TESTIMONY BEFORE

THE U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES

Subcommittee on Domestic Monetary Policy and Technology

112th Congress

September 13, 2011

Dr. Lawrence Parks

Executive Director

Foundation for the Advancement of Monetary Education

Box 625 FDR Station

New York, NY 10022

Larry@LarryParks.com

Contents

Short Bio 3
Opening Statement 4
Where we are headed 4
Collapse of the monetary system 5
Why legal tender irredeemable paper-ticket-electronic money is dishonest: 8
Fraud: nondisclosure of material information and misrepresentations about our monetary system 14
Legal tender 16
The kind of money we use is a moral issue 21
Property rights and money 21
Governmental monetary integrity 22
The perils of money creation 23
Boom & bust in the economy 28
Likelihood, duration, and size of wars 28
Military preparedness and the ability to wage war if need be 28
Who gets the wealth of society? 28
Social mobility: the ability to improve one's lot in society 29
Social engineering (the redistribution of wealth) 29
Unfathomable Waste: 29
Research & Development and Science Education 29
Manufacturing jobs and employment: 30
Money creation effects on state and local taxes: 34
Real Wages 37
Propensity to Save 38
Pensions in peril 39
Balance of Trade 43
Federal Taxes and Spending 44
Government deficits 47
Financial market instability and the best argument against gold 48
Levels of debt 50
Long-term interest rates 52
Interest rate and foreign exchange rate volatility 53
Wall Street and the banks 56
Special privileges for banks and other financial players 61
Taxes on money 61
Summary and Recommendations 62
"Truth in Testimony" Disclosure Form 64

Short Bio

Dr. Lawrence Parks

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

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

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

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

Opening Statement:

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

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

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

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

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

Where we are headed:

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

Exhibit 1: Scenes relating to currency destruction

Collapse of the monetary system

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

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

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

Exhibit 2: Sweeping Hungarian money into the sewer circa 1946

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

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

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

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

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

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

---

[1] Remarks by Chairman Alan Greenspan At the Catholic University Leuven, Leuven, Belgium January 14, 1997

[2] "Highly illiquid portfolios" are portfolios that cannot be sold except at a substantial discount to par.

[3] The most "liquid" portfolio consists of cash that the Federal Reserve creates out of nothing.

[4] Private investors would pay less for these assets than would the Fed. In fact, depending upon how "illiquid" these portfolios were, private investors might pay nothing.

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

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

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

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

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

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

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

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

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

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

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

What an incredible acknowledgment! In other words, we can conclude that if the banks had not been induced by the safety net/subsidy to increase leverage, the banking system would not have collapsed in the 1930's and

we would not have experienced the Great Depression. Many think that the Great Depression was a "market failure." Mr. Greenspan has written extremely eloquently that the Great Depression was in fact caused by the Federal Reserve feeding too much credit into the banking system, i.e., enabling the banking system to increase leverage too much.[5]

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

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

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

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

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

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

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

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

Exhibit 2: United States One Dollar Note

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

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

Exhibit 3: U.S. Silver Dollar

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

Exhibit 3: One dollar Federal Reserve Note

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

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

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

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

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

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

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

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

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

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

[6] 7th Amendment to the Constitution.

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

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

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

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

And hang it on a dog,

Does the dog become a cat?

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

Are all dogs with cat signs now legally cats?

[7] *Coinage Act of 1792*

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

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

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

Jefferson, for example, wrote:

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

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

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

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

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

In addition, he wrote:

---

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

> "Paper money has had the effect in your state that it will ever have, to ruin commerce, oppress the honest, and open the door to every species of fraud and injustice."
>
> Washington, in his circular letter of June, 1783, to the governors of the several United States, wrote that "honesty will be found on every experiment to be the best and only true policy," being convinced that "arguments deduced from this topic could with pertinency and force be made use of against any attempt to procure a paper currency."

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

Exhibit 7: $1 Federal Reserve Note

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

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

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

Exhibit 8: $5,000 Federal Reserve Note

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

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

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

Exhibit 9: $10 Federal Reserve Note

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

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

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

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

A full disclosure critical review will tend to reveal:

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

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

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

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

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

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

Some misrepresentations about our monetary system are:

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

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

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

All frauds are eventually found out and collapse.

Legal tender:

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

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

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

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

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

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

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

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

---

[14] Interestingly, after the French Revolution and the issuance of legal tender irredeemable paper-ticket money, called *Assignats*, eventually the penalty for non-acceptance was death pursuant to a special law called *The Law of the Maximum*.
[15] Sloan, Herbert; *Principle and Interest: Thomas Jefferson and the Problem of Debt*; University of Virginia Press (2001).

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

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

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

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

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

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

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

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

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

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

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

---

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

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

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

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

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

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

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

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

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

---

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

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

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

Exhibit 10: $1 legal tender Greenback

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

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

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

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

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

In my view, Chase has this right. Further, it seems clear to me that by not giving the legal tender power to the general government, and limiting legal tender by the states to only gold and silver, mindful that the 10th Amendment to the *Constitution* declares "The powers not delegated to the United States by the Constitution,

nor prohibited by it to the States, are reserved to the States respectively, or to the people," it means that sovereignty over money is reserved to the people.

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

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

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

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

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

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

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

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

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

The history of how our money became transformed from constitutionally mandated gold and silver to legal tender irredeemable paper-ticket-electronic money is not well understood. Legal tender and other important

monetary concepts have been removed from textbooks and, as far as I know, are taught nowhere. Today, I cannot find a textbook that deals with the history of how our legal tender irredeemable paper-ticket-electronic money became legal tender and the controversies that resulted.

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

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

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

The kind of money we use is a moral issue

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

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

Property rights and money

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

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

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

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

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

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

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

Governmental monetary integrity

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

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

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

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

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

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

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

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

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

The perils of money creation

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

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

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

As John Kenneth Galbraith explained:

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

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

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

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

Exhibit 13: How banks create money

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

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

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

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

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

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

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

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

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

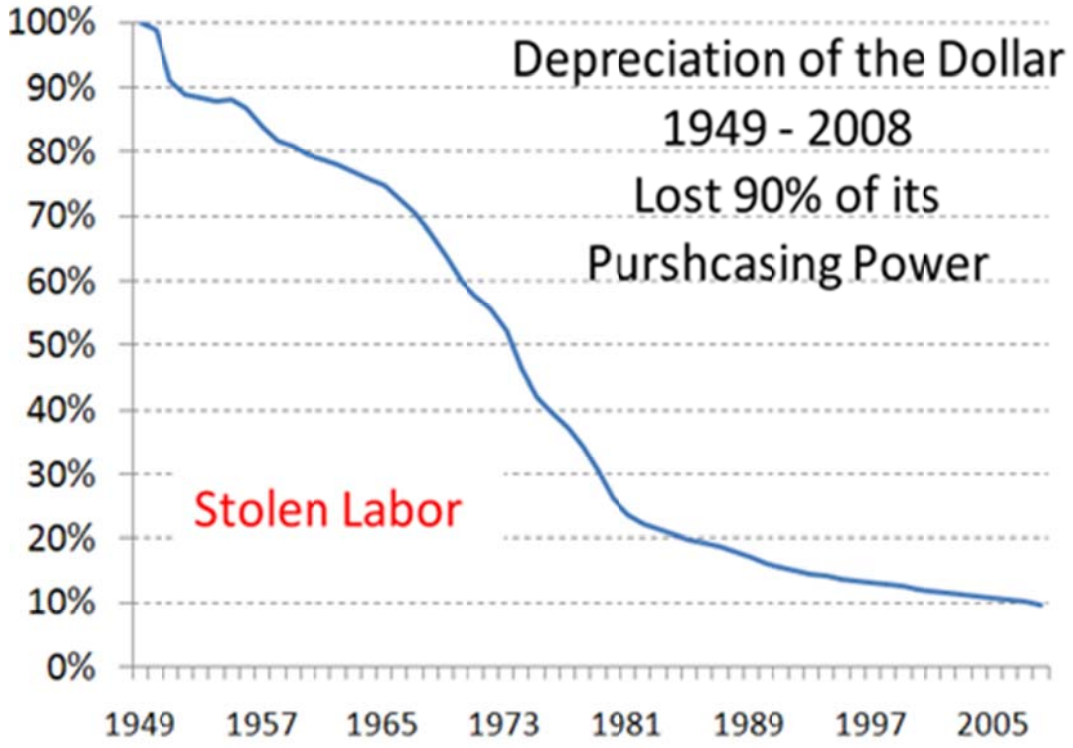


Exhibit 14: Depreciation of the dollar 1949 – 2008; Source: Federal Reserve CPI data.

