, reserves, investments, etc. Obviously, they oppose any government fixing of exchange rates between fiat money and the precious metals, and any legal limitation of fiat money issue. They are longing to write contracts in gold and to conduct international trade and commerce with foreign partners who are free to enter gold contracts and sign gold clauses.

The essential element of this reform is freedom. U.S. currency must be freed from government monopoly. The Federal Reserve System must be abolished, and no one in government must be permitted to exert influence on money matters. If government suffers a budgetary deficit, it must raise the needed funds in the loan market, in competition with other borrowers.

Freedom of our currency is the fundamental issue; it is the keystone of a free society.

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THE CAUSES OF ECONOMIC DISINTEGRATION

To inquire into the causes of specific monetary policies is to search for the monetary theories that guide the policy makers. Ideas control the world, and monetary ideas shape monetary policies. Several distinct economic and monetary doctrines have combined their forces to give our age its inflationary characteristics. Some of these doctrines are as popular as they are fallacious. The notions that politicians must issue and manage money because the people are unfit to manage their own, that economic prosperity and expansion depend on the issue of more money, that gold and silver are in short supply, that economic depressions are caused by shortages of money, that inflation springs from individual greed and the desire for higher incomes and prices, that politicians and officials are valiant inflation fighters, and that the U.S. dollar has won its battle over gold are just a few of the widely accepted, yet entirely erroneous, notions that guide monetary policy.

Even some champions of private property and individual freedom want the government to manage money. They are convinced that money cannot be left to the "vagaries" of the market order, but must be controlled by government. Money must be supplied and regulated by government or its central bank. *That money should be free is almost inconceivable to us in the twentieth century.* We depend on government to mint coins, issue notes, define "legal tender," establish central banks, conduct monetary policy, and then manipulate the price level. In short, we wholly rely on government control over money. Unfortunately, our trust in a money monopoly invites monetary destruction and economic disintegration. Money is inflated, depreciated, and ultimately destroyed whenever politicians and officials hold monopolistic power over it.

Chapter 1
The Money Monopoly: The Federal Reserve System

Nearly everyone believes that a modern economy needs a central bank. A central bank, people argue, must "maintain stability of the price level," must "provide a growing economy with an elastic currency and credit system," and must "maintain the rate of investment at a level that assures full employment." A central bank monopoly is said to be needed because it affords discretionary regulatory powers, without which an economy cannot be directed toward the common good.

The Federal Reserve System, in its present manifestation, is the product of such an ideology. The seven governors who manage the System are vocal spokesmen for central bank power and privilege. They may disagree with members of the Congress and the administration about the person or persons who are to exercise authority and wield the power, but no one in government ever questions the rationale of monopolistic power over money and banking. It is most unwise to raise any question about the money monopoly.

Federal Reserve Independence

The Fed's commander in chief is the President of the United States; no one in the System can resist his wishes and suggestions. He has the power to direct its policies; he appoints the seven governors and designates the chairman and vice-chairman. It is obvious that this power of appointment affords the President the power to direct the course of monetary policies. If the President embraces "easy-money" notions, he can be expected to appoint only advocates of "easy money." He may also call on Congress to pass new monetary legislation. On more than one hundred occasions, Congress actually has amended the original Federal Reserve Act, often upon recommendation of the President. Moreover, the President's spokesmen in Congress may "question" the governors in public hearings, censure their policies, or even cast doubt on their motives until they recognize the error of their ways. This is why the Federal Reserve never

has been, nor possibly could have been, independent of the government that created it. On all crucial issues the System had to accede to the wishes of the President.

Surely, the Federal Reserve Board continues to enjoy some remnants of formal independence. Once a governor is appointed, he is free to cast his vote within the limits of Federal Reserve legislation and political consideration, but even this "independence" is under severe attack by reform forces in Congress. Recent reform proposals would require the President to make *public* recommendations for the governors to follow in the execution of monetary policy. Other proposals call for legislative guidelines that would circumscribe the actions of the System. Of course, the Board of Governors, like any other agency of government, vigorously opposes such shifting of power from itself to other arms of government. It is most eager to maintain and even enlarge its functions.

To many Federal Reserve observers, the chairman of the Board of Governors, who presides over the System, is the financial czar of American money and banking, the Caesar of the monetary world. In a certain sense, this may be true. Any individual who wields control over the American money and credit monopoly, and in that capacity manages the world monetary order, undoubtedly is the most powerful man on earth, but it is erroneous to conclude that the chairman of the Board of Governors is that person. Actually, his powers are purely derivative and are strictly limited by his persuasive abilities, like those of an advisor to the President. In the final analysis, all executive powers rest with the President of the United States and all legislative powers with the U.S. Congress. The Federal Reserve System is no exception to the rule.

Instability and Unemployment

At its beginning, the Federal Reserve System was intended merely to safeguard economic stability. According to the preamble to the Federal Reserve Act, it was "to furnish an elastic currency, to afford means of rediscounting commercial paper, and to establish a more effective supervision of banking in the United States."

More than seventy years have passed since the Act was voted into law on December 23, 1913. While many human institutions have grown old and faded away in seventy years, the Federal Reserve System has grown into a vigorous and destructive instrument of power. It came into existence as an institution that was to accommodate the needs of business, as a *passive* reserve bank that was to provide a flexible currency by issuing bank notes backed by commercial notes, drafts, and bills of exchange arising out of actual commercial transactions.

When the first two decades of the System became decades of unprecedented instability, when booms and busts alternated while the System faithfully accommodated the requirements of business, the Federal Reserve began to take the lead and *actively* create the money it wanted business to have. The market order is inherently unstable, the governors declared; it is in need of guidance and assistance through monetary planning and other governmental measures. The market order reveals inflationary and deflationary movements; it breeds stagnation and unemployment. The Federal Reserve System, which set out as a cooperative undertaking by the banks of the country to pool their reserves, thus developed into an institution that finds grievous fault with individual enterprise and the market order.

The Federal Reserve has made *full employment* one of its primary objectives. In Federal Reserve terminology, the System is "to help counteract inflationary and deflationary movements, and to share in creating conditions favorable to sustain high employment, stable values, growth of the country, and a rising level of consumption."* It takes its mandate from the Employment Act of 1946, which instructs all government agencies to pursue full employment as a primary government objective.

Ever active in the pursuit of government programs and policies, the System inflates or deflates, lowers or raises interest rates, always exercising discretionary power. There is no code of rules for it to follow, no regulator that forces the System to act in a predetermined way. At all times, it is expected to assist the U.S.

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* Board of Governors, *The Federal Reserve System, Purposes and Functions*, Washington, D.C., 1954, p. 1.

Treasury and act as its fiscal agent and lender of last resort.

Wielding three "instruments of control"—discounts, open market operations, and regulation of bank reserves—the System presides and exerts control over American money and banking. It holds the power over economic booms and recessions; the power to change the content of every deferred payment and to increase or decrease the real value of every bond, wage and profit; and the power to affect employment or unemployment. In fact, the Federal Reserve System is the most important tool in the armory of the political command system.

During the seventy years of its existence, the tool has grown from an institution that was intended to serve banks in times of crises to a central banking system that serves the federal government in the realization of its economic and social objectives. The growth of Federal Reserve powers reflects the growth of political power in the United States.

To avoid booms and busts, stagnation and unemployment, the Federal Reserve System would actually have to refrain from using its vast monetary powers. It would have to refrain from initiating the boom to avoid the bust. It could not use its statutory authorization to engage in open-market purchases, to lower member banks' reserve requirements arid to expand its discounts and advances. Each one of these measures creates additional reserves, on the basis of which the member banks embark on credit expansion of their own; credit expansion imparts uncertainty and instability.

Booms and depressions do not lie in the nature of the market system; they are imposed by governments and central banks expanding or contracting the stock of money and credit. Business cycles first made their appearance with the coming of the central banking and deposit system. They plagued England during the latter part of the eighteenth century, and then spread, always in conjunction with the development of central banking and fractional deposit banking, to Western Europe, North America, and Central, Southern and Eastern Europe. At the close of the nineteenth century, trade and commerce throughout the world were familiar with bank credit expansion and trade cycles.

In the mainstream ideology of our time, full employment and rising levels of consumption require occasional bursts of credit expansion, which are said to be "contra-cyclical" in nature. According to the Employment Act of 1946, "it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy to promote maximum employment, production, and purchasing power." When economic activity declines or begins to show signs of decline, the Federal Reserve is expected to expand credit and thereby prevent the decline. If economic activity nevertheless continues to falter, the Federal Reserve may be called upon to facilitate contra-cyclical expenditures by government. It may have to create the money for vast schemes of government spending on public works, doles, and other projects.

In every case the full-employment recipe calls for monetary expansion which, according to all principles of economics, is the root cause of instability. It is a disruptive and inflationary element in the private property order; it actively nourishes the transfer ideology and promotes the political command system.

In the Service of Government Financing

The Federal Reserve System was barely two years old when it underwent rapid changes in appearance, character, condition, and function. In 1917, it was drafted for the purpose of financing government expenditures for World War I, and it has served it faithfully ever since. It was forced to provide huge amounts of money smoothly and painlessly, to spare government from taxing the people more onerously or from borrowing the desired funds at higher interest rates. The monetary expansion, of course, led to an ominous depreciation of the U.S. dollar.

The Federal Reserve's new-found function brought forth applause and gratitude from politicians and officials. Unfortunately, there were no critics who described the Fed as a powerful engine of inflation working full speed for the government. No one pointed out that the Fed's basic objective was broadened significantly, and that the System was embarking upon the road to monetary destruction.

Nearly every government program requires massive expenditures that place a heavy financial burden on the public treasury. Government, at first, may merely seek to "redistribute" income and wealth. It may tax Peter to pay Paul, but this very convenient and popular method of redistribution is soon exhausted when it causes stagnation and unemployment. After all, capital, like labor, ceases to function properly when government seizes most of the return.

The ease with which the Federal Reserve System finances huge Treasury deficits has created illusions of grandeur. The American people have grown accustomed to vast Treasury deficits, and to Federal Reserve manipulations of money and credit to cover the deficits. For all practical purposes, the System is the agency through which the federal government has assumed complete control over money, and through which it clearly dominates the credit markets.

Most economists are greatly alarmed about the level of federal spending made possible by the System. Relating spending to saving, they deduce frightening consequences from an excess of spending over saving. Federal debt tripled during the 1970s and hit $1 trillion in 1981. In 1986, it will exceed the $2 trillion mark. With federal deficits running at more than $200 billion a year, the continuous operation of government depends on finding ever more buyers in the United States and abroad for that growing mountain of debt.

Unfortunately, economic income and wealth do not flow from a mountain of debt; they spring from savings and investments. As a person's material wealth, commonly called net worth, rises when income exceeds spending, and declines when spending exceeds income, so does national wealth vary with income and outgo. What is true for one individual is true for 23 million or 230 million individuals.

It is self-evident that an excess of national spending over saving tends to impoverish society, just as the excess of individual spending over saving tends to drain an individual. Economists call it "consumption of capital" or, in contemporary terminology, "de-capitalization of industry." It is observable in inefficient tools and equipment, antiquated shops and factories, and other worn out facilities. Soaring interest rates point at depleted and exhausted capital markets. The loss of productive capital obviously necessitates a reduction in labor income. Wage rates may decline in real terms. Workers may have to grant "give-backs," laboring longer hours for less pay and fewer fringe benefits.

The American people are not accustomed to deteriorating economic conditions. Although they themselves may favor the political transfer system as indicated by the elections, they may not appreciate its effects. With ever-increasing fervor, they may search for political recipes and prescriptions that promise more spending with more prosperity. Politics becomes ever more important, more acrimonious and divisive.

In reaction to the visible deterioration of the economic wellbeing of so many people, the administration in power can be expected to resort to desperate measures. In particular, it may call upon the Federal Reserve to substitute new money for the economic substance consumed, paper money for real savings, and paper credit for productive capital. Such substitutions constitute rampant inflation which, in the end, breeds hyperinflation. Although we know the economic effects of such a disaster, it is difficult to foresee its social and political effects.

The Central Bank of the World

In position, power, and function, the Federal Reserve System differs materially from all other central banks. When the U.S. dollar emerged as the primary international currency serving trade and commerce the world over, the Federal Reserve emerged as the central bank of the world. It already had acquired a leading position under the Bretton Woods system that had made the U.S. dollar the international reserve money, payable in gold at a price of $35 per ounce. When, in August 1971, President Nixon repudiated the Bretton Woods agreement, the world continued to use the U.S. dollar without its redeemability. After all, the world's merchants and bankers had grown accustomed to it. The dollar afforded access to the markets of the most productive country in the world, and its record of relative stability was one of the best in recent monetary history, despite its devaluations in 1934 and 1971. Above all, the official repudiation of gold created a void which no other fiat currency could possibly fill. It left the Federal Reserve dollar in the most prominent position for becoming the world medium of exchange and reserve asset.

The world desperately needs a common money that facilitates foreign trade and international transactions. For hundreds of years, gold served as the universal money uniting the world in peaceful cooperation and trade. Today, the U.S. dollar is called upon to assume the functions of gold, but in contrast to the gold standard, which was independent of any one government, the dollar standard depends completely upon the wisdom and discretion of the Federal Reserve System. That is, the world monetary standard now rests solely on the political forces that shape the monetary policies of a single country—the United States.

The U.S. dollar serves as the international monetary reserve currency and the leading exchange currency in international trade. It is the counting unit of all other currencies, and the unit of account for most commercial transactions and nearly all capital dealings in the world. Oil contracts are denominated in U.S. dollars. In countries with chronic inflation, it may even serve as an illegal substitute for the national currencies. Far from waning after the Bretton Woods system died, the U.S. dollar-thanks to the needs of world trade and commerce—is more important than before.