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

---

[24] *The Story of Money*, 8th Printing, 2005, Federal Reserve Bank of New York, page 17
[25] *The Federal Reserve Today*, 15th Edition, Federal Reserve Bank of Richmond, page 16

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

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

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

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

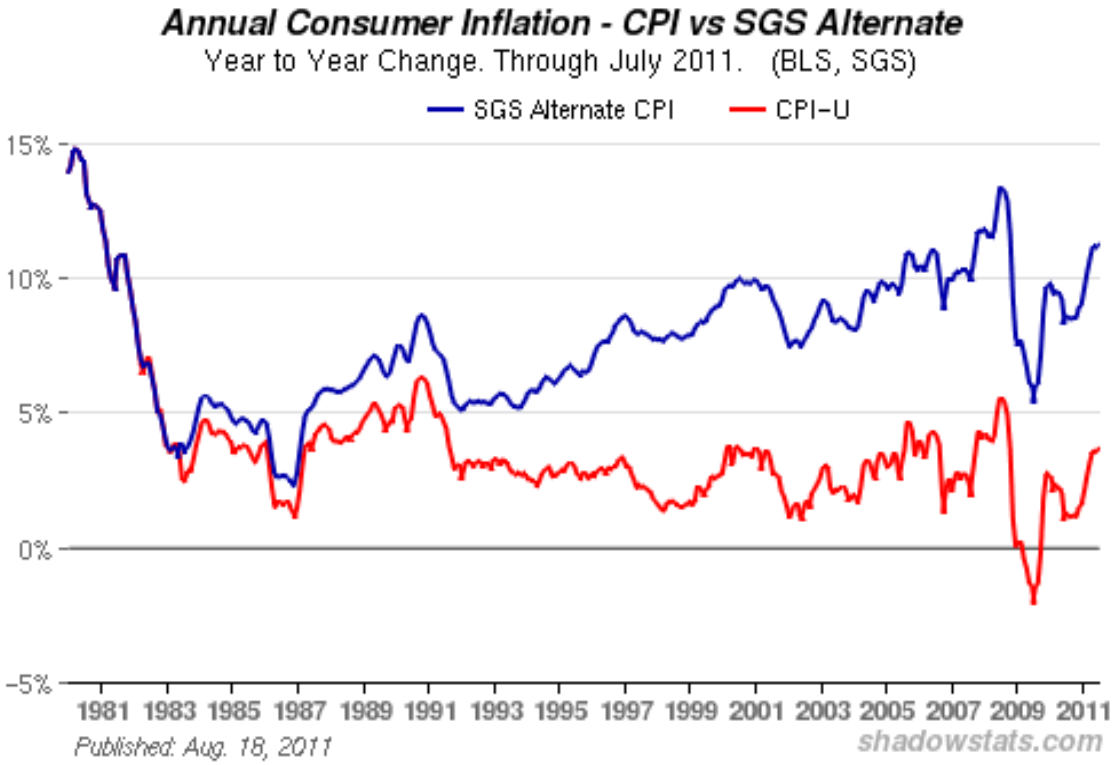


Exhibit 15: Annual Consumer Inflation vs. Shadowstat.com computation using a consistent methodology from the early 1980s.

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

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

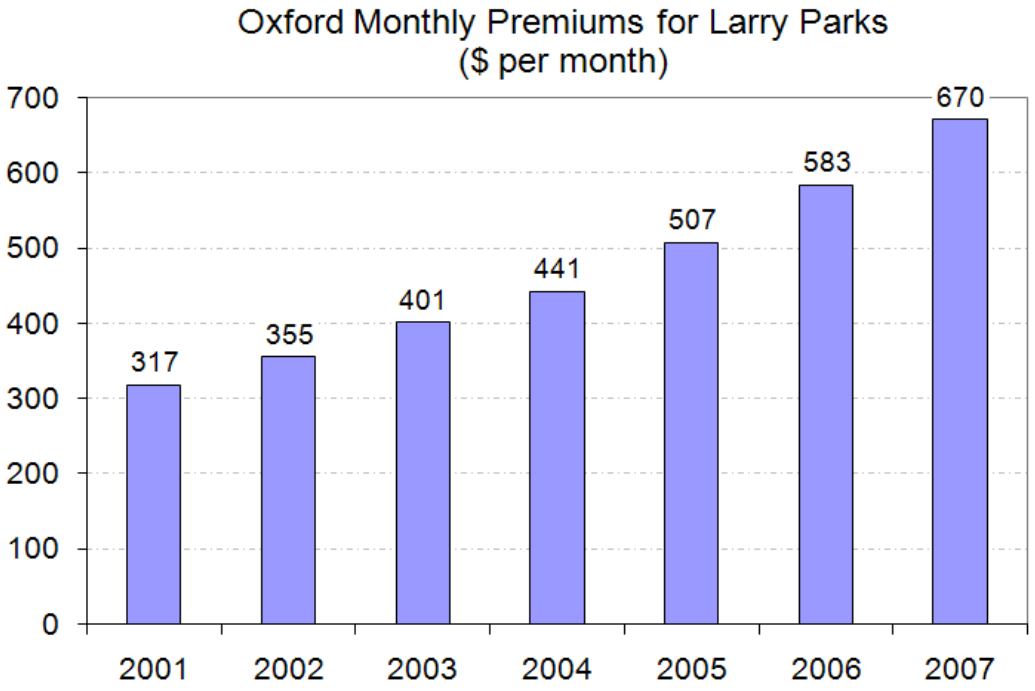


Exhibit 16: Oxford Health Plan monthly premiums for Larry Parks 2001 - 2007

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

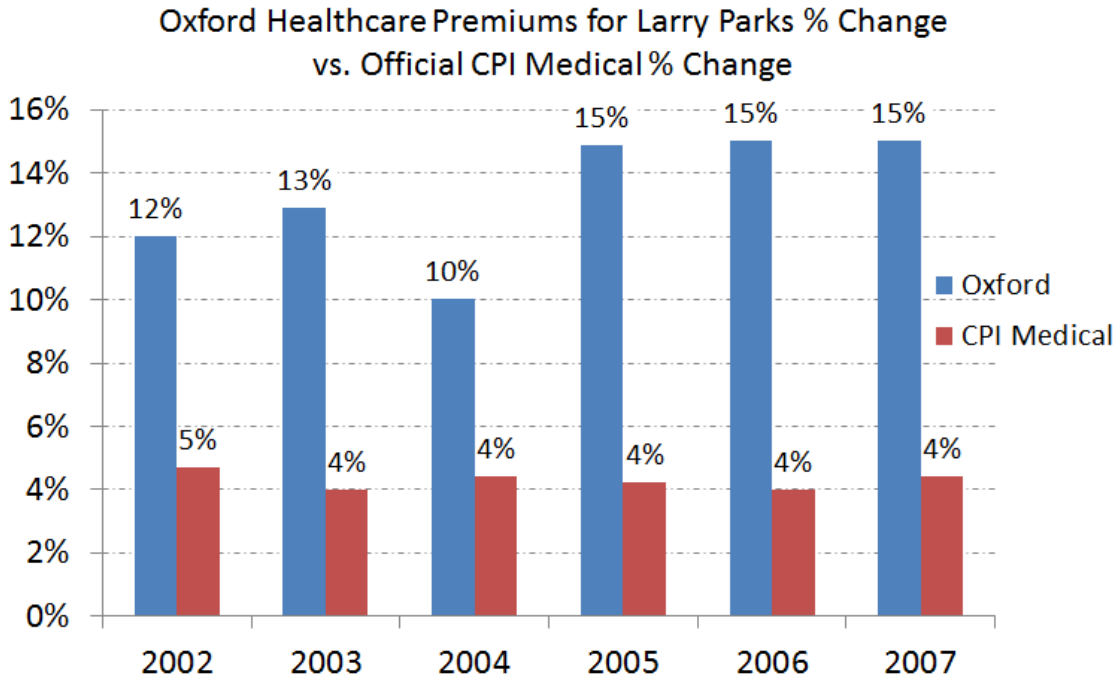


Exhibit 17: Medical component of the CPI contrasted with increased premiums charged by Oxford Health Plan; Source: BLS and data from Larry Parks' Oxford bills

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

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

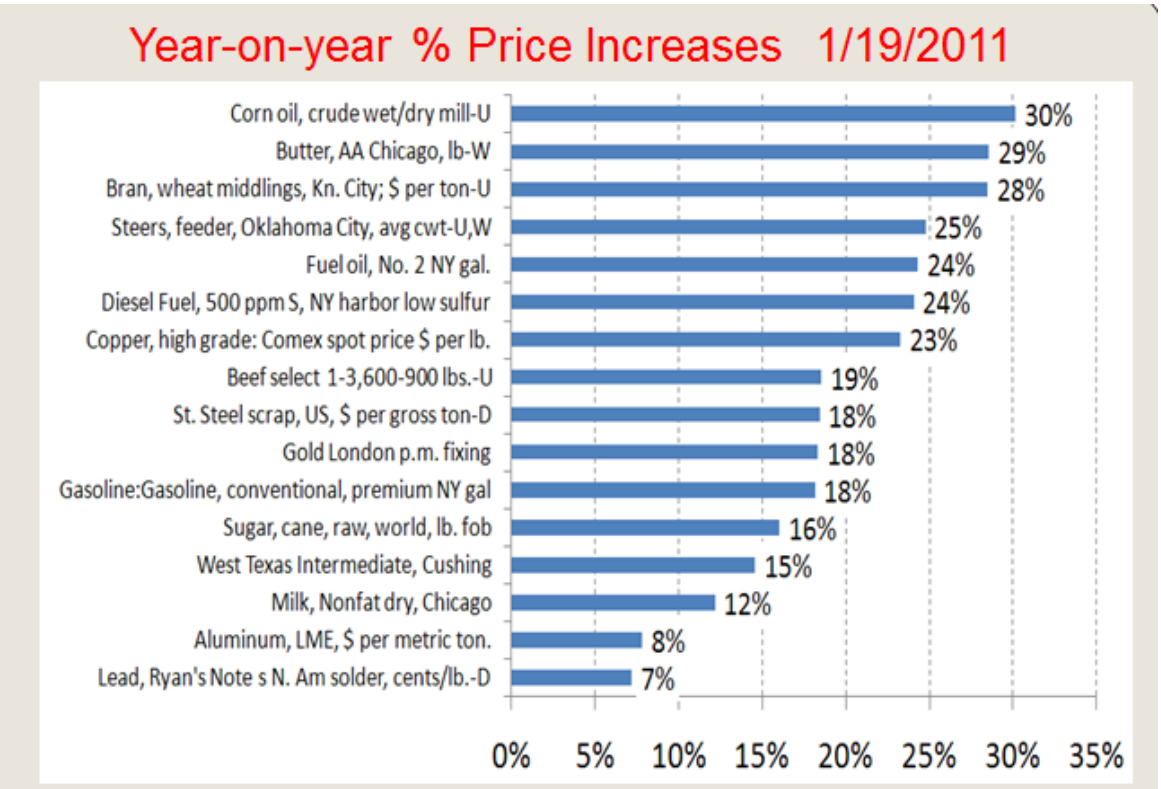


Exhibit 18: Year-on-year price increases as at 1/19/2011; Source: *Wall Street Journal*

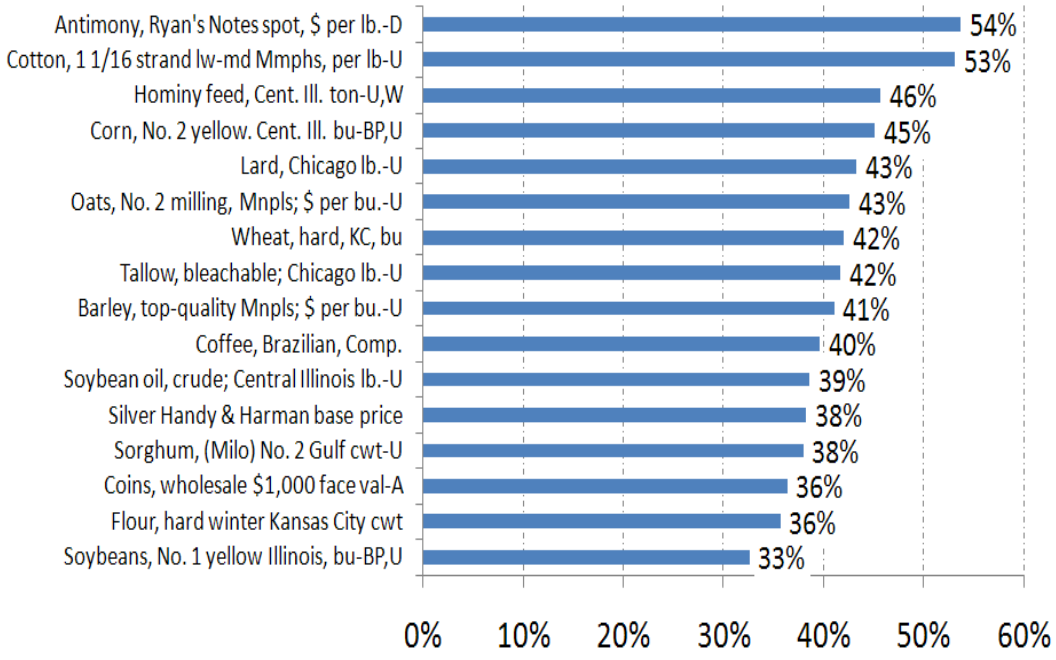


Exhibit 19: Year-on-year price increases as at 1/19/2011; Source: *Wall Street Journal*

It's hard to imagine that these large price increases will not at some point be incorporated into consumer products one way or another. For example, the media has reported on many products whose packaging and

content sizes have been reduced, while maintaining the prior price per package when it contained more product. In this way, and many others, the effects of currency depreciation are being obfuscated.

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

Boom & bust in the economy

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

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

Likelihood, duration, and size of wars

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

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

Military preparedness and the ability to wage war if need be

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

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

Who gets the wealth of society?

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

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

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

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

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

Social engineering (the redistribution of wealth)

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

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

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

Unfathomable Waste:

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

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

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

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

Research & Development and Science Education

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

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

Manufacturing jobs and employment:

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

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

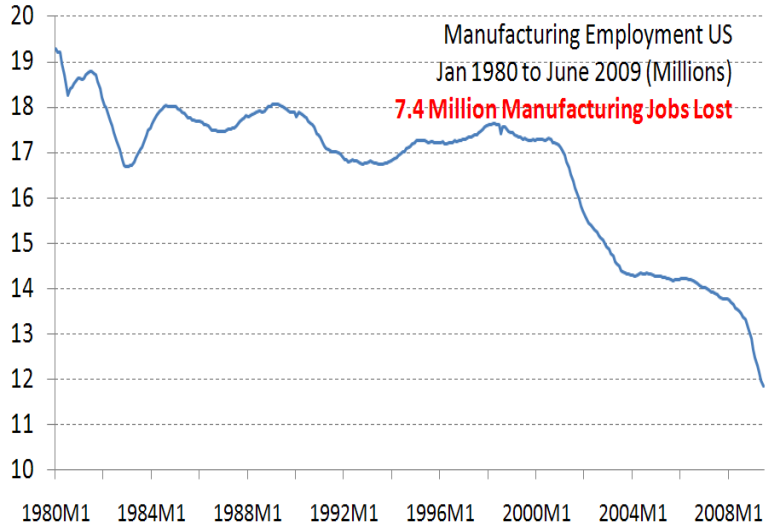


Exhibit 20: U.S. Manufacturing Employment January 1980 to June 2009; Source: BLS

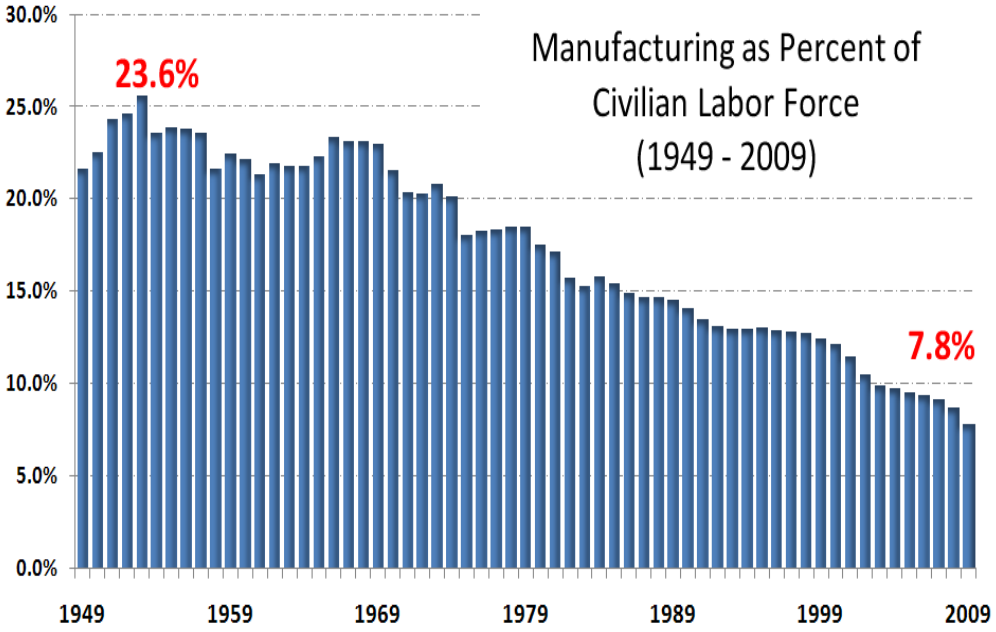


Exhibit 21: Manufacturing as a percent of the civilian labor force 1949 – 2009; Source: BLS

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

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

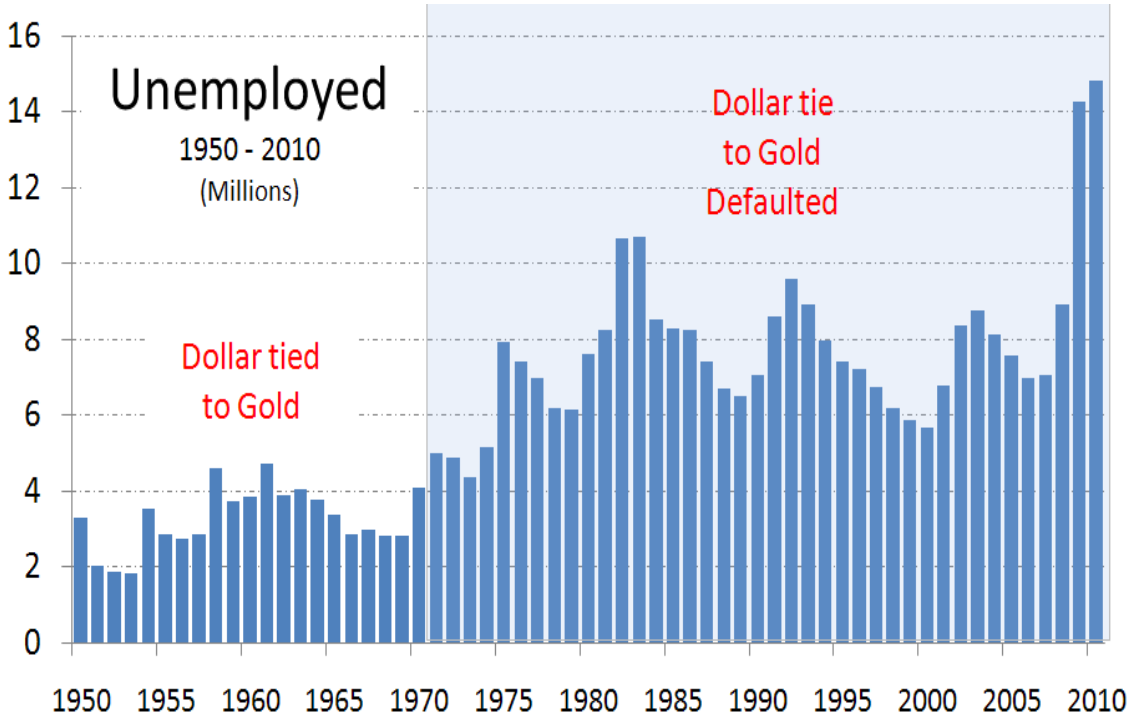


Exhibit 22: Unemployed persons series U; Source: BLS

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

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

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

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

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

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

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

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

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

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

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

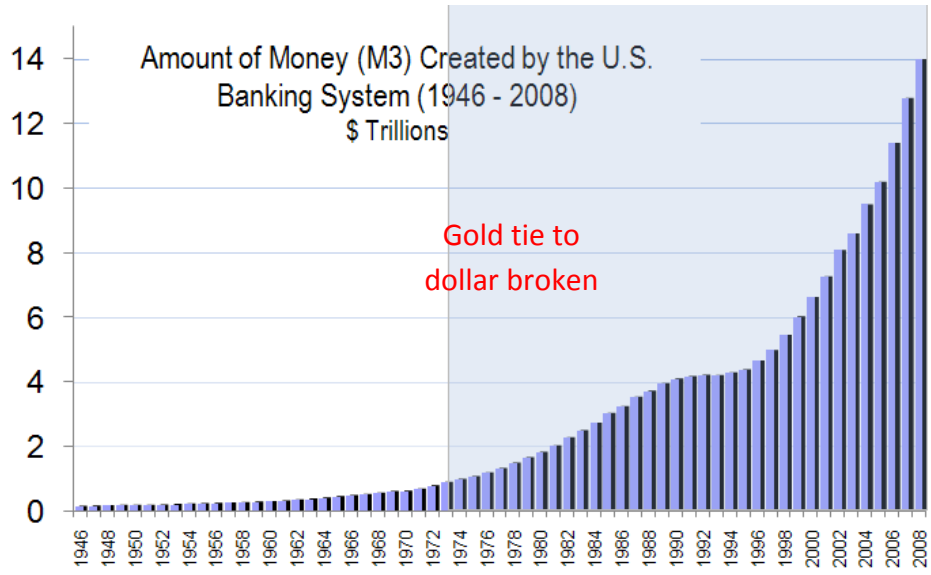


Exhibit 23: The broad money supply (M3) from 1946 to 2008. Source: Federal Reserve until March 2006 when the Fed stopped reporting this metric. From April 2006 to December 2008 the data reflects estimates of various observers based on known components of M3.