The international demand for dollars has given them extraordinary strength among world currencies, although they continue to depreciate in purchasing power. The central banks of OPEC countries, Western Europe and Japan are holding the bulk of their currency reserves in claims to U.S. dollars, primarily in U.S. Treasury securities. Purchasing Treasury bills, notes and bonds, they are financing substantial portions of federal budget deficits, which otherwise would have to be financed by the Federal Reserve. Were it not for these foreign loans, the stock of Federal Reserve money would probably be much larger and the rate of inflation much higher.

The global monetary order, hinging on the U.S. dollar and manipulated by the Federal Reserve System, makes the world economy an extension of the U.S. economy. When the Federal Reserve expands its credit to stimulate economic activity or just to finance the federal deficit, the effects resound all over the world. When it acts to tighten credit for any reason, the money markets of the world reverberate immediately. Within minutes, Federal Reserve actions are felt in London, Paris, Frankfort, Tokyo, and Hong Kong. No one designed the world dollar standard, no government created it, and no international agreement legalized it; it is the outgrowth of economic notions and doctrines that make government the guardian of the people's money and a central bank its manager.

A Vanguard of Socialism

The Federal Reserve System is even more than the world central bank. Since its modest beginning, it frequently has acted as the champion and vanguard of the political command system. Many of the amendments to the Federal Reserve Act, giving the System ever greater power for monetary expansion, were enacted upon the recommendations of the governors. In its annual reports, the Board frequently included a section recommending legislation for enactment by Congress. Only during the early years of the Roosevelt New Deal was the federal government at times more demanding in its legislation than was the Board in its recommendations, but even then, the federal government did not act without the Board's advice.

Today, the System is holding practically unlimited power of expansion, yet the Board is clamoring for more. It is pleading and insisting that it be granted permanent power to control the uses to which its credit may be put. In other words, it would like to manage the credit markets to channel the benefits of inflation and credit expansion towards its most favored debtor, the federal government.

The Federal Reserve is a financial information center. It distributes mountains of books, booklets and papers through many channels of communication and education. Most of its publications are available without charge. More than one million copies of its basic text on *The Federal Reserve System, Purposes and Functions** have been distributed since it first appeared in 1939. At least one copy has been placed in the hands of every economist, banker, and student of money and banking.

As can be expected, all the System's publications are attempts at apology and justification for its monetary policies. In periods of disastrous expansion, which are so numerous in the history of the System, the publications "explain" the governors' reasons for inflationary policies. In periods of contraction and depression, they lay the blame on speculators, foreigners, or other bystanders. Such misinformation has made the System an influential and potent defender of political power.

The Federal Reserve Act was probably the most tragic blunder ever committed by Congress. The day it was passed, old America died and a new era began. A new institution was born that was to cause, or greatly contribute to, the unprecedented economic instability in the decades to come. It fostered the formation and growth of pressure groups clamoring for government protection and compensation; obviously, individual enterprise was unreliable and old-fashioned, rendered obsolete by the command system. There cannot be any doubt that the Federal Reserve helped to usher in the era of regulation and control.

To a serious student of money and banking, the lesson from seventy years of Federal Reserve manipulation can be no other than this: the Federal Reserve System not only is a vital tool of political control over our lives, but also an implacable foe of the enterprise system and an influential *avant-garde* of the command system. This is why the champions of individual freedom will not rest until it has been abolished summarily.

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* Board of Governors, *The Federal Reserve System, Purposes and Functions* (Washington, D.C.: United States Government Printing Office, 1939).

Chapter 2
Compulsory Money: Legal Tender Laws

Evil acts are often linked one to another. The evil of inflation is linked to indigence and destitution, which are linked to social conflict and political strife. Inflation is an effect of politics, and in turn affects politics as an antagonist of order.

Politicians alone are accountable for inflation because only government, which is political authority, conducts monetary policy and orchestrates the credit markets. It may do so directly through legislation or regulation, or by means of a central bank that directs the monetary affairs. In the United States, inflation is a contrivance of the federal government, acting through the Federal Reserve System.

To be accountable for inflation does not imply that government is the origin and source of money. Government may seize money, monopolize it, depreciate it and destroy it, but not create it. Money always springs from man's need of a saleable good that can be readily traded for others. Man values and chooses one good over another, including the most marketable of all goods, money. His own interests lead him, without any prior contract, without government compulsion, and even without regard for the public well-being, to exchange his service or product for the most marketable commodity, which is money. Money springs from man's propensity to specialize and exchange his goods and services.

The value of the economic good used as money is subject to the same considerations as other goods. Individuals give it value because it is useful; it permits them, in the near or distant future, to acquire other goods. They value it because it has purchasing power, and it has purchasing power because people give it value.

This is circuitous reasoning, unless we realize the proper order of the value process. The exchange value of money is a function of people's subjective valuations; these are influenced by their recollection of past purchasing power which, in the end, can be traced back to the use-value of the monetary good. Without knowledge of the origin of its exchange value, but with full recollection of yesterday's purchasing power, people give money value according to their value scales. They may increase their cash holdings if the cash is more valuable than the economic goods offered in exchange, or they may reduce their cash holdings if the goods available in exchange are more valuable. Individual value changes affect the changes in purchasing power.

Government Power Over Money

Some people are satisfied with relatively small holdings, while others prefer to hold more cash. They all would like to hold a store of money with exchange power. Obviously, they would not want to hold anything that is expected to lose its power. They would quickly turn to another good and make it their money-if they were free.

Unfortunately, they are not. Government monopolizes money; government passes and enforces legal tender laws that deny the freedom of choice. It forces people to accept legal tender money if they want to be paid at all. Workers must accept it or forfeit their wages; merchants must accept it in exchange for merchandise or forfeit the purchase price.

The risk of forfeiture, which is the risk of expropriation by jurisdiction, forces them all to accept legal tender currency. It explains why some national currencies continue to function, after a fashion, although their governments are inflating them, year after year, at hundreds and even thousands of a percent.

The power to inflate rests on the monopoly power over money. An early step in this direction was the *government monopoly of the mint. To* secure possession of the precious metals used as coins, the sovereigns prohibited all private issues and established their own monopoly. Minting became a special prerogative of the sovereign power. Coins either carried the sovereigns' pictures or were stamped with their favorite emblems. Above all, their mints could charge any price for the coins they manufactured, or they could reduce the precious metal content of the coins, thus obtaining princely revenues through coin debasement. Once this prerogative of sovereignty was safely established, the right to clip, degrade, or debase the coinage was no longer questioned. It became a "crown right" that was one of the chief sources of revenue.

Government achieved full control over paper money with the passage of legal tender laws, which dictate to people what their legal money can be. Such laws are obviously meaningless and superfluous wherever the ordinary law of contract is respected. Where government wants to issue inferior coins or paper notes, it must use coercion in the form of legal tender legislation. It then can replace honest money with dishonest money, gold coins with fiat notes, and silver coins with money tokens; falsify the exchange ratios between both forms; and discharge its debt with fiat notes or make payment with tokens. In fact, once legal tender laws are enacted and enforced, debt repudiation through monetary depreciation becomes a common practice of government finance.

The courts afford no protection; they are utterly paralyzed in their defense and administration of justice once they accept legal tender laws. A debt of one million gold marks can be legally discharged with one million paper marks that buy less than one U.S. penny, and a government debt of fifty billion 1940-dollars can be paid or refunded with a 1985-dollar issue that is worth less than one tenth of the original value. With the blessings of the courts, millions of creditors can now be deprived of their rightful claims, and their property legally expropriated.

Legal tender legislation is one of the great evils of our time, the necessary basis of inflation and monetary destruction. It gnaws at the moral and economic foundations of economic society, largely because it is misunderstood and ignored. Mainstream economists are unaware of its problems and, therefore, do not discuss it.

Misleading Definitions

According to most dictionaries, legal tender is any kind of money which by law must be accepted when offered in payment of a debt expressed in the country's money unit. Such a legal definition shows no understanding of the moral implications and economic consequences of the principle of legal tender. A more meaningful definition that would reveal its ominous implications would read: "Legal tender is the legal obligation to accept Federal Reserve notes at their nominal value, no matter how much their purchasing power has fallen or is expected to fall," or "legal tender is the legal obligation, enforced by courts and police, of every creditor to accept Federal Reserve notes of uncertain and usually depreciating value."

The inscription, *"This note is legal tender for all debts, public and private, "* which appears on all Federal Reserve notes, should read: *"This note, regardless of its value, may be forced on anyone in settlement of all debts, public and private.* "Legal tender power is for the central bank what the power to tax is for the Internal Revenue Service. It embodies the power to force acceptance of its money, to impose fictitious value, and to seize property in exchange for depreciated money.

Legal tender coercion may take several forms:

1. Government may force its citizens to accept its notes at face value. It may repay or refund its dollar debt of a given value and purchasing power with dollars that are worth less. The courts always cooperate; they judge it proper and fair that the U.S. government, together with all other debtors, retire its 1955 debt with 1985 dollars that are worth only one fifth of the original purchasing power.

2. Government may establish an issue monopoly by outlawing competition in any form. The monopoly of government money, which drives out alternative currencies and prohibits alternative units of accounts, forces acceptance on anyone who participates in monetary exchanges. The issue monopoly is coercive in character and amounts to legal tender force.

3. Legal tender conceivably may be limited to the issuer only, which is the only honest and honorable tender force. This form corresponds to the general obligation to pay one's debt in full and to abstain from cheating and, defrauding others. If it were made applicable, the U.S. government

would have to accept payment in Federal Reserve notes at par, but could not force their acceptance on anyone else. To discharge its old debt, the U.S. government would have to compensate its creditors for losses suffered.

4. Legal tender quality may be given to gold and silver only, which gives rise to a commodity standard. When given to gold, legal tender quality brings forth a legal tender gold standard; when given to silver, a silver standard. Legal tender quality given to both metals at a fixed rate of exchange is bimetallism; depending on the exchange ratio, this brings forth either the gold standard or silver standard. When given to both, without a fixed rate of exchange, legal tender quality gives rise to a parallel standard in which both metals function as money.

To confer legal tender force on gold or silver is anomalous, superfluous, and potentially harmful. No honest money needs legal tender to be accepted in settlement of debt. Gold does not need to be made legal tender, nor does a currency with 100 percent gold reserve. Without the help of politicians and judges, gold would prevail over bad money. To make gold legal tender is to set a bad example, no matter how honorable the intention may be. It elevates the political apparatus to the status of regulator of economic affairs, and paves the way for legislation that creates forced currency and grants privileges of exclusiveness. Under conditions of changing metal value, making gold legal tender may even give rise to evils similar to those created with government money.

No Inflation Without Legal Tender

To declare paper money legal tender may be one of the greatest evils government may inflict upon its subjects. It confers terrible financial power on government-far greater, indeed, than the power to tax. It affects economic production and distribution, influences the formation of prices, and makes all private property easily accessible to government. Legal tender laws permit government to take income and wealth without the people's consent, usually even without their knowledge. In the end, it is bound to destroy the private-property economy.

Legal tender power permits government to finance vast budgetary deficits, to incur any expenditure, finance any program and project, and pay for wars and revolutions. The money monopoly, together with legal tender power, permits government to multiply its money virtually without limits, while the people may not even realize that government is engaged in multiplying it. It permits government to direct the people's frustration and anger toward businesses who dare to discount the money and charge higher prices. Legal tender legislation outlaws the price mechanism for currencies, the equivalent of breaking the thermometer that measures the fever.

There can be no inflation without legal tender legislation. If the people were free to use alternate moneys and accept depreciating paper only at its market rate, they would discount the paper in terms of the other moneys. Since Israel suffers from 1000 percent inflation per year, Israeli vendors would offer their goods at more stable dollar prices, while they would discount Israeli shekels and demand ever higher shekel prices. Since there is no other money permitted, they have no choice but to show prices only in depreciating shekel units. In popular terminology, this is called "inflation."

Only legal tender money can raise all prices. It permits government to force people to accept its monopoly money, to flood the market with it, and to raise all prices. The more money government issues, the higher prices tend to go. In a system of monetary freedom, in which government would be one of several currency issuers, the government might over-issue its notes, but could not raise all prices. Goods prices would remain virtually unchanged in terms of the other currencies; however, government money would soon be discounted and, in the end, be refused. In short order, a government that printed too much money would soon find itself out of the note-issuing business.

There are natural limits to the volume of monopoly money. Monopolistic legal-tender currencies conceivably could be issued in such large quantities that the human mind could no longer calculate simple prices. When a newspaper costs millions, billions and trillions of monopoly money units, its end comes in sight. When the social division of labor grinds to a halt for lack of honest money, legal tender legislation may give way to freedom of choice. Finally, the "law of cost," which stipulates that, ultimately, the value of paper money will be no greater than the cost of printing it, may call a halt to the monopoly money issue. The limit is near, indeed, when, as in the German hyperinflation in November 1923, the printing costs amounted to no less than 48 percent of the value of the newly printed notes.

In societies accustomed to civil obedience and submission to government authority, legal tender issues may run their full course of economic destruction; similarly, the death penalty and other inhuman penalties for legal-tender violations may widen the scope of monopoly-money issue. In societies with traditions of individual freedom and self-reliance, the scope of destruction may be much narrower. Many people are quick to escape and descend to the underground economy and use commodity money, in defiance of legal tender laws.

Legal Tender in the United States

The legal tender evil has come to the United States in periods of, and in the name of, national emergencies. Between 1775 and 1779 the Continental Congress issued some $241 million of currency to finance the Revolution. It did not itself declare the bills legal tender, but urged the states to give them legal tender standing. The states complied without demurring.