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

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

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

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

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

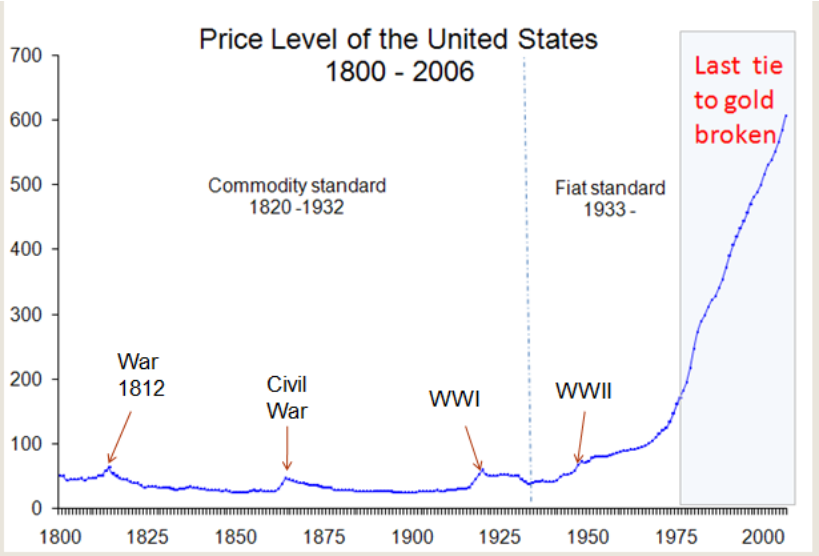


Exhibit 24: Price Level of the United States 1800 – 2006. Source: Federal Reserve Bank of Dallas.

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

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

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

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

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

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

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

Money creation effects on state and local taxes:

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

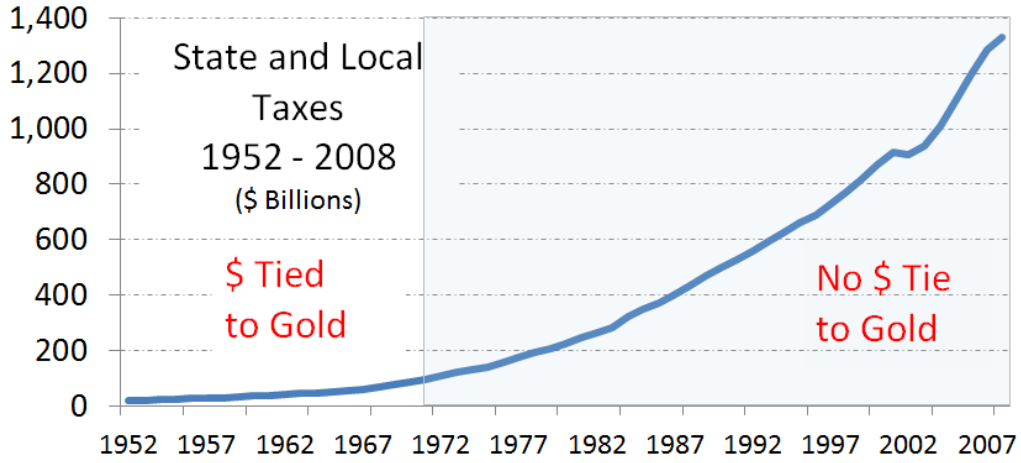


Exhibit 25: State and Local Taxes 1952 – 2008; Source: government data

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

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

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

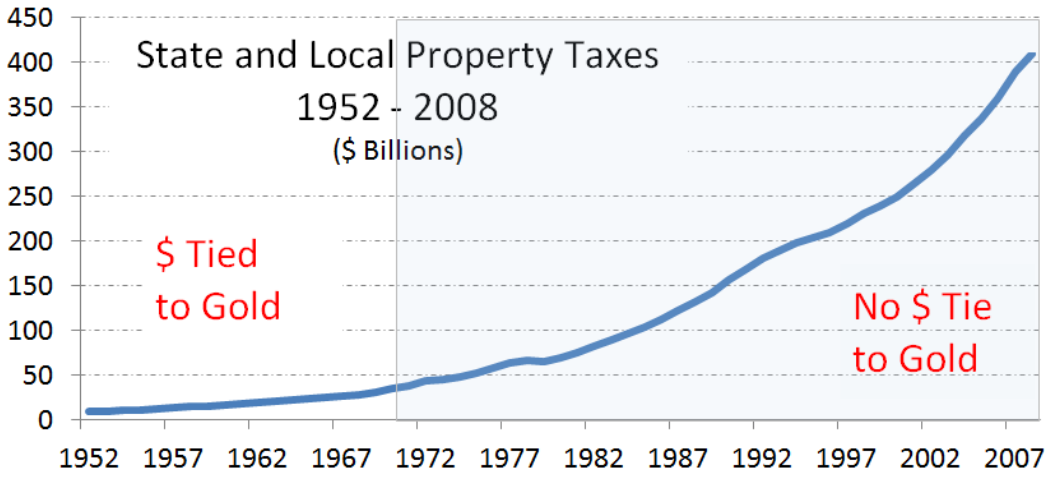


Exhibit 26: State and Local Property Taxes 1952 – 2008; Source: Government data

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

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

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

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

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

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

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

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

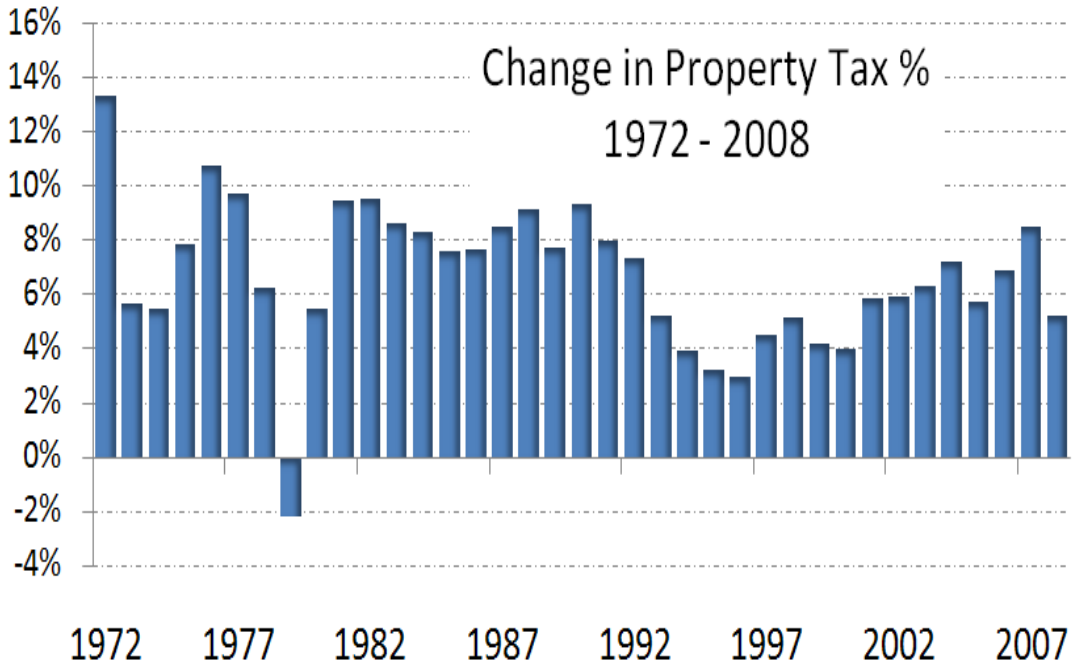


Exhibit 29: year-on-year percentage change in property taxes; Source: government data

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

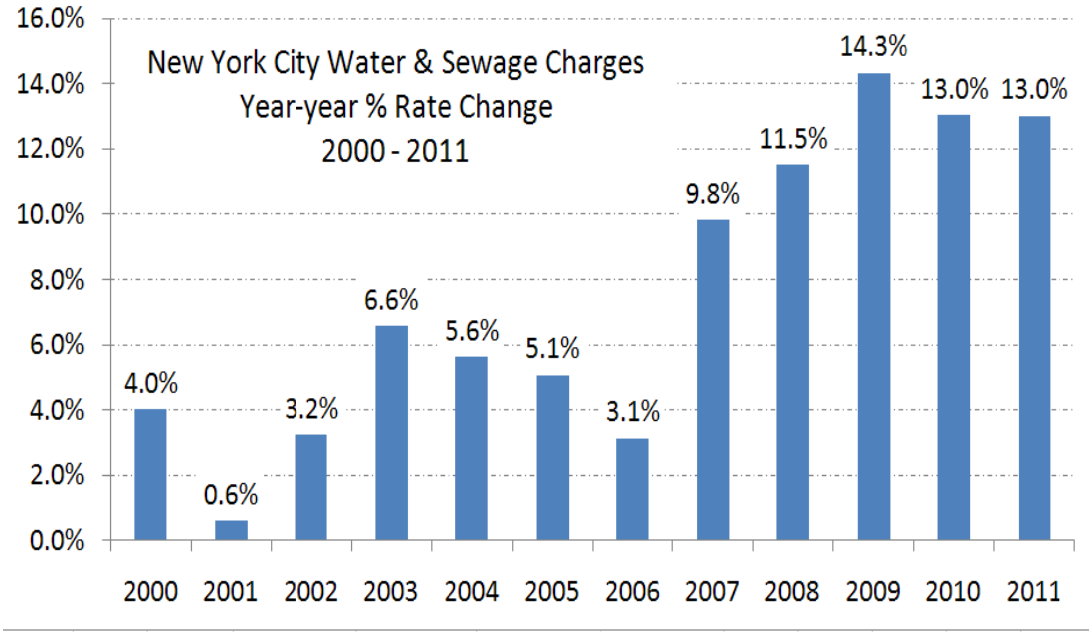


Exhibit 30: New York City Water & Sewage Charges year-on-year change 2000 – 2001; Source: New York City Government

Real Wages

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

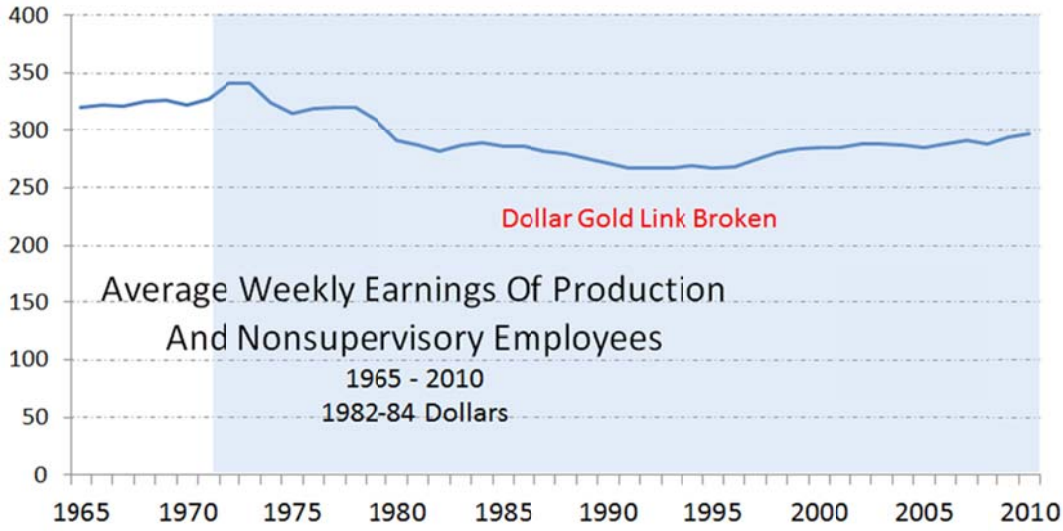


Exhibit 31: Average Weekly Earnings Of Production And Nonsupervisory Employees, 1982-84 Dollars; Source: BLS

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

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

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

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

Propensity to Save

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

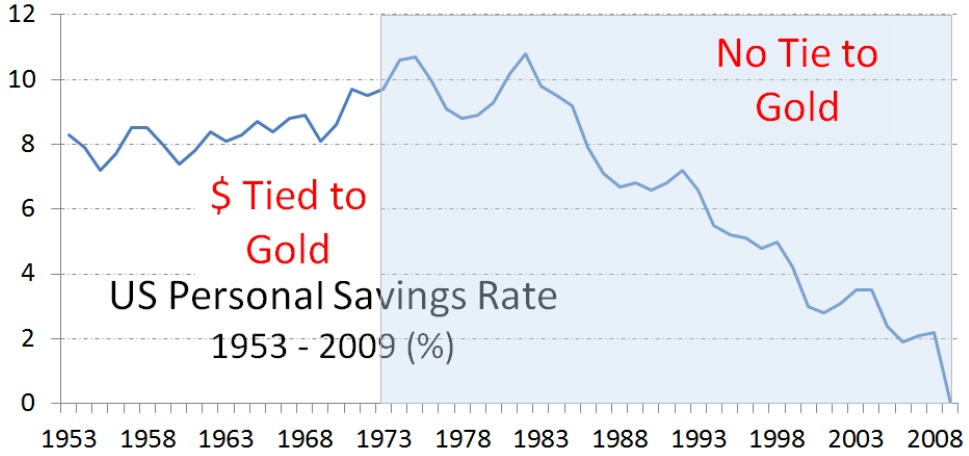


Exhibit 32: U.S. Personal Savings Rate; source: http://www.bea.gov/national/nipaweb/SelectTable.asp#S5

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

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

Most important, since legal tender irredeemable paper-ticket-electronic money always depreciates, less of it is saved than otherwise. One deceptive escape hatch for some people is to allocate their savings to the equity

markets and hope for the best. As will be shown, the capital markets benefit mostly those who get fees for facilitating transactions.

Pensions in peril

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

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

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

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

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

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

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

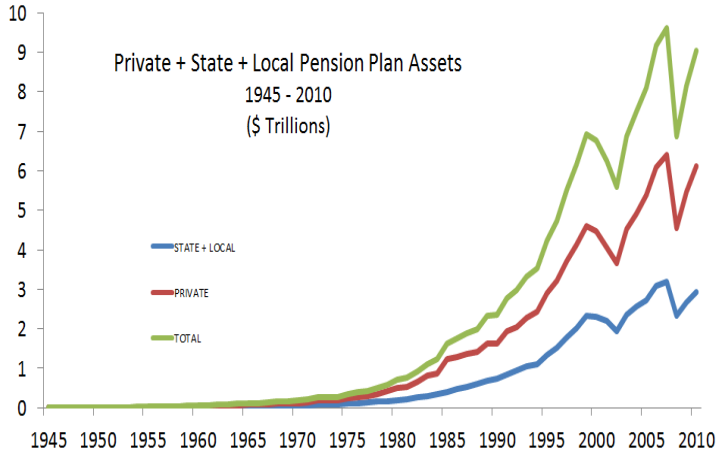


Exhibit 33: U.S. private and state and local pension assets. Source: Federal Reserve Flow of Funds

Pension assets, while supposedly under the control and by law the fiduciary responsibility of pension plan trustees, are *de facto* under the control of consultants and Wall Street money managers from whom trustees take their marching orders. Order of magnitude, all factors considered, I estimate that fees and overhead for these funds is about one percent of assets, $100 billion per year. This structure is enshrined in major legislation

including *The Employee Retirement Income Security Act* (ERISA) and *The Pension Protection Act Of 2006* (PPA) which require trustees to be "prudent."

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

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

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

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

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

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

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

More telling, the article continues:

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

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

---

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

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

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

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

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

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

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

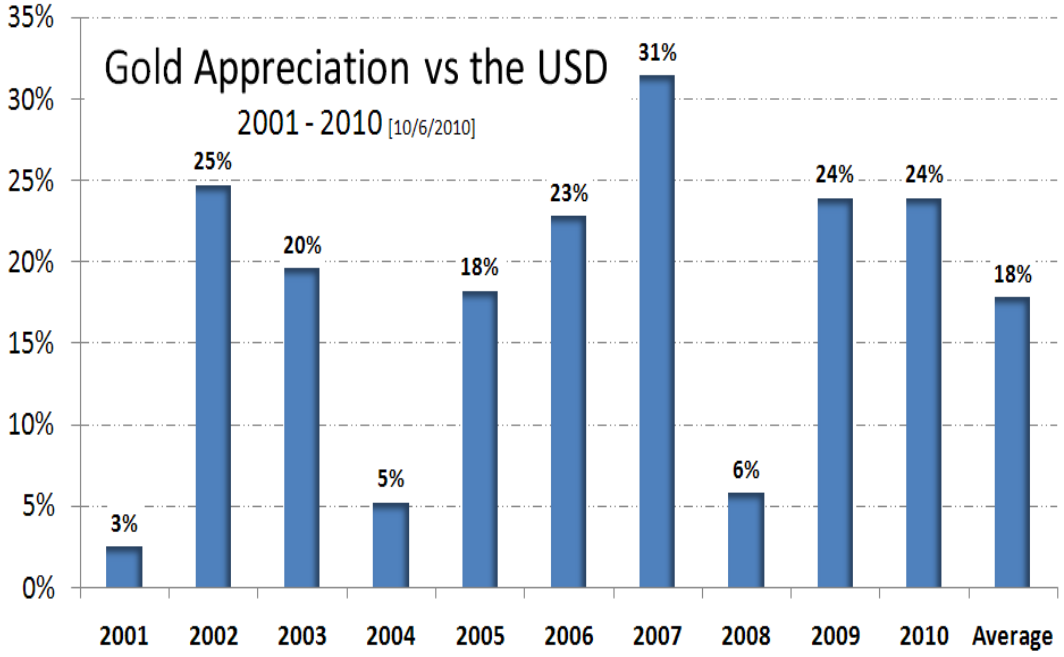
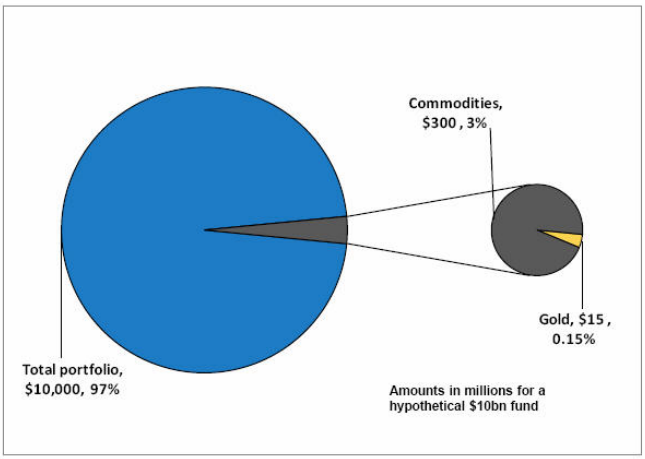


Exhibit 34: Gold appreciation vs. the dollar 2001 - 2010

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

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

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



Source: TRS

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

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

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

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

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

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

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

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

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

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

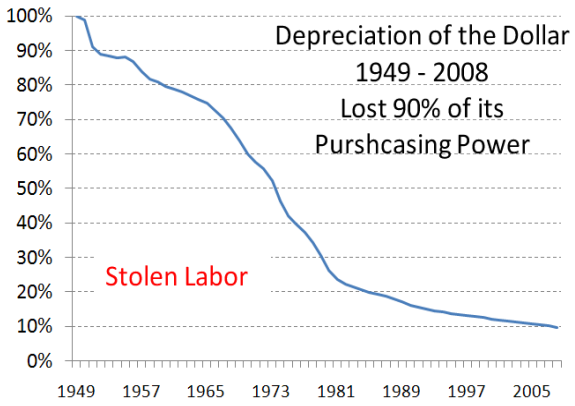


Exhibit 36: Depreciation of the Dollar 1949 – 2008; Source: CPI data, BLS

Balance of Trade

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

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

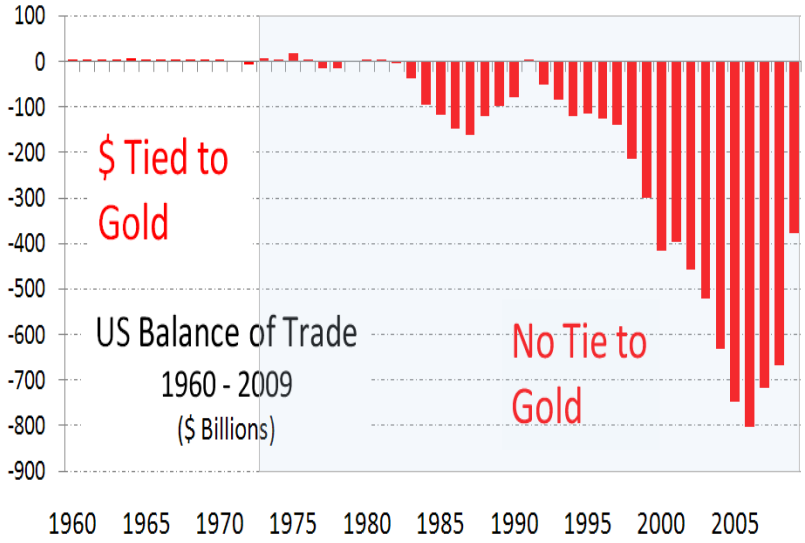


Exhibit 37: U.S. Balance of Trade 1960 – 2009: Source: Government data

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

While the Business Roundtable, along with the AFL-CIO and others were complaining about "currency manipulators," and while Wall Street embraced the process, now called "globalization" and was cheerleading the globalization as concomitant to "wealth creation," overlooked was the fact that the dollars accumulating

overseas weren't really dollars at all. It was, as Jefferson called it, "only the ghost of money, and not money itself."

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

Federal Taxes and Spending

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

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

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

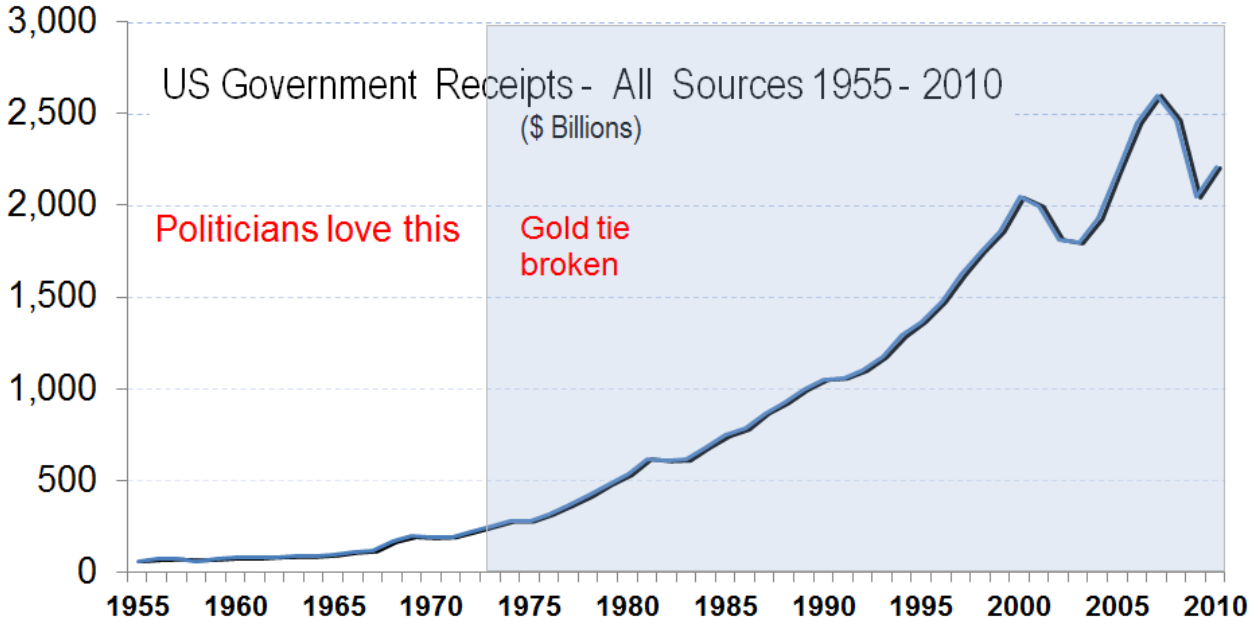


Exhibit 38: U.S. Government Receipts: 2955 – 2010; Source: U.S. Department of Treasury: Monthly Treasury Statement - Table 1; FRB 1.39 (for historical fills)