Depreciation of the Continental paper dollar set in as early as 1776. To derive any purchasing power from its issuance, the Congress printed Continental dollars faster and faster. Its first issue amounted to a mere $2 million of bills of credit; in 1779, government printing presses turned out $140 million. By 1780 the specie value of the Continental dollar had fallen to three cents, and was still declining. Congress resolved to print no more money, and to finance its expenditures by other means, only when the cost of printing notes was almost higher than their value. By that time, the people refused to accept any more Continental dollars, which in the end forced the states to repeal their legal tender laws.

During the Civil War, the Lincoln administration issued some $450 million of Treasury notes and granted them the quality of legal tender. A series of legal cases reached the Supreme Court between 1868 and 1870. The Court promptly ruled that legal tender provisions were unconstitutional. While more cases were pending, Congress raised the membership of the Supreme Court from seven to nine; President Grant, making the appointments, selected only those justices known to favor the constitutionality of legal tender, thereby creating a pre-established majority for legal tender. It was a foregone conclusion thereafter that the Court would uphold legal tender legislation.

In 1933, the federal government expropriated the people's gold coins and bestowed legal tender force on all Federal Reserve notes and U.S. Treasury currency. In every case brought before the Supreme Court, the justices confirmed the monetary powers claimed by government.

On June 5, 1933, a Joint Congressional Resolution voided gold clauses in all contracts, public and private. In 1935, the Supreme Court acclaimed and approved the Resolution. In the words of Chief Justice Hughes, "Parties cannot remove their transactions from the reach of dominant constitutional power by making contracts about them."* With a stroke of the pen, the Court permitted every debtor to defraud his creditors, and granted government the privilege of robbing its creditors under the pretext of paying them—all in the name of the Constitution.

Born in the passion and violence of national emergencies, legal tender compulsion now at last was to be anchored in the Constitution—by orders of five Supreme Court justices. Another day may come when five other justices will read the Constitution and arrive at a different conclusion.

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* Henry Mark Holzer, *Government's Money Monopoly* (New York: Books in Focus, 1981), p. 185.

II
FALSE SOLUTIONS: MANAGED MONEY

Economic policies are the product of economic ideas. This is true also in the sphere of monetary policy and the organization of the monetary system. The founders of the Federal Reserve System set out to reorganize the monetary order because they were convinced that the old order was deplorably deficient and in need of legislative revision. They were motivated by the age-old thought that the monetary order had to be tailored to the monetary needs of business.

In particular, they believed that commodity bills financing the actual sale of commodities were an ideal instrument for currency adjustment. They were convinced that the people's gold reserves had to be concentrated in a central bank and employed on central command like the army reserves in a decisive battle. Thus, they hoped, the American currency system would acquire the desired elasticity and stability so vividly described by many monetary writers.

After seventy years of money management, it is evident that the new system is more deficient than any other in history. It has given rise to unprecedented instability, and reduced the purchasing power of the U.S. dollar to a few pennies of its former value. It has bred inflation, which enriches some people and impoverishes others, thereby generating social conflict and strife. It is an affliction that is neither accidental nor the outcome of individual failure or malice. It is the end product of certain economic ideas that guided our legislators who designed the system, and of our monetary authorities who manage it.

Most Americans readily accept the current system because they accept the very notions and doctrines that gave it birth. They may not always agree with all its aspects and manifestations, nor willingly accept all its evil consequences; they may want to reform it through legislative additions or deletions, or simply impose guidelines that would make it function more efficiently and satisfactorily; however, they are convinced that they themselves, if they were the money czars, would manage it more efficiently and beneficently than all other czars.

To give "scientific" justification to their lofty claims, a host of contemporary economists have developed intricate theories, commonly known as the "new economics." Basically, they all ascribe to government the magic power of creating real wealth out of nothing, of raising the "national income" through the efforts of the central bank and its printing presses. They are unanimous in their condemnation of the gold standard, which to them means domination by "external forces" and denial of national independence in economic policies. Of course, the "independence" they so jealously uphold is tantamount to government control over money matters. They want "fiat money"; i.e., government money without restraint by a commodity such as gold.

John Maynard Keynes, the prophet of the "new economics," summarily rejected the gold standard for causing stagnation and unemployment. In his own words, "It is interesting to notice that the characteristic which has been traditionally supposed to render gold especially suitable for use as the standard of value, namely, its inelasticity of supply, turns out to be precisely the characteristic which is at the bottom of the trouble."

Keynes advocated a fiat standard with flexible exchange rates. According to the "Keynes Plan," the standard was to be coordinated by an international monetary authority. As head of the British delegation to the Bretton Woods conference in 1944, he was instrumental in the formation of the International Monetary Fund and the International Bank for Reconstruction and Development. His magnum opus, *The General Theory of Employment, Interest and Money,** was to become the starting point for modern macroeconomic theory and policy. It ushered in a "theoretical revolution" that was followed by a policy revolution, as governments the world over launched their full-employment programs.

Most critics of the Keynesian order readily accept its ideological foundation. They may disagree with the Keynesian structure, but they all agree with the master that they must guide the people and manage their money.

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* John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York: Harcourt, Brace & Company, 1936).

Chapter 3
The Monetarists

The most vocal critics of the Keynesian order are the monetarists whose home base is the University of Chicago, and its senior, Milton Friedman. The members of the school, who are called "monetarists" because of their emphasis on monetary factors, are strong advocates of the enterprise economy, but in contrast to a few critics who deplore the very nature of political interference and control, they stress the need for government to establish guideposts and guidelines for the private sector. They would like to provide a *framework* within which the free market is permitted to function. Their basic program of economic reform probably was summarized best by Henry C. Simons (1899-1946), the founder of the school, in his 1934 essay, *A Positive Program for Laissez Faire:*

- To provide an effective framework, Simons argued, government must eliminate all forms of monopolistic market power; in particular, it must break up oligopolistic corporations and apply the antitrust laws to labor unions. A federal incorporation law may be used to limit corporate size.
- Government must seek and promote equity and fairness through income tax reform.
- Government must limit waste by restricting advertising and other wasteful practices.
- And finally, government must establish "... more and adequate 'rules of the game' with respect to money, through

  1. Abolition of private deposit banking on the basis of fractional reserves
  2. Establishment of a completely homogeneous, national circulating medium, *and*
  3. Creation of a system under which a federal monetary authority has a direct and inescapable responsibility for controlling (not with broad discretionary powers, but under simple, definite rules laid down in legislation) the quantity (or, through quantity, the value) of effective

money."*

Milton Friedman is the best-known contemporary advocate of the Simons philosophy and the most vocal critic of the Keynesian doctrine. He directs his strongest criticism against the use of fiscal policy to stabilize the economy; instead, he would use monetary policy of the Simons type.

Professor Friedman argues that it is well-nigh impossible to counteract and offset the economic swings of the private sector with government spending and tax changes. We cannot dependably forecast the movements of the business cycle; even if we could, "there is likely to be a lag between the need for action and government recognition of the need for action and the taking of action; and a still further lag between the action and its effects."† The net result, according to Friedman, may actually be worse than the situation which the action was supposed to correct; government will always be late in its corrective action and, therefore, may turn the correction into further error.

To monetarists, monetary policy has far more potent effects than fiscal policy. To support their position, they point to the quantity theory of money, according to which the total quantity of money determines the general level of prices. They do not propose to make use of this knowledge by conducting active monetary policy. They want neither easy money to stimulate activity and achieve full employment, nor tight money to fight inflation. They favor *neutral* money that facilitates long-term economic growth. Professor Friedman favors a steady increase in the stock of money at a fixed annual rate, as a means of achieving economic growth and full employment.

To prove the point that instability in the monetary order is the primary cause of economic depressions, Professor Friedman, together with Anna Schwartz, studied the monetary history of

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* Henry C. Simons, "A Positive Program for Laissez Faire", *Economic Policy for a Free Society* (University of Chicago Press, 1948), p. 57.

† *Essays in Positive Economics* (Chicago: University of Chicago Press, 1953), p. 315.

the United States.* According to their findings, lack of monetary accommodations always generated depressions. Policy bungling by the Federal Reserve System first helped to bring on the Great Depression in 1930, and then prolonged it. If only the monetary system had been more stable, the economic system would have been stable as well.

Professor Friedman is convinced that, under present conditions, a major depression in the United States is almost inconceivable. Establishment of the Federal Deposit Insurance Corporation (FDIC) has made bank failures "almost a thing of the past." The phenomenal growth in government debt has made government liabilities an important part of bank assets, which afford greater stability to the stock of money and credit. Finally, Professor Friedman cites the "dethroning of gold," which "reduced the sensitivity of the stock of money to changes in external conditions." Economic activity has become more stable because of the "dethroning of gold"!

For ultimate stability, Mr. Friedman favors a fiat standard with a given percentage rate of monetary growth. Distrusting politicians and bureaucrats, he would make his plan an article of the U.S. Constitution. If he could enact it, the Twenty-eighth Amendment to the Constitution of the United States would read as follows: "Congress shall have the power to authorize non-interest bearing obligations of the government in the form of currency or book entries, provided that the total dollar amount outstanding increases by no more than five percent per year and no less than three percent."

False Solutions Build on Force

Monetarist conclusions are drawn and solutions are offered in the sphere of macroeconomics, in which the total money supply and a given velocity determine the price level. Monetarists call on government to take measures to stabilize the price level, and thereby cure the business cycle. In this respect,

* M. Friedman and A. Schwartz, *A Monetary History of the United States (1867-1960)* (National Bureau of Economic Research: Princeton University Press, 1963).

they are akin to the Keynesians who, too, seek knowledge from macroeconomic calculations, and pursue stabilization through government manipulation. However, while the Keynesians recommend compensatory fiscal policies, the monetarists realize the futility of continuous fine tuning, and, therefore, seek long-term stabilization through a steady three to five percent expansion of the money stock.

Obviously, such an expansion of the stock of money not only presumes the existence and employment of a monetary authority to expand the stock, but also relies on legal tender for forcing its acceptance at par. Without the use of force, the new issue would go to an immediate discount or even be refused. Moreover, the issue, no matter how large or small, would suffice to generate some mal-investments and mal-adjustments that later would necessitate readjustments, that is, recessions.

It is odd that monetarists, who are such staunch defenders of the market order, should call on politicians and bureaucrats to provide the most important economic good—money. Granted, monetarists do not trust them with discretionary powers, which leads Friedman to write a detailed prescription, a Constitutional Amendment; however, the Constitution is a supreme force, backed by courts and police. The amendment is a political formula to be adopted by political authorities and, when enacted, a constitutional prohibition of monetary freedom.

Issue of government money in the form of "non-interest bearing obligations" would not alter the nature of currency expansion; it merely would change its technique. The stock of these obligations is supposed to grow, year after year, without any obligation to repay, which changes their nature from being "obligations" to being mere government paper. The Friedman proposal would merely simplify the technique of money issue; instead of the Federal Reserve creating and lending its funds to the U.S. Treasury, earning an interest thereon and then returning the interest to the Treasury as "miscellaneous receipts," Friedman would have the Treasury issue non-interest bearing U.S. notes. This would save the U.S. Treasury the interest it is now paying, and eliminate the "miscellaneous receipts" the Treasury is now receiving.

Futile Search for Absolute Stability

In its frantic search for stability, the Friedman amendment, unfortunately, proceeds on the old road to nowhere. There is no absolute monetary stability, never has been, and never can be. Economic life is a process of perpetual change. People continually choose between alternatives, attaching ever-changing values to economic goods; therefore, the exchange ratios of their goods are forever adjusting. Since nothing is fixed, nothing can be measured. Economists searching for absolute stability and measurement are searching in vain, and they become disruptive and potentially harmful to the economic well-being of society when they call upon government to apply its force to achieve the unattainable.

Money is no yardstick of prices. It is subject to man's valuations and actions in the same way that all other economic goods are. Its subjective, as well as objective, exchange values continually fluctuate and, in turn, affect the exchange ratios of other goods at different times and to different extents. There is no true stability of money, whether it is fiat or commodity money. There is no fixed point or relationship in economic exchange.* Yet, despite this inherent instability of economic value and purchasing power, man is forever searching for a dependable medium of exchange.

The precious metals have served him well throughout the ages. Because of their natural qualities and their relative scarcity, both gold and silver were dependable media of exchange. They were marketable goods that gradually gained universal acceptance and employment in exchanges. They even could be used to serve as tools of economic calculation, since their quantities changed very slowly over time. This kept changes in their purchasing power at rates that could be disregarded in business accounting and bookkeeping. In this sense, we may speak of an *accounting stability* that permits acting man to compare the countless objects of his economic concern.

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* Ludwig von Mises, *Human Action* (Chicago: Henry Regnery Company, Third Revised Edition, 1963), p. 219.

Throughout the long history of money, a clamor for stability always arose when governments engaged in coin debasements and paper money inflation. Certainly the Romans yearned for monetary stability when their emperors resorted to every conceivable device of monetary depreciation. Medieval man longed for stability when his prince defrauded him by clipping, reducing or debasing the coins. And throughout the seventeenth and eighteenth centuries, the early Americans sought monetary stability when the colonial governments issued legal tender "bills of credit." They were dreaming of monetary stability during the Revolution when the Continental Congress issued vast quantities of Continental dollars until they became utterly worthless.

Hopes for monetary stability spring from a yearning for government to abstain from monetary depreciation. This is the only permissible meaning of our search for stability, which is as old as inflation itself. In our century, the search again has gained in intensity and urgency, as governments the world over are depreciating their currencies at dazzling rates.

Fiat Expansion Causes Economic Instability

Contrary to monetarist doctrine, an expansion of the money stock of three to five percent would suffice to generate the business cycle. Economic booms and busts occur in every case of fiat expansion, whether the expansion is one percent or hundreds of a percent. The magnitude of expansion does not negate its effects; it merely determines the severity of the maladjustment and necessary readjustment.

Even if most prices should decline while monetary authorities expand credit at a modest rate, the injection of fiat funds falsifies interest rates and thereby causes erroneous investment decisions. If the expansion should be directed at certain industries only, instead of being distributed widely over the loan market, the mal-adjustments would grow even worse in the industries thus favored. The inevitable recession that followed would be more painful yet.

Monetarists are quick to proclaim that business recessions in general, and the Great Depression in particular, are the result of monetary contraction. Mistaking symptoms for causes, they prescribe policies that would treat the symptoms; however, the prescription, which is re-inflation, tends to aggravate the maladjustments and delay the necessary readjustment.

The Friedman amendment, unfortunately, would cause the same economic and social conflicts as the present fiat system. It would create income and wealth with the stroke of a pen, and then distribute the booty to a long line of eager beneficiaries. The amendment would fix the quantity of issue, but the mode of its distribution, which confers favors and assigns losses, would be left to the discretion of the monetary authorities. It would enmesh them in ugly political battles about "credit redistribution," which soon would spill over to the halls of Congress, just as it does today.

The monetarists actually have no business cycle theory, merely a prescription for government to "hold it steady." From Irving Fisher to Milton Friedman the antidote for depressions has always been the same: re-inflation. The central banker who permits credit contraction is the culprit of it all. If there is a recession, he must issue more money, and if there is inflation, that is, rising price levels, he must slow the increase in the supply of money, but increase it nevertheless.

Professor Friedman himself seems to be aware of his lack of business cycle theory when he admits "little confidence in our knowledge of the transmission mechanism." He has no "engineering blueprint," but merely an "impressionistic representation" that monetary changes are "the key to major movements in money income." His "gap hypothesis," therefore, is designed to fill the gap of theory and allow for the time it takes for all adjustments to be corrected. He seeks to time the recession without explaining it.

Making Matters Worse

It is difficult to share Professor Friedman's great faith in the stabilizing power of the FDIC. In the final analysis, this power is nothing but the Federal Reserve's power to create new money. Surely, in a depression with massive credit contraction, FDIC reserves would be grossly inadequate to meet the demands of banks in difficulties-unless the money monopoly came to the rescue with legal tender power. Such a rescue, which would be tantamount to massive inflation, might "stabilize" the situation momentarily, but it would further depreciate the dollar, mislead business and, in the end, make matters worse.

The increasing importance of government obligations as bank assets gives great confidence to monetarists; however, it creates anxiety because government obligations merely are receipts for money spent and savings consumed. Every budgetary deficit that creates more government obligations consumes productive capital and thereby hampers economic production. The growing importance of government obligations in bank portfolios actually signals government consumption of economic substance and wealth. To commercial banks, it means the loss of real property securing the loans, and the addition of yet more government promises to tax, print and pay. A banking system built primarily on government IOUs is in a precarious condition.

What Professor Friedman calls the "dethroning" of gold was, in truth, the default of central banks to make good on their legal and contractual obligations. Following the example set by the United States on August 15, 1971, central banks all defaulted in their duty to redeem their currencies in gold. The default, unfortunately, did not bring stability and prosperity; it opened the gates for world-wide inflation. It made the U.S. dollar the world currency, elevated the Federal Reserve System to the world central bank, and inundated the world with U. S. dollars and Eurodollars.

The default in gold payments made international economic relations more vulnerable than ever before. It permitted the Federal Reserve System to initiate and orchestrate a worldwide expansion, with all its evil effects. Dozens of sovereign countries chose to default in their payment obligations, and many others may follow.

The monetarist doctrine of the built-in stabilizers is akin to the Keynesian recipe. Both are powerful forces for economic disruption.

Chapter 4
The Supply-Siders

In politics, the days we pass with new hopes and happy prospects are more numerous by far than those coming to fruition. With every new political election, hope offers an easy cure for our social and economic ailments. Yet our hopes prove mostly to be delusions that, in the end, leave us nothing but hope.

When Ronald Reagan moved into the White House, he brought with him a new breed of counselors, the supply-siders. They had a new vision of economic growth and prosperity for all, a new perception of a brighter future through tax reductions and return to a gold standard. It brought them great popularity, less so for the originality of their thinking than for the sympathy they showed for the prejudices of our time.

But no matter what we may think of their achievements and prospects for future success, supply-siders deserve our earnest consideration. They have brought new life to the stale atmosphere of economic discussion. After nearly fifty years of Keynesian orthodoxy, which built its tenets on the supremacy of demand and the importance of consumption, the supply-siders have rediscovered the importance of production. After many decades of multiplier and accelerator talk, after rampant inflation and economic stagnation, the debate at last has shifted to saving, investing and forming capital.

Most supply-siders are not trained economists. Guided by notions of popular economics, they readily accept the Keynesian framework. They are journalists, columnists and politicians waxing eloquent about aggregate supply and demand, and reflecting on actual and potential gross national product (GNP). Their frame of mind is holistic and collectivistic—just like that of their Keynesian counterparts; however, supply-siders are ever ready to use the mighty apparatus of government, which was created for redistributive ends, to promote their own GNP objectives. In particular, they promise a bigger economic pie and bigger slices for all.

In their debates with monetarists and fiscalists, supply-siders rarely argue their case on grounds of economic theory and political morality. Their promises always have political appeal; they give hope of higher productivity and greater efficiency that assure rising incomes and revenues for workers, investors, businessmen and beneficiaries of government handouts, from welfare to Medicare. They do not question the need for more social benefits through redistribution, but may resist such demands on grounds of "lack of funds." To the millions of beneficiaries of the transfer system, this argument never rings true; it implies a promise of greater redistribution in the future when more funds become available.

Supply-siders derive their popularity with the public and the press from their promises of tax cuts for all. Unfortunately, they obscure the fact that the real burden of government is not the weight of taxation, but the dead weight of government spending. Taxation is merely one of several methods of public finance. Tax reductions without spending reductions merely shift the burden of government from taxpayers to other victims.

It is conceivable, indeed, that a tax reduction for people with lower incomes shifts the burden of government to the loan market, where government crowds out business and consumes more capital. Budget deficits, thus financed, cause interest rates to rise, investments to decline, and economic conditions to deteriorate. A tax reduction benefiting corporations may be granted one year and rescinded the next; yet even if business taxes are reduced while government expenditures rise and deficits soar, government merely shifts its exactions to the loan market, depriving business of needed capital.

In every case, the tax reduction is a sham that may deceive the voters, but does not grant relief to business. Only a reduction in expenditures will reduce the burden of government, but that's a discussion which supply-siders diligently seek to avoid.

Price Rules for Gold

Supply-siders who were recruited from the ranks of Keynesians and monetarists share the Keynesian-monetarist concern about instability and stagnation, but a few also remember the golden days of the gold standard: low interest rates, stable money, economic stability and high rates of economic growth. They are convinced that a gold standard, together with lower business taxation, would recapture some of those characteristics and usher in a new era.

The gold standard they envision would be managed by the Federal Reserve System, especially its Open Market Committee. These friends of gold would love to manage the System; they would not change it, and surely would not abolish it. In fact, they do not even address the crucial problem of government control over money, the money monopoly and legal tender force, nor do they question the legality and advisability of the monetization of federal debt. They do not challenge federal spending and deficits, alleging that deficits do not matter. It is no surprise, then, that the U.S. government is suffering the largest deficits in history.

The school of supply-siders who favor a gold standard is led by eminent writers and politicians, such as Robert Mundell, Arthur Laffer, Jude Wanniski, and Congressman Jack Kemp. They all want the Federal Reserve to follow a "price rule," that is, to stabilize the value of the dollar by holding the price of gold at a certain point or within a certain range.

The Federal Reserve is to engage in open-market operations or adjust the discount rate to maintain the price of gold at a certain point or within a certain range. With a price rule of $300 to $400 an ounce, if the price approached $400, the Fed would contract its total volume of credit to exert downward pressures on the price of gold; when the price fell to $300, the Fed would expand credit and send the price of gold back up again. By stabilizing the gold price through credit expansion or contraction, all other prices would be stabilized in the end.

The supply-side scheme of price rules for gold is a derivation of Irving Fisher's scheme for stabilizing the purchasing power of money by way of a "commodity standard." However, while Professor Fisher (1867-1947) wished to retain redemption in gold, although no longer at a fixed weight of gold, most supply-siders have no such immediate intention. They would merely observe the price of gold, and then manage Federal Reserve credit in reaction to price changes.

In a sense, the gold price rule is akin also to the Keynesian formula of full employment and economic growth through contra-cyclical credit manipulation; however, Keynesian managers expand and contract always with an eye on several indexes, especially those of employment and economic growth. The task of supply-siders is much simpler; they merely need to watch the price of gold.

The monetarists may notice a kinship to supply-siders despite their heated debates. Both build their structures on the foundation of a money monopoly and legal tender force; both would try to stabilize economic life through currency adjustments. Monetarists seek stability by means of a steady rate of currency issue; supply-siders prefer a price rule that calls for prompt adjustments in the stock of money. Both seek price stability.

Supply-siders seem to be alone in their great naïveté about the Federal Reserve System's ability to hold the price of gold at any level. In 1934, after just ten years of Federal Reserve manipulation, the dollar was devalued from $^{1}/_{20.67}$ of an ounce of gold to $^{1}/_{35}$, which raised the price of gold from \$20.67 an ounce to \$35.00. The dollar has suffered two formal devaluations and countless "floating" devaluations since then, raising the price of gold from \$35 per ounce to more than \$300 today.

The System failed not for lack of good intentions or individual ability, but as a result of the rising popularity of inflation and its inebriating effects. A society that prefers fiat money over commodity money, that creates a money monopoly with legal tender power, that permits government to engage in deficit spending and that expects it to inflate the currency and create credit for the sake of employment and growth cannot stabilize anything, least of all the price of gold. It is naïve to believe that, under conditions of trillion dollar deficits during just one Presidential term of office, the System could hold the price of gold for more than a fleeting moment.

Robert Mundell

To its many advocates, supply-side economics simply is classical economic theory, updated to deal with modern central banking and progressive income taxation. Credit for its development usually is given to the Canadian economist, Robert Mundell, now at Columbia University, New York. His protégé, Arthur Laffer, later adorned supply-side theory with his celebrated Laffer curve. Both earned fame by pointing out the confusion among Keynesians and monetarists and their inability to explain the economic turbulence of the 1970s, and by correctly predicting world-wide inflation and economic stagnation after the collapse of the Bretton Woods system in 1971.

Professor Mundell takes issue with the influential monetary economists of our time—Keynes and Friedman—for their construction of closed-economy models and proposals. Both disregard the international interdependence of countries, and ignore the world monetary order based on gold. Both neglect the fact, Mundell charges, that gold continues to represent the principal monetary reserve of the world. Building on inconvertible paper standards, Keynesians favor an adjustable exchange-rate peg, and Friedman a floating exchange-rate system. Mundell would like to return to an international monetary structure similar to the Bretton Woods system of the 1950s and 1960s, but "without the dead-weight difficulties of under-devalued gold."

In form and design, the Mundell proposal is a Keynesian concoction with supply-side ingredients. The proposal is devoid of the beggar-thy-neighbor features of both the Keynesian and monetarist structures and, instead, seeks international cooperation and coordination; it is ever mindful of the important role gold has played in the past and must play again in the future; and it is anxious to reduce business taxation to spur economic growth. Keynes and Friedman entreat national governments to adopt and enforce their proposals; Professor Mundell urges all allied governments to organize, cooperate and coordinate their efforts on behalf of his proposal, which calls for more order and discipline. The U.S. government, in consultation with its allies, must stabilize the dollar price of gold in the range of $300 to $650; the West German government must fix the Deutsche Mark to the U.S. dollar in the range of DM1.80 to DM2.20; and others must fix their exchange rates to the dollar, using the balance of payments as a guide to appropriate monetary policy.

For the new gold standard to function efficiently, U. S. monetary authorities must allow the money base to increase or decrease with gold purchases and sales. Governments must coordinate interest rates "to prevent excessive disparities from developing between money market centers, and gales of hot money [from] disrupting confidence and purchasing parity relationships of exchange rates and price levels." Governments must embark upon "multilateral surveillance of the balances-of-payments problems and exchange-rate policies" and engage in "multilateral discussion of anti-inflation policies and unemployment-stagnation problems." Governments must provide for "programmed adjustment of dollar-gold portfolios of major reserve holders to encourage more expansive or restrictive monetary policies." To mitigate the business fluctuation, governments must employ "general budgetary policies and, if necessary, incomes policies with tax cuts and extra government expenditures to stimulate aggregate demand and reduce unemployment during recessions, and with budgetary surpluses to restrain aggregate spending in periods of inflationary boom." These first steps toward a managed gold standard, Professor Mundell assures us, would improve national economic management on a scale not experienced since Bretton Woods.*

Robert Mundell's faith in political wisdom and official astuteness is shared by few other economists; most are fully aware that government, acting alone or in cooperation with others, is exercise of power, no matter in what form, and application of naked force. It uses power, great or small, in all circumstances. Every point of the Mundell proposal calls for politicians to enlarge and government officials to enforce the power of government. Agents of government are to provide the money, stabilize it, fix exchange rates, adjust gold portfolios, stimulate aggregate demand, and, if necessary, apply income policies, that is, set prices and wages. The proposal envisions an

* Robert Mundell, *The Wall Street Journal*, September 30, (1981), p. 7.

international command system, coordinated and disciplined, the likes of which has never been seen in the free world.

Gold miners and their associates may welcome the Mundell proposal to issue a gold coinage (various fractions of an ounce) but they should not overlook the stated condition: the stabilized gold parity, which may never be met. The Mundellian monetary order would be as unpredictable and unstable as the unadulterated Keynesian order. It is even more political than the ordinary Keynesian order, which makes for more intervention and disruption.

The Mundellian monetary order would facilitate fiduciary credit expansion by commercial banks and other financial institutions, would tempt government to use the system for its own ends, and would have government officials set and coordinate interest rates. Once the business cycle had been launched, it would call upon government to manipulate aggregate demand, which would disrupt all markets and render economic activity even more unstable. Finally, whatever had not yet been unstabilized would be thoroughly disrupted by the imposition of police controls over prices and wages. With all such new factors of instability, it may be wise not to expect also "the stabilized gold parity" and promised issue of gold coins.

The Mundellian monetary order would be a festering source of social and political conflict. It would divide society into two antagonistic social classes: the regulators and the regulated, those who issue orders and those who must obey them. In international affairs, it would reaffirm the supremacy of U.S. officials in all matters of world finance, and confirm the servile role of all others. Professor Mundell seems to sense the great potential for international strife, which leads him to call for "an imaginative solution involving a world central bank... with assets of about $1 trillion." Unfortunately, he does not advise us whether the trillion is to be printed before or after the gold-price stabilization; surely, as a supply-sider, he would not want American taxpayers to shoulder this amount.

Arthur Laffer

Professor Arthur B. Laffer's proposal for the reinstatement of dollar convertibility is much less taxing, but more persuasive. He does not seek to lead the world, but merely to urge the United States to return to a pre-1933 standard. His *Reinstatement of the Dollar: The Blueprint*[*] describes how to effect the return with little disruption in financial and real markets. It provides for a transition period that permits gold, not the economy, to make the initial adjustment inherent in a return to a gold-based monetary system. It also allows for "safety valves" that would minimize the chances of major altercations in the gold market.

To return to gold convertibility, Laffer would prescribe a three-month preparatory period, during which the Federal Reserve System and the U.S. Treasury would remain completely inactive, so as not to disrupt the financial markets. At the end of this period, on the day of reform, the Federal Reserve would establish parity by making the average transaction price of gold in the London market the official value of the dollar and price of gold. Thereafter, it would stand ready to sell gold at a price 0.7 percent higher than the official price, and to purchase gold at a price 0.7 percent lower than the official price. Over time, the Federal Reserve would attempt to establish a gold reserve equal to 40 percent of its liabilities.

Federal Reserve monetary policy would hinge on this "target reserve quantity." Within a 25 percent band of this quantity, the monetary authority would have full discretion to pursue monetary policy, to conduct open market operations, to discount eligible paper, and even to intervene in the exchange market; however, if actual reserves should fall below or rise above the reserve band, the authority's policy discretion would be removed. The "outer points" would trigger a mandate for appropriate policy responses to restore equilibrium. If all the gold reserve protection measures should fail, all gold dollar conversion provisions would cease. The standard would be

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[*] Arthur B. Laffer, *Reinstatement of the Dollar: The Blueprint* (Rolling Hill Estates, Calif: A. B. Laffer Associates, February 29, 1980).

temporarily suspended, and the price of gold would be set free for a three-month adjustment period.

There is knowledge and wisdom in the Laffer blueprint for dollar convertibility. He knows the past and, therefore, easily gleans a warning for the future. He hopes to profit by and gain experience from past errors. Mindful of the Federal Reserve Act, a revolutionary piece of legislation in American banking history, Laffer sets out to build a new order on the old foundation. Unfortunately, he fails to reexamine this foundation to determine whether it was resting on the great principles and precepts of a free society.

He who has enough energy to build a new structure should go further and try to lay a new foundation. Arthur Laffer is reconciled to the old characteristics of the Federal Reserve System: its control over money and banking, its legal privileges that made it a money monopoly with legal tender power, and its enlistment in the service of government financing. He accepts these offensive features without question. This apparently also leads him to submit to the ideological forces that, in time, have weakened, eroded and ultimately destroyed the gold standard. His blueprint simply ignores the forces of destruction and redesigns the fallen structure. Surely, Professor Laffer could do more good by meeting and facing the forces than by ignoring them.

Jude Wanniski

The movement to lower taxes and return to gold received great impetus from the writings of Jude Wanniski, a former editor of the *Wall Street Journal* and founder of Polyconomics. His widely acclaimed book, *The Way the World Works,** which Professor Arthur Laffer praised as "the best book on economics ever written," achieved an overnight influence on contemporary economic and social thought. It is a popular reader in the suites of corporate executives as well as in the offices of Congress.

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* Jude Wanniski, *The Way the World Works* (New York: Simon and Schuster, 1978).

Mr. Wanniski's monetary heroes are Alexander Hamilton and Nicholas Biddle. Alexander Hamilton, in 1790, recommended to Congress the creation of a "national" bank that would serve both as a large-scale commercial bank and as a financial organ of the federal government. Nicolas Biddle, as president of the second Bank of the United States, taught us how to run a central bank: "Stop printing dollars when people show up with dollars demanding gold." The economy always had precisely the right amount of money.

The whole idea of a gold standard, which has not changed since Nicolas Biddle pointed the way, is to supply the proper quantity of money required for transaction purposes, Mr. Wanniski informs us. Surplus currency is taken to the bank and presented for redemption in gold; when individuals ask for money in exchange for gold, the administrators are expected to create it.

How plain and simple, yet so mysterious. Generations of economists failed to see the simple truth: the administrators of the national stock of money need merely to determine the money requirements, which can be ascertained easily by observing the people. When they redeem some of their money, they signal a surplus; when they buy currency for gold, they indicate a shortage. Obedience to this simple rule is guaranteed to maintain financial and economic stability, prevent painful disruptions, avoid contractions and depressions, and facilitate steady economic growth!

Actually, there is no given need of money for transaction purposes or any other end. A given quantity of money can render all the services money is expected to render. Some 175 years ago David Ricardo eloquently refuted the need argument: "If the quantity of gold or silver in the world employed as money were exceedingly small, or abundantly great. . .the variation in their quantity would have produced no other effect than to make the commodities for which they were exchanged comparatively dear or cheap. The smaller quantity of money would perform the functions of a circulating medium as well as the larger." *

* Piero Sraffa, ed. "The High Price of Bullion," Works, Vol. III,

Individual demand for money in any form always depends on the valuations, preferences, and choices of the individuals who are holding it. They are bidding for money, or are offering it, in accordance with their value judgments. People do react to changing conditions, and they themselves change. When they observe changes in government that may signal easy money and credit expansion, they may reduce their cash holdings; when they expect economic decline and depression, they may increase them.

Individuals may react in different ways. People with undaunted faith in government management of money may keep greater money reserves than people who have lost all faith in political money. Individual action and reaction to money cannot be measured or calculated, which explodes the notion of a money demand in a popular sense.

It is spurious to liken the demand for money to the public demand for a community swimming pool, the water level of which is kept constant by attentive managers operating the supply valves; yet even if there were a national money pool, it could not be converted to anything but paper. Today's newspapers (April 8, 1985) report that "currency in circulation," which means U.S. dollars in cash holdings, amounts to $179.556 billion, and the Treasury gold stock to $11.093 billion. If people behaved like molecules of water in a pool, they could be managed by gold administrators, but it is highly unlikely that millions of people could be regulated by a gold valve. For any reason, or no reason at all, they may rush to the gold redemption agency and withdraw $11.093 billion as fast as the administrators can hand it out. Mr. Wanniski's gold standard may last a few hours.

The Federal Reserve report on the money stock reveals M1 at $569.3 billion, M2 at $2.42 trillion, and M3 at $3.04 trillion. Surely, the owners of these forms of money must not be ignored; they, too, deserve the right to redeem their funds in gold. To forestall their rush into gold, the administrators may want to raise the price of gold from $42.22 an ounce, at which the U. S. Treasury is calculating it today, to $422.20 or even $4,222 an

(Cambridge: Cambridge University Press, 1951), p. 73.

ounce. However, even such a ninety or ninety-nine percent reduction in the gold value of the dollar would not remotely meet the potential demand for gold by people who, for a great variety of reasons, may run from government money.

Mr. Wanniski prefers not to touch on the issues of individual choices and actions; he is preoccupied with holistic notions of national demand for and supply of monopolistic money issued and managed by wise politicians and administrators. Nor does he care to search for any explanation of depression and unemployment other than taxation. He writes eloquently and convincingly about the ruinous effects of confiscatory tax, but he startles his readers with his abiding faith in political money.

Congressman Jack Kemp

Congressman Jack Kemp is one of the most prominent and articulate politicians who favor economic revitalization through tax cuts, reductions in the size and dominance of government, and return to honest money, the gold standard. His book *An American Renaissance: A Strategy for the 1980's** is a powerful indictment of excessive taxation and rampant inflation. Government would be more efficient and responsible, Kemp asserts, if it would create incentives rather than destroy them through taxation and regulation. He even would reduce excessive federal spending on the safety net of social programs, which does not entail removal of the net that protects the poor and weak; he would reduce the number of people who need it by providing more opportunities through real growth.

Mr. Kemp's concern about inflation leads him to the gold standard. Stabilization and reform must be international, he asserts, because "the United States cannot go it alone." The United States, together with all its trading partners, must convene a worldwide conference and reconstruct a stable international monetary order. A new international monetary agreement must improve upon the weakness which led to the breakup of the Bretton Woods system."

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* Jack Kemp, *An American Renaissance: A Strategy for the 1980's* (New York: Harper & Row, 1979).

In the monetary order, à la Kemp, the monetary standard serves as an "error signal" for the proper management of the people's money, "with the people of the country at the switch."* When government creates more money than, the people need for trade and commerce, they will want to exchange it for gold. When government produces too little, they will want to buy dollars for gold. By fixing money to gold, Mr. Kemp insists, "the dollar value of all other commodities is more or less fixed."†

Unfortunately, the Kemp reform plan goes astray where all supply-siders miss out. It would make government the creator and guardian of money, grant it monopolistic privilege, and give it legal tender power. It calls on government to, manage money according to a gold price rule established by government. Surely, faith and confidence impart a wondrous inspiration to their possessor; but we can no longer share his faith in a government that has broken our confidence innumerable times.

A man prone to depend on others to go along is mostly waiting for others to take the lead. If it is true, as Congressman Kemp asserts, that "the United States cannot go it alone" and must wait for others, assembled in worldwide conference, the American people may be condemned to wait from here to eternity. There is transcendent power in leadership; the United States can reform others by leading the way. It can offer a shining example to the world by setting its people free in all matters of money and credit; toward that end, no international conference would be needed.

Unfortunately, Mr. Kemp does not search for monetary freedom; he would like to build on the Bretton Woods system, which was the product of a 1944 conference of forty-four wartime governments assembled at Bretton Woods, New Hampshire, and of a 1971 reconstruction by an international conference at the Smithsonian Institute, Washington, DC. The Bretton Woods system was born of government longing for more money, and died from government indulging in rampant creation of money. President Nixon merely gave it the *coup de grâce* when he suspended gold payment.

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* *Ibid.*, p. 100.

† *Ibid.*, p. 114.

Chapter 5
Advocates of Social Credit

In a setting of ominous foreboding, it cannot be surprising that numerous writers are pressing for reformation of the monetary system. Under the name and pretense of reformation, they advance their proposals which, it often turns out, make matters worse. Reformation, in the world of reality, turns into deformation; while one defect is mended, two defects may be made. The reform proposals range from a return to sound money and the unadulterated gold standard, as it existed at times during the nineteenth century, to proposals for a world central bank that creates world money and doles it out to member governments.

One of the popular reform movements springs from the economics of neo-populism and builds on the foundation of the populist movement that flourished before the turn of the century. Its nineteenth-century spokesmen demanded principally the free and unlimited coinage of silver and the government ownership and operation of all railroad, telegraph, and telephone facilities. Contemporary neo-populism, particularly its monetary complement called the "social credit movement," is enormously popular among conservatives. Dozens of right-wing groups are promoting new versions of old causes: free and unlimited issue of paper money, and government ownership of all money and banking facilities. They all echo the old populist hatred of the "International Banking Conspiracy" (which frequently turns into the "International Jewish Banking Conspiracy").

Many right-wing groups are enamored of social credit ideas; they promote and publish books and pamphlets written by authors like Wickliffe B. Vennard, Congressman McFadden, Whitney Slocum, Major Douglas, Frederick Soddy, R. McNair Wilson, A. N. Field, Gertrude Coogan, and above all, Father Charles Coughlin. Several conservative politicians are known to favor social credit neo-populism. A few advocates of social credit try to make their teaching the only true "Christian" one.*

Wickliffe B. Vennard of Houston, Texas, is an effective spokesman of the movement. He holds forth on basic principles of Constitutional government, and promotes a monetary reform that is taken from the armory of radical inflationism. Its realization could have no effect other than the complete destruction of the American money and credit system.

The preliminary objective of Vennard's proposal, presented as a "joint resolution" to the legislatures of the states, is the nationalization of the Federal Reserve System. He would like the federal government formally and legally to own the System, but in spite of all the fuss and fury about ownership, the objective is rather empty and meaningless. In essence and substance, the Federal Reserve System is already the nationalized monetary arm of the federal government. It is true, the Federal Reserve Act of 1913 assigned the System's "stock" to the member banks, but this "stock" grants no right of ownership or policy control; the seven members of the governing body, the Board of Governors, are appointed by the U.S. President and approved by the Senate. From the beginning of the System, in 1914, to this very day, they have conducted money and credit policies in accordance with the wishes of Congress and, especially, the chief executive, the U.S. President.

Even if we were to consent to formal incorporation of the Federal Reserve money and credit system in the U.S. Treasury, on grounds that such formality would provide little change in substance, we must object strenuously to the rampant inflation the Vennardian system would inflict on us. Advocates of social credit would abolish interest payments on the national debt. Again and again they emphasize that their monetary system would have saved taxpayers hundreds of billions of dollars in interest, and now would save them more than $130 billion every year.

It is obvious that advocates of social credit are unaware of the

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* Gary North, *An Introduction to Christian Economics*, (Nutley, N.J.: The Craig Press, 1973) pp. 124-161.

first principles of money and interest. To cancel interest payments on any debt, government or private, is to destroy its value and the savings of its owners. The federal debt of some $1.738 trillion (April 3, 1985) is owned by millions of people who invested their savings in Treasury bills, notes and bonds; they deposited their money in commercial banks, and savings and loan associations, bought insurance from insurance companies, opened accounts with dealers and brokers, nonprofit institutions and pension funds, which in turn lent the funds to the U.S. government. To cancel interest payment on this debt is to destroy its value, bankrupt most of its owners, and deny any future credit to the bad debtor—the U.S. Government. It would produce an instant depression, the likes of which no one can imagine.

Owners of credit instruments that do not earn a return may want to liquidate their claims. The owners of $1.7 trillion in federal obligations may demand immediate repayment, which advocates of social credit are likely to meet with new cash fresh from federal printing presses. In fact, in a pamphlet prepared by Wickliffe B. Vennard and distributed by the Constitution Party, we are told about the benefits of an "interest-free currency." According to Vennard, "Had interest-free currency been used, as advocated by President Jackson, and constitutionally used by President Lincoln, instead of borrowing at interest, the U.S. Treasury would have $41 billion cash on hand *with no debt.*"

It is hard to imagine how anyone can so blithely ignore the effects of rampant inflation. Do advocates of social credit really believe that the U.S. government deficits of the last seventy years, of World Wars I and II, the Korean and Vietnam wars, and the transfer society from Kennedy to Reagan, should have been covered with an equal amount of brand new cash from the U.S. Treasury printing presses? The freshman student of economics learns that the most important factors in the valuation of any economic good are its utility and scarcity. To print another $1.7 trillion of Treasury notes or Federal Reserve notes and force the people to accept them would surely reduce their value. Is it possible that advocates of social credit are unaware of this most basic principle of economics?

Whenever the federal government spends more than it takes in, it has no alternative other than to raise its levies or to borrow the desired funds from those who have saved them. When government borrows the funds, it must pay for their use, for people will not lend their savings to the government, or any other commercial borrower, unless they receive interest in return.

When government increases its tax exactions in order to cover a deficit, it deprives taxpayers of the real goods and services; the same is true when it resorts to currency expansion, i.e. inflation, which is a tax on all money holders. It reduces the income and wealth of all owners of money and claims to money, while it enhances the purchasing power of the money issuer, the federal government. It is a deceitful and cruel tax, as it silently reduces the purchasing power of millions of fixed-income receivers, pensioners, widows, and other savers who own money or claims to money. It breeds economic and political radicalism among its millions of victims, and destroys the moral fiber of society. In the end, rampant inflation impoverishes everyone as it weakens the social division of labor and consumes business capital.

It can hardly be surprising that the social credit doctrines, so hostile to private property and individual investments, are also imbued with anti-Semitism. According to Vennard, among all the world movements aiming for world control, "Zionism is the daddy of them all, and it has absolute control over these other movements, whether or not the movements realize it."* He also states, "Our enemy was and is within—the international Zionists who steered our ships of state from Wall Street by means of money control." Such are the doctrines of radical statism, simpleminded, and yet so noxious. Individual liberty has another sound.

Public-spirited advocates of social credit, imbued with love of freedom and the values of Western civilization, should reassess their economic beliefs if they find themselves in total agreement with a resolute foe of their values: an agent of the Soviet Union.

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* Wickliffe B. Vennard, *The Federal Reserve Hoax*, 7th ed. (Boston: Meador Publishing Co., 1959), p. 119.

They should be aghast to hear themselves echo communist dogma and the Party line; unless the agent has changed, they themselves have embraced the communist dogma. Many advocates of social credit are articulate in their defense of American values and institutions, yet it can be shown beyond any reasonable doubt that some of their pronouncements sound like readings from a Soviet textbook. It can be demonstrated, in particular, that Marxian doctrines of money and banking have invaded American thinking, and swayed social credit thought.

In *The Fundamentals of Marxist Political Economy,*[*] by L. Leontyev and published in Moscow, American banking is described in familiar language:

> A few of the biggest banks advanced to the fore, as in industry. These banks accumulated huge money resources. In each of the principal capitalist countries three, four or five big banks came to dominate the entire banking system. The other banks were fully subordinated by these giants. The huge capital accumulated in the banks was invested in industry. This is how banks became co-owners of industrial enterprises and gained a say in their affairs.
>
> Giant banks became closely interlinked with monopoly associations in industry. As a rule, the same tycoons head big banks and industrial monopolies. Banking and industrial capital merge and form finance capital. That is why imperialism is also called the epoch of finance capital.
>
> In each capitalist country the key positions of the entire economic life are concentrated in the hands of a few of the richest industrial monopolists and bankers. They dispose of tremendous capital and lord it in the biggest industrial corporations and banks. The huge profits created by the labour of millions of workers flow into their bottomless safes. And he who rules economic life, rules the entire country. The destinies of any capitalist country are decided by a few of the biggest financial and industrial monopolists,

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[*] L. Leontyev, *The Fundamentals of Marxist Political Economy* (Moscow, U.S.S.R., 1965).

the omnipotent financial oligarchy.

When Marxist authors describe the fortunes of American industrialists, they can hardly be distinguished from contemporary American writers. The Leontyev description of the Rockefeller and Morgan wealth reads like a chapter in many American college textbooks:

> The Rockefellers are old kings. They own oil fields in the United States, Venezuela, Iran and Eastern Arabian countries. They are lords, and masters in various mining corporations, banks, railways, insurance companies and very many other enterprises. The control of the Rockefellers extends to enterprises with a total value exceeding $60,000 million.
>
> The powerful house of Morgan is a rival of the Rockefellers. These are the steel kings. The possessions of the Morgans extend to banks and insurance companies, railways, public utilities and many other enterprises. The wealth controlled by the house of Morgan exceeds $65,000 million.
>
> The Rockefellers and the Morgans are the biggest financial groups in the United States. Together with six other large financial groups they control banking, industrial, insurance, railway and other establishments valued at more than $218,000 million. This is more than one fourth of the resources of all the corporations in the United States.*

In his *Imperialism, the Highest Stage of Capitalism,* V I. Lenin, the Russian revolutionist and first premier of U.S.S.R., described capitalist banking:

> Finance capital, concentrated in a few hands and exercising a virtual monopoly, exacts enormous and ever-increasing profits from the floating of companies, issue of stock, state loans, etc., strengthens the domination of the financial oligarchy and levies tribute upon the whole of

* Leontyev, op. cit, p. 78.

society for the benefit of monopolists.*

In his 1917 essay, *The Proletariat and the Party on the Road to October,* Lenin promised the prompt nationalization of all banks in case of communist takeover. "We did not propose nor could anybody have proposed, anything but the *immediate* establishment of control over the trusts, the banks, trade, the *parasites,* and over foodstuffs."†

And finally, Karl Marx, the ideological father of them all, recommended a central bank in Point Five of his *Communist Manifesto,* first published in 1848. The Communist State was to be realized through government measures that achieve "centralization of credit in the hands of the Federal Government, by means of a central bank with government capital and an exclusive monopoly."

It is indicative of the incredible confusion among many Americans, and especially advocates of social credit, that they echo the Marxian and Leninist lines while professing to defend American values. They denounce the large fortunes of our eminent industrialists, blithely ignoring that these fortunes consist of productive capital employed in the service of millions of consumers and managed far more efficiently by their owners than by politicians and bureaucrats. They attack our bankers and stockbrokers, totally unaware of the paramount importance of free capital markets that channel the peoples' savings to the most productive uses, rather than to politicians and bureaucrats. They clamor for centralization of currency and credit in the hands of a government-owned central bank, although such centralization constitutes the cornerstone of a command system.

* V. I. Lenin, *Selected Works* (New York: International Publishers, 1960), Vol. V, p. 47.

† *Ibid.*, Vol. VI, p. 142.

III
TERMINATING THE MONEY MONOPOLY

To facilitate trade and social cooperation, societies need a reliable and honest medium of exchange. This is why, from the beginning of time, they have searched for such a medium among a great variety of economic goods, from cattle and corn to powder and shot. When gold and silver proved to be most marketable, they sought to standardize coins for purposes of convenience and order. Unfortunately, the quest for order brought forth the political lord who, in urgent need of revenue, seized the power over the mint and made it an important source of revenue.

The history of Western society is a long register of the struggle between the individual longing to be free and the political lord insisting on sovereignty and order. The struggle over money must be seen as an integral part of this fateful confrontation. Where people seek liberty, self-determination and self-government, they seek to regain their freedom of money or, at least, to force government to be honest in monetary matters. They may lead government to adopt an unadulterated gold or silver standard.

The classical economists gave the world a new perspective on economic life and ushered in an age of individual freedom and enterprise. They succeeded in imparting honesty to money matters but, unfortunately, failed to remove government entirely from the people's money. In retrospect, the classical economists proved to be naive in their trust of politicians. They looked upon the costs of a metallic currency—the gold coin standard—as a waste, which the gold bullion standard was said to reduce. They blithely assumed that no government of a civilized nation would exploit such a standard for inflationary objectives.

David Ricardo, perhaps the most influential English economist of the nineteenth century, placed his trust in the hands of commissioners who "not removable from their official situation but by a vote of one or both Houses of Parliament," would issue paper money. "Five commissioners shall be appointed, in whom the full power of issuing all the paper money of the country shall be exclusively vested."*

Many contemporary economists still echo this particular train of thought. While we may understand the naïveté of classical economists, who had never experienced hyper-inflations and devaluations in England, modern economists cannot be exculpated so easily. They should be aware of the warning by William Graham Sumner, the great Yale economist of the pre-Federal Reserve era:

> Scheme after scheme has been proposed and tried for realizing the gain which it was believed that cheap money could produce for the public; that is, for those who buy and use currency. This gain has been pursued as the alchemists pursued the philosopher's stone, by trial and failure. Whether there be any such gain or not, our attempts to win it have all failed, and they have cost us, in each generation, more than a purely specie currency would have cost, if each generation had had to buy it anew.... The revulsions to which the system was subject overwhelmed us in every decade. The notions on which the system was based are proved to have been delusions, disastrous to everybody concerned, including those who tried to profit by them.†

To return to sound money is to return to free money, free from any infringements by politicians and bureaucrats. Monetary freedom, like all other economic freedoms, clears the way for energy, intellect and virtue. However, it is an unfortunate fact that most Americans are no longer seeking freedom; they are surrendering their inalienable rights to politicians and government officials who promise comfort and security.

It may be a maxim of economics that government, which is the political apparatus of coercion, cannot improve economic

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* David Ricardo, "Plan for the Establishment of a National Bank," *Works,* Vol. IV., ed. Piero Sraffa (Cambridge University Press, 1951), p. 285.

† William Graham Sumner, "History of Banking in the U.S.," *The Journal of Commerce and Commercial Bulletin,* 1896, p. 472.

conditions by hampering productive efforts. Political control weakens individual self-reliance and energy, causes want and poverty and, in the end, breeds tyranny and oppression. In matters of money and banking, political control leads to government creation of monopolistic rights—in particular, to a central bank with legal tender powers and monopolistic privileges. It gives rise to a money and banking monopoly resting on legislation, jurisdiction and police enforcement. Obviously, such a monopoly differs fundamentally and diametrically from the phantom of monopoly depicted by Marxist writers. The former rests on brute police power; the latter springs from the fertile imagination of Marxist writers who know little about the private property order.

Chapter 6
The Gold Standard

The gold standard, in its broadest sense, is a monetary system that uses gold as the primary medium of exchange. It was the monetary standard of the Western world throughout the ages, from Philip II of Macedonia in the fourth century B.C. to the United States of the twentieth century. It was paramount in the Byzantine and Arab empires, and in the great commercial republics of Italy during the thirteenth century and thereafter.

In a narrower sense, the gold standard is a legal-tender system in which government makes a fixed weight of gold the standard money unit. Under this standard, the U.S. dollar was a piece of gold of a certain weight and fineness, with free coinage, free melting and free movement of gold. It was a *gold coin standard* that put gold coins in the cash holdings of the people, along with bank notes, checkbook money, and fractional coins. They all were money substitutes, payable on demand in gold coins.

The virtues of the classical gold standard were twofold:

1) It limited the power of government to inflate the stock of money and thus depreciate monetary purchasing power. The supply of gold remained unrelated to the needs of government and the presumed needs of business. It depended instead on the costs of mining, refining and processing, which effectively limited the quantity of newly mined gold coming to the market.

2) The classical gold standard united the world in one monetary system, facilitating world-wide division of labor and growth of the world economy. With national currencies representing fixed quantities of gold, it gave certainty and stability to exchange rates. It created international capital markets, and encouraged the exportation of European capital to all corners of the world, bringing economic life to many backward areas.

Mutilation and Destruction

Deterioration of the gold standard set in when, early in this century, governments began to restrict the actual use of gold, and hoard it in their treasuries or central banks. They gradually established the gold bullion standard, which introduced the people to paper money. Gold coins were withdrawn from cash holdings and replaced by national currency that was no longer redeemable in gold coins, but only in large, expensive gold bars. The gold bullion standard, in effect, prevented redemption by most people, limiting it to a few specialists in international trade and finance. During the early decades of this century, many countries had standards of this type.

The gold standard system was weakened further by the advent of the gold exchange standard. Some governments preferred to hold their country's gold reserves in foreign claims to gold rather than in actual gold. They were buying and selling foreign currencies that continued to be redeemable in gold coin or gold bullion at rates reflecting the legal parity. A few central banks thus accumulated the world's monetary gold and became the reserve banks of the world.

After World War II, the Bank of England and the U.S. Federal Reserve System controlled most of the world's monetary reserves. More than sixty nations were holding their reserves in pound sterling claims to gold, forming the sterling area. Some twenty nations, mainly in Latin America, belonged to the dollar area; however, the Bank of England was holding most of its reserves in dollar claims to gold. This made the Federal Reserve System the ultimate reserve bank of the world, and the gold exchange standard a *de facto* dollar exchange standard.

During the 1950s and 1960s, several monetary crises and runs from the British pound triggered world-wide demands for dollar redemption. These demands greatly depleted the American stock of gold, and created precarious payment situations. During the crisis of March 1968, most governments joined the British government in blunting the gold exchange standard even further. They introduced the "two-tier system" that called for gold payment among governments and central banks and summary denial of all private claims for redemption in gold. At the same time, President Johnson persuaded the Congress to remove the requirement that one fourth of U.S. currency be backed by gold.

The final repudiation was performed by President Nixon on August 15, 1971, when he suspended ill U.S. gold payments. Notwithstanding the international agreement on the resumption of gold payments reached it the Smithsonian Institute a few weeks later, which he called "the most important monetary agreement in the history of the world," the U.S. government chose to repudiate all gold claims. Thus ended the gold exchange standard and begin the world dollar standard.

The demise of the gold standard in its most insipid and feeble form ushered in the age of irredeemable legal-tender piper money, which is a product of politics under the guiding influence of public opinion. It is synonymous with the age of inflation and monetary depreciation. Every national currency is filling nearly continually; all have been devalued officially, and several replaced with new issues that are depreciating again. The paper standard is self-destructive.

Natural Qualities of Gold

The gold standard will return as soon as people realize that honesty is the best policy. As hope of ill gain is the beginning of the fiat standard, so is honesty the mother of the gold standard. The gold standard is as old as civilization. Throughout the ages, the gold standard emerged again and again because man needed a dependable medium of exchange. Gold provided such a medium. It was the most marketable good that gradually gained universal employment—and thus became money. Its natural qualities, i.e., its use for the manufacture of ornaments and jewelry, its easy divisibility, great durability, storability and transportability, made this precious metal well suited to serve is money.

Gold is more marketable than any other economic good. As economizers, we like to carry a reserve in the form of gold—coins, nuggets, bullion, gold ornaments and plate—because it is readily saleable and acceptable in trade. It can be exchanged easily on the markets for other goods, and can be hoarded for exchange at a later date. It can be readily sold in small quantities or larger sums without much difference in price, to individuals of all races and nationalities. Every individual is a potential buyer, although he may not need the gold. It may be added to the store of personal wealth, and passed from generation to generation as an object of family wealth. There is no other economic good as marketable as gold.

Gold is an abundant commodity, accumulated for more than two millennia, unessential for consumption and, therefore, available to serve as money. Existing supplies of gold, in the form of coins, jewelry, decoration and plated coating, are greater by far than annual production or consumption; this makes annual additions of gold through new mining rather unimportant. This characteristic of gold, in which it differs from all other metals, removes the risk of sudden changes in quantity that would affect its value.

Governments throughout the ages have sought to amass gold in their treasuries because it meant wealth and power. Yet its use as a medium of exchange has caused it to be diffused with the passage of time. In contrast, platinum, palladium and other precious metals are industrial metals in the possession of dealers and producers, which limits their marketability and deters their use as money. Even silver cannot compete effectively with gold because its current production, relative to its visible supplies, is large, exposing its value to sudden changes in quantity. No other metal has such large stockpiles and small current production as gold. No other commodity enjoys as much universal acceptability and marketability as gold. It is naïve to believe that irredeemable paper based on the debt of legal-tender governments could ever acquire the universal marketability and take the place of gold.

No one had to make the gold standard work as an international system; it evolved without intergovernmental treaties and institutions. When the trading countries had adopted gold as their currency, the world had an international money. True, the coins bore different names and had different weights; this hardly mattered as long as they consisted of gold and could be exchanged freely. An ounce of gold is an ounce of gold, whether it consists of guineas, sovereigns or eagles.

An International Standard

The gold standard was a world standard, facilitating international trade and investment. It encouraged countries to specialize in the production of those goods in which they enjoyed the greatest advantage, thus raising labor productivity and levels of living. Moreover, it permitted and encouraged exportation of capital from the industrial countries to backward areas, from London and Paris to New York and Buenos Aires. In search of profitable employment opportunities on all continents, European capital built commerce and industry, and thereby improved the living conditions of people around the globe.

Countries on a gold standard suffered no balance-of-payments problems, no shortages of money, no currency crises. Exchange rates of bank notes, bills of exchange and acceptance, moved between two definite points: the gold import and export points, which were determined by the costs of transport and gold delivery. When the use of gold was less expensive than foreign exchange, debtors preferred to ship gold rather than drafts and acceptances to settle a foreign debt. Gold would enter a country when foreign debtors would prefer to ship gold to buying exchange. They would prefer to ship gold if their own currency was inflated and depreciated, or if gold itself were coming to the market from new mining.

The gold production that followed the discovery of gold in California (1849) was probably the greatest the world had witnessed heretofore, which caused the United States to suffer large exports of gold. During the 1850s and 1860s, large quantities of California gold entered the markets, and even larger quantities of greenbacks took the place of gold. The reasons for the outflow of gold were well understood: the growing quantities of money in individual cash holdings.

Under the gold standard, commercial banks and central banks kept their currencies at par with gold and foreign exchange through unconditional redemption. At the parity rate, they bought any amount of gold against domestic banknotes and deposit currency. They sold without discrimination at the parity rate. The gold standard thus provided trusted national currencies that were mere money substitutes for the world medium: gold.

Creation of Freedom

Monetary freedom can be expected to give rise to the gold standard and private gold coinage. From colonial times until the middle of the nineteenth century, Americans used gold coins struck by private mints. The Chalmers Shilling, issued by a goldsmith of Annapolis, Md., in 1783, was freely used by the founding fathers. The ten-dollar pieces coined in 1830 and later by the mint of Templeton Reid of Georgia, containing gold valued at $10.06, widely circulated throughout the South. Another mint in Rutherfordton, North Carolina, issued some $2.2 million of gold coins. In fact, an 1851 U.S. Mint report speaks of twenty-seven different kinds of gold coins issued by fifteen private mints. This number even increased thereafter, when numerous private mints in California issued fine gold coins bearing the names of the manufacturer. Business transactions were conducted in these coins, which also served to redeem money substitutes, such as bank notes and deposits. Redemption on demand kept them at par with gold.

In freedom, the gold standard is a gold coin standard that is utterly independent of government. It is true, it cannot achieve the unattainable ideal of an absolutely stable currency. There is no such thing as stability and unchangeability of purchasing power, but the gold standard protects the monetary system from the influence of governments, as the quantity of gold is utterly independent of the wishes and manipulations of government officials and politicians, parties and pressure groups. There are no "rules of the game," no arbitrary rules which people must learn to observe. It is a social institution that is controlled by inexorable economic law.

The issuers of money substitutes, whether private or public, keep their currencies at par with gold through unconditional redemption. A note-issuing bank buys any amount of gold against its currency or deposits at the parity rate, and sells indiscriminately and on demand any amount of gold against its notes or deposits. It thereby renders no national service, nor "defends" nor "protects" its currency. It merely fulfills the contract it made when it issued the money substitutes.

Under the gold coin standard, inflationary policies are not rendered impossible, but made difficult. Redemption demands and the threat of drains of their gold reserves would restrain the issuers of money substitutes from inflationary expansion. Any such expansion would alarm the owners of substitutes and cause them to demand redemption in gold coin, which would spell ruin to the issuer.

Chapter 7
Beyond The Gold Standard

The age of inflation is rooted in illusion, which promises employment and growth, income and wealth with just another spin of the printing press. It will draw to a close when we return to explanations that are true, rather than pleasing. That day will come as soon as the American people grow weary of booms and busts, depreciations and devaluations. At that time, they will listen to the story of gold—and be utterly confused by the great number of standard varieties and proposals.

Most reform recommendations are vague in their objectives. The vagueness lends appeal and strength to the gold movement, which concentrates its attention on the failings of the present monetary order, rather than on concrete features of a gold standard. A few proposals are very clear in their objectives and the measures to be taken, but whether vague or clear, nearly all proposals call on the federal government to conduct a reform and enact a new monetary order based on gold.

Most reform advocates would like to restore the gold standard as it existed at a given moment in history. Some would return to the gold coin standard of the pre-Federal Reserve era, when the gold dollar was the basic currency unit and the Treasury gold reserve the pillar of the currency system. Some would lead us to the standard of the 1920s, under which the new Federal Reserve System sought to manage and neutralize the gold coming from abroad by issuing gold certificates instead of reserve notes. Some would restore the standard of the 1930s, when the Federal Reserve Board received much control over member bank credit and centralized authority and responsibility within the System. Some would be content with returning to the Bretton Woods system, which made the U.S. dollar the kingpin of national currencies and placed it on a foundation of gold.

A few economists are eager to break new ground and move on to a new monetary order based on gold. They, in turn, hold to a great variety of opinions on the proper relationship between the quantity of money and the quantity of gold. At one extreme, some favor a standard of one hundred percent with a rigid one-to-one relationship. At the other extreme, some envision a small fractional gold reserve and a flexible relationship managed by monetary authorities.

Some favor the gold standard to avoid monetary management; others want it as a guidepost for managers. Some favor the use of gold coins; others would be content with redeemability in gold bullion. Some would impose reserve requirements on banks; others would subject them to no special conditions. Some would limit or even prohibit the issue of money by government; others would impose no special limitation on government. However, they all agree that the issuer must be honest, that he must honor his commitment to pay a certain quantity of gold. He must not "devalue" his obligation; the gold content of his money must be inviolate.

One of the most sagacious monetary thinkers is Nobel Laureate F A. Hayek. Coming a long way from his earlier acquiescence in legal tender and ready acceptance of central banking, he now proposes a "denationalization" of money. In the classic tradition of Adam Smith, he argues that government monopoly of money is destabilizing economic life and breeding inflation. It is permitting government to inflate its own expenditures and generate business cycles. Trying to take money out of politics, Hayek searches for the solution in the self-interest of monetary associations that would suffer economic repercussion if they failed to supply satisfactory media of exchange. It is a revolutionary proposal that would replace government control of money with freedom of choice, and the central bank with competing private issuers in the market.

Hayek finds grievous fault with the gold standard, and yet manages to defend it. "Though gold is an anchor," he argues, "and any anchor is better than a money left to the discretion of government—it is a very wobbly anchor. It certainly could not bear the strain if the majority of countries tried to run their own gold standards. There just is not enough gold about." Further below, he speaks for the gold standard under certain conditions. "I still believe that, *so long as the management of money is in the hands of government,* the gold standard with all its imperfections is the only tolerable safe system. But we certainly can do better than that, though not through government."*

What Hayek has in mind is a standard kept constant, but not fixed, by competing private issuers who, from the outset, would announce the collection of commodity prices in terms of which they would keep their moneys constant. In international money markets, a few note-issuing banks "might continue to try and refine the precise composition of the standard 'basket' of commodities whose price they tried to keep constant in their currency."† Professor Hayek obviously is building his "concurrent" currency system on his "commodity reserve currency" of earlier years.

Joe Cobb and James U. Blanchard III, who are the moving forces of the U.S. Choice in Currency Commission, build their case on the desirability of competition in money and banking. Competition in financial services and deregulation of banking, they argue, are moving forward rapidly, but we must now proceed to the next phase: a competitive environment for the Federal Reserve System. We need competition in currency.

The Currency Commission envisions the competition to come from a second currency, the "Gold Eagle," which was the recommendation of the U.S. Gold Commission to Congress. It induced the friends of gold in both houses of Congress to introduce The American Gold Eagle Coin Act (H.R. 1663 and S. 42), calling for a new gold coinage to compete with the Krugerrand in the domestic market. There would be no fixed price between Federal Reserve notes and Gold Eagle coins, no official exchange rate. The U.S. Treasury would, at all times, offer the one-ounce coins for sale at a free market price.

One-ounce gold coins obviously would be too expensive for use in most retail trade transactions, but they may serve as alternate currency units in mortgages, long-term bonds, certificates of deposit, and other instruments of domestic and

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* F. A. Hayek, *Denationalization of Money,* (London: The Institute of Economic Affairs), 1978, p. 126.
† *Ibid.*, p. 72.

international finance. With further deregulation of American banking, they could be useful for a competitive deposit system that avoids the uncertainties of policy and the instability of Federal Reserve money.

Proposed Legislation

Where there are thought leaders who offer new ideas and explanations, men of action soon appear and implement changes in policy. American thought leaders congregate in or around informal organizations such as the Foundation for Economic Education, the Leadership Foundation, the Cato Institute, the Foundation for Rational Economics and Education, the Council for Monetary Reform, the Mises Institute, the Institute for Humane Studies, the Pacific Institute, the Committee for Monetary Research and Education, Citizens for a Sound Economy, the Freeman Institute, the Choice in Currency Commission, and several investment newsletters informing and guiding their readers. The men of action are eminent politicians on the national scene who, in the halls of the U.S. Congress, are acting on enduring principles.

In 1981, Congressman Ron Paul introduced a bill (H.R. 391) that would revolutionize the monetary order by authorizing free banking and repealing the legal tender laws. It would simultaneously restore individual freedom in monetary affairs, salvage remnants of the old order, and mandate the direction of the new order. It would establish a new gold gram currency, and require one hundred percent reserves, not only for bank notes but also for bank deposits. To save the U.S. dollar, it would provide for a fixed conversion rate between the dollar and the gold currency, and assure its redemption at this ratio. The bill proposing the Monetary Freedom Act was cosponsored by Congressmen Thomas Hartnett, Jim Jeffries, Philip Crane, Daniel Crane, George Hansen, and Mark Siljander.

A reform bill introduced in both the House and Senate, H.R. 3789 and S. 1704, was called the Free Market Coinage Act. Sponsored by Senators Symms, McClure, Helms and Goldwater, and Congressmen Daniel Crane and Ron Paul, it would establish freedom of choice in currency for individuals. All legal tender statutes in conflict with the law would be repealed, and financial services denominated in units of gold would be deregulated. It would create a government coinage consisting of a five-gram Adam Smith gold coin, a ten-gram Jefferson gold coin, a Lincoln coin of one-troy-ounce gross weight, and a Kennedy coin of one-troy-ounce net weight. The U.S. Treasury would redeem, on demand, Federal Reserve notes and deposits in gold coins at the market price.

Senator Steve Symms of Idaho introduced an ingenuous proposal (S. 1849) that calls for the issue of gold bonds. Denominated in one, five and ten kilograms of gold, the principal and interest of these bonds would be paid, at the option of the holder, in bullion-weight coin or in dollars. The rate of interest would be two percent and the maturity fifty years. Bonds and coupons would be highly liquid and negotiable, which would permit them to form the basis for a new gold standard with gold-denominated currency.

The Symms proposal, as well as all other reform proposals, reveal the best intention for sound money and restoration of a gold standard, but many good purposes and intentions lie buried in the archives of the U.S. Congress. Nearly all the proposals call for reform laws, restoration laws, or other government cooperation in the return to sound money. They decry the mismanagement of money by government and, therefore, press for new rules of management based on gold. However, rules of management, no matter who drafts them, are not sufficient to produce good results unless the monetary order itself is safely lodged on a solid foundation.

A few proposals are seeking to rebuild the foundation. F A. Hayek, Ron Paul and others, questioning the very rationale of central banking and legal tender, would rebuild the monetary order on the foundation of freedom of transaction in any kind of money. They are enjoying encouragement and support by influential writers such as Howard J. Ruff, Gary North, Jerome Smith, Mark Skousen, John Pugsley, Lewis Lehrman and James McKeever. To all of them, freedom is a necessity that enables the monetary order to be what it ought to be.

One recent proposal, introduced into the U.S. Congress by Representative Jerry Lewis and Senator Robert Dole, would provide for the minting of one-ounce gold and silver bullion coins from the large stockpiles of gold and silver held by the U.S. government. This bill, H.R. 1123 and S. 636, would create a new form of money to compete with Federal Reserve notes and dollars. These gold and silver coins would not be legal tender in the usual sense; however, they could be used to discharge debts contracted for payment in gold and silver. No one would be forced to accept the gold and silver coins, but they would be a legally recognized form of money useable as an alternative to government paper money. Unfortunately, the bill would make the U.S. Treasury the sole issuer of the coins. Nevertheless, it would be a step down the road to monetary freedom.

Chapter 8
Free Money

Currencies are sound, not as they are managed, but as they are free. This essay urges reconstruction of the monetary order on the foundation of freedom. It differs from all other reform proposals in both the simplicity and audacity of its objective: only freedom. It neither petitions government to grant a reform act or issue gold bonds, nor proposes to render currency constant with a basket of commodities. It merely calls for individual freedom as an inalienable right. Monetary freedom, in its present political and economic setting, would give rise to a parallel standard that freely admits both the old and the new: Federal Reserve notes and deposits, U.S. Treasury moneys, and whatever free people are prone to try; however, this writer is confident that, in freedom, gold will emerge again as the most marketable economic good and the most popular and dependable monetary standard.

Restoration of sound money may be a long and arduous task, as it was lost in a gradual erosion of monetary freedom. We may have to retrieve it slowly and painstakingly. We seek *no reform law, no restoration law, no conversion or parity, no government cooperation: merely freedom.* The road is short and direct, and yet, depending on the resistance offered by ignorance and prejudice, by political greed and lust for power, it may take us many years to traverse. For the weary traveler, it has several intermediary steps that provide convenient targets for supreme effort. The legal underbrush that has grown up over the years—legal tender laws, tax discrimination against gold and silver coins, banking regulations preventing the opening of accounts denominated in ounces of gold, and so forth—must be cleared away so that Americans are once again free to use sound money.

The primary objective must always be the abolition of the money monopoly and legal-tender coercion. Man possessed, prior to the formation of any state, the right to provide for his own sustenance. He has an inalienable right to his life and to sustain it through his own effort and ability. Every restraint of this right, whether practiced by a monarch or a popular assembly, is a degree of tyranny.

Political money with legal-tender power, which is currency issued by politicians or bureaucrats and forced on people at face value, is an ominous restraint of human rights. Currency sheltered from competition by criminal law threatening fines and imprisonment is an alienation of politics. It causes inflation and depressions, and breeds social and political strife. *Money* is the most important economic good, the basic tool for man's division of labor and peaceful exchanges; in the hands of politicians and endowed with monopolistic privileges, money becomes dishonest and despotic, violates contracts, sanctions legal fraud, and takes property without compensation. Political money raises taxes without legislation.

Government may never voluntarily surrender its monopolistic money powers. Politicians and bureaucrats can be expected to defend them with all the instruments of coercion at their disposal, from fines and imprisonment to capital punishment. The only time monopolistic money powers may be violated with some degree of immunity is in times of hyperinflation, when the evils are clearly visible to everyone, even to a federal judge or legislator. When the last measure of conceivable coercion has failed, and the last penny of money income and wealth has been taken from lenders and given to debtors, 'the political monopoly game may be suspended for the moment. Politicians and reformers may then press for a new currency, a new monopoly issue—so that the game may be played all over again.

We must call a halt to the monopoly game. We need a *free money movement* that opposes the game by any conceivable peaceful means, through information, education, legislation, litigation, and demonstration. Newspapers and journals must try to enlighten the public on this important subject; they must show how the money system impoverishes most people and benefits politicians, government officials, and entitlement cronies.

Legal tender coercion permits debtors, of whom the largest is the U.S. government, to pay their creditors with mini-dollars. Lenders, holders of savings bonds, for example, are cheated out of most of their income and wealth. They owe it to themselves and future generations to press their charges of fraud, to seek compensation for losses suffered, and to advocate the abolition of the money monopoly. Although their chances of success, at first, may be negligible, they would impart valuable information and knowledge which, in the end, may enlighten even judges and legislators. Legal tender victims, such as owners of savings bonds and life insurance, who are paid off in mini-dollars, must be imbued with the same fervor of resistance that the numerous advocates of social credit have, pressing their futile pleas for interest-free "constitutional money."

The free-money resistance movement may want to forge an alliance with the tax resistance movement, which scored remarkable success in recent years. The popular opposition to onerous taxation of income and real property should lend support to the call for "no taxation through inflation" or "no exaction through legal tender." While tax rebels may refuse to make payment to the taxing authorities, the legal tender rebels would have to refuse payment offered in legal tender mini-dollars and would have to press for full-value settlement of debt. Legal tender legislation is political aggression against honesty and social peace. It is monetary dictatorship no matter where it is practiced. He who resists the legal tender monopoly is defending honesty, decency and peace.

The leaders of religion, ethics and morality should join the free money movement. Listening to the loud voices of politicians and legislators or counting votes does not provide answers to questions of morality. Legal tender legislation that deprives lenders of their rightful claims is immoral; a majority vote cannot make it right.

In a society seeking justice, the individual who distrusts political money is free to refuse it, unless he has a contractual obligation to accept it. If no one can force bad money on anyone, it cannot do any harm. If individuals have the choice to refuse bad money or accept it at its market value stated in gold weight units, bad money will only harm the issuer. The owner of a U.S. Treasury bond falling due, or a life insurance policy that is payable, or a mortgage loan that is outstanding, would refuse payment in mini-dollars or accept them at a discount reflecting their loss of purchasing power.

Without the legal tender force, the issuer of bad money could issue his money only at a discount or, if the public has lost all confidence in his integrity, would be unable to issue any, but he always would be liable to accept his own money at the stated value. In short, he may be able to issue money at a discount, but must accept payment at face value. It is doubtful that, under such conditions, the issuer of money would care to print another cent. Even a government dedicated to easy money and credit expansion might hesitate to issue any more.

In a monetary order without legal tender and a money monopoly, there could be no inflation. Printing and issuing new money would not raise the prices of goods and services, but would merely lower the exchange rate of the issue in terms of other competing moneys. People would discount depreciating moneys, but would not generally raise prices. Good money would drive out bad money; this would be the opposite effect that inflation has in the legal tender system, in which bad money drives good money into hiding (Gresham's Law).

Inflation is a symptom of the money monopoly; it comes to an end only when the monopoly is dismantled. The monopoly may swell and retreat—always in accordance with the aspirations of the politicians in power. Its end result is destruction of the national currency; this is followed by "currency reform" that brings forth another monopoly issue, which in time will be inflated again. The age of inflation is likely to endure as long as the money monopoly is allowed to exist.

The road to honest money and peaceful social relations is marked by a few mileposts. The first mile post points toward the inalienable right of everyone to select his own money. Every individual must be free to use whatever economic good is personally acceptable. No one has the legal right to force one type of money on another, no one has the right to demand payment in any particular medium of exchange, unless he has a valid contractual right to such payment. There must be no legal tender coercion, not even of gold or silver.

All legal tender laws must be repealed and all monopoly banking privileges rescinded. Obviously this cannot be done at once, but this must be our goal. Government regulation and manipulation of money must cease; the credit and banking prohibitions, licensing, and the penalties inflicted and favors bestowed must come to an end. The individual must be free again to use gold or any other medium of exchange. The ordinary law of contract, rather than public law and regulation, must again apply to economic production.

There are several specific steps that must be taken to end the money monopoly. Each of these actions is designed to remove restraints on competition in money and banking and to facilitate the development of sound money. A free money movement, consisting of both coalitions of organizations and new organizations of citizens for sound money, must strive to achieve the following objectives:

1. Mint gold and silver coins denominated only by weight and purity.
2. Repeal legal tender laws and permit specific performance of payments.
3. Permit financial institutions to issue private notes, and permit banks to accept deposits denominated in foreign currencies and weights of gold and silver.
4. Permit free entry into banking.
5. Permit interstate banking..
6. End mandatory membership in the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and any other agency or cartel.
7. Prevent tax discrimination against all forms of money.

Monetary freedom cannot repair the incalculable damage wrought in the past; it cannot heal past wounds inflicted by the money monopolists during more than seventy years of their reign. Freedom cannot restore the people's savings and pensions depleted by depreciated money, nor can it exact fair compensation from the money monopolist. There can be no restitution, because the monopolist has no wealth that can be distributed. Coercion must not breed more coercion; evil must not be permitted to bring forth more evil.

We may call this new system of monetary freedom the "parallel standard." It would not in the least curtail honest government or impede government finance. Stripped of its monopolistic powers, the Federal Reserve System could continue its operations, and the U.S. Treasury would receive taxes and make payments in Federal Reserve money. All contracts stated in U.S. dollars would have to be met in U.S. dollars, but contracts stated in ounces and grains of gold, silver or any other unit would have to be met in the money agreed upon in the contract.

Government money and contract money would be used side by side, and their exchange ratio would continually fluctuate in response to changing valuations. The market, unimpeded by Gresham's law, would determine the ratio. If Federal Reserve money should fall to a discount versus other moneys, the U.S. government, as its legal parent, would have to accept it at face value, but could not force it on hapless victims at face value.

Individual freedom in exchange transactions is impaired when financial institutions must bow to a money monopoly. It is weakened severely when banks may not enter into a gold contract, receive deposits of gold, make loans in gold and hold claims to gold, although the individual may have such rights. Most financial institutions in the United States lack basic freedom in monetary matters. They are examined by one or several of the federal supervisory agencies, which exercise a considerable influence on lending and investing policies. Through their insistence upon "sound standards" for the "protection of depositors," as defined by the supervisors, regulators encourage financial institutions to submit to the money monopoly.

The American banking system today is as vulnerable as it was during the 1920s and 1930s. The 1985 crises in Ohio and Maryland are undeniable evidence of that vulnerability. Living faithfully by the rules of present legislation and regulation, banks are caught in the vise of inflation and regulation. They have suffered, and continue to suffer, staggering losses in wealth and purchasing power, which they pass on to their depositors.

They must be set free to compete in their services, to hold and use gold, to enter gold contracts, to receive gold deposits and make gold loans, just like individuals. Banks must be deregulated. For gold received, they must be free to issue gold coins or gold certificates. If, for any reason, government cannot be made to set them free, it must be prevented from restraining new competition that tends to arise from unexpected quarters. Gold will come forth wherever government does not prevent it. Gold does not need legal tender force; no honest money needs legal tender, but it needs to be free from government regulation, taxation, manipulation, intervention, and the threat of confiscation.

Sound money and free banking are not impossible; they are merely illegal. This is why money must be deregulated. All financial institutions must be free again to issue their notes based on ordinary contract. In a free society, individuals are free to establish note-issuing banks and create private clearinghouses. In freedom, the money and banking industry can create sound and honest currencies, just as other free industries can provide efficient and reliable products. Freedom of money and freedom of banking, these are the principles that must guide our steps.

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