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

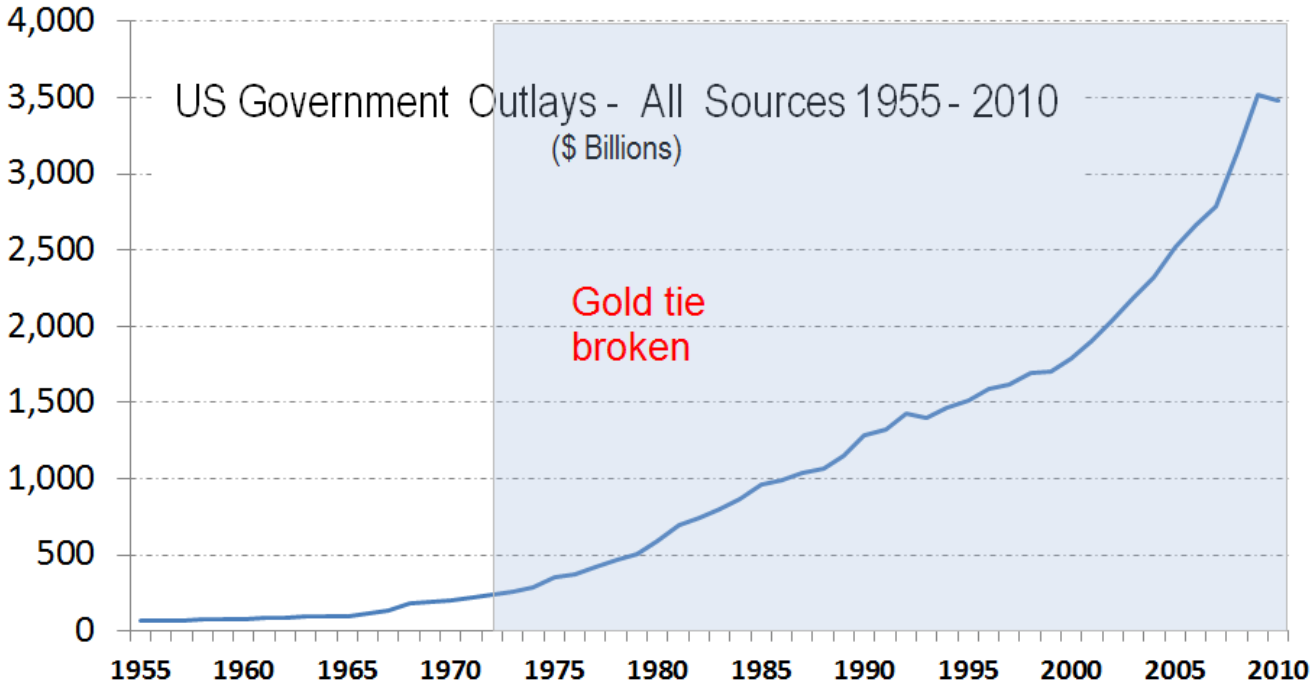


Exhibit 39: U.S. Government Outlays 1955 – 2010; Source: U.S. Department of Treasury: Monthly Treasury Statement - Table 1; FRB 1.39 (for historical fills)

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

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

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

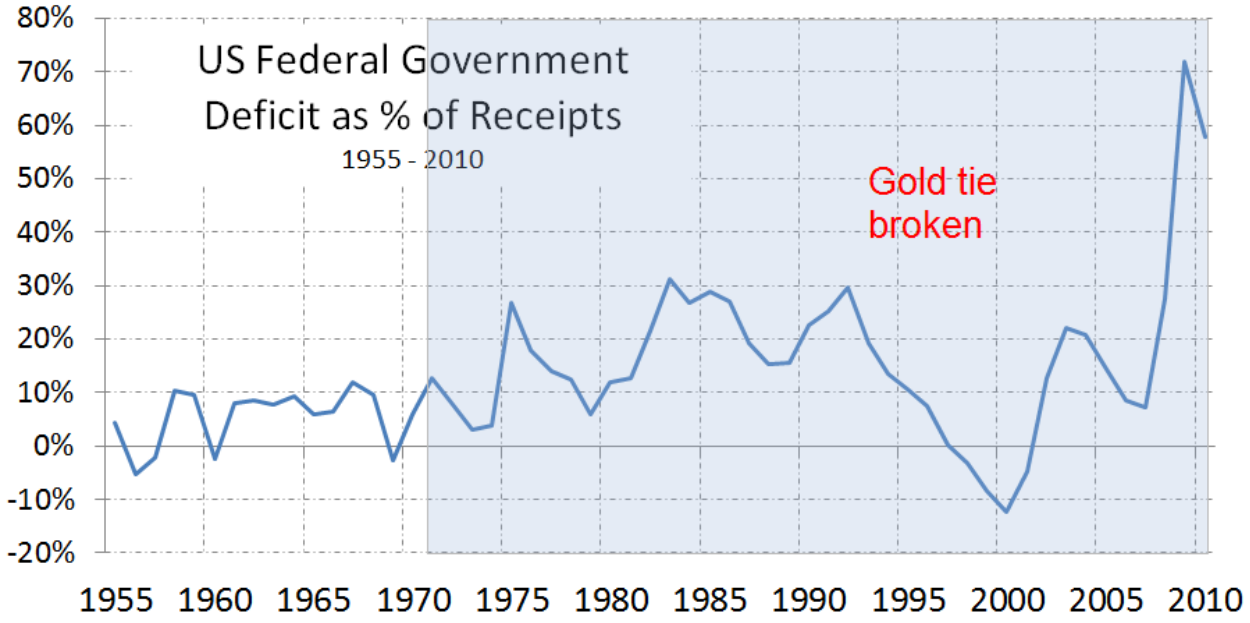


Exhibit 40: U.S. Federal Deficit as a % of receipts; Source: U.S. Government

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

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

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

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

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

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

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

Government deficits

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

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

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

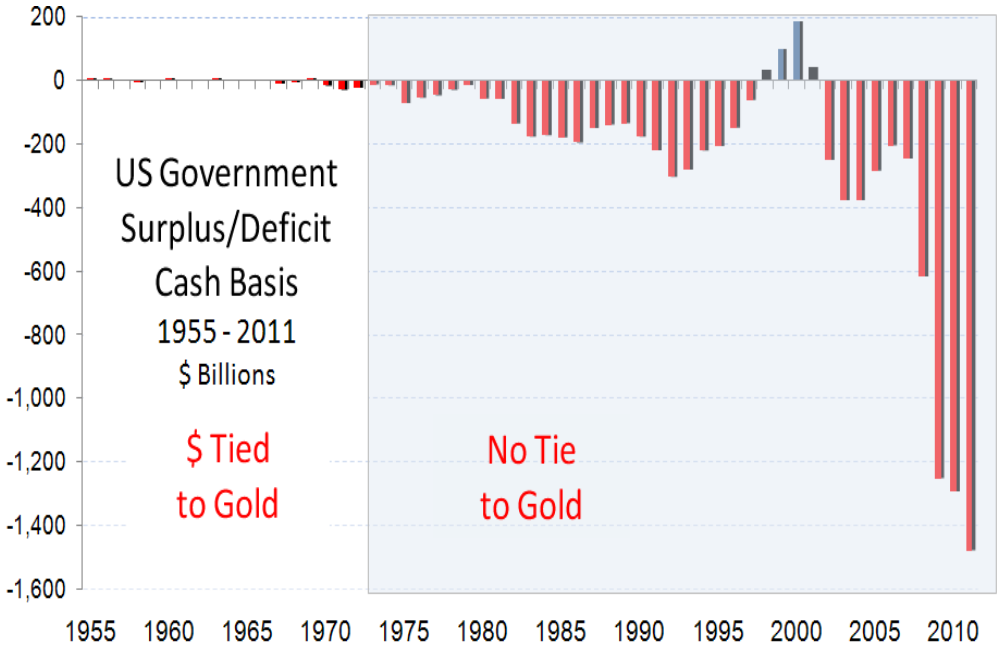


Exhibit 41: U.S. Government Surplus/Deficit Cash Basis 1955 – 2011; Source: BLS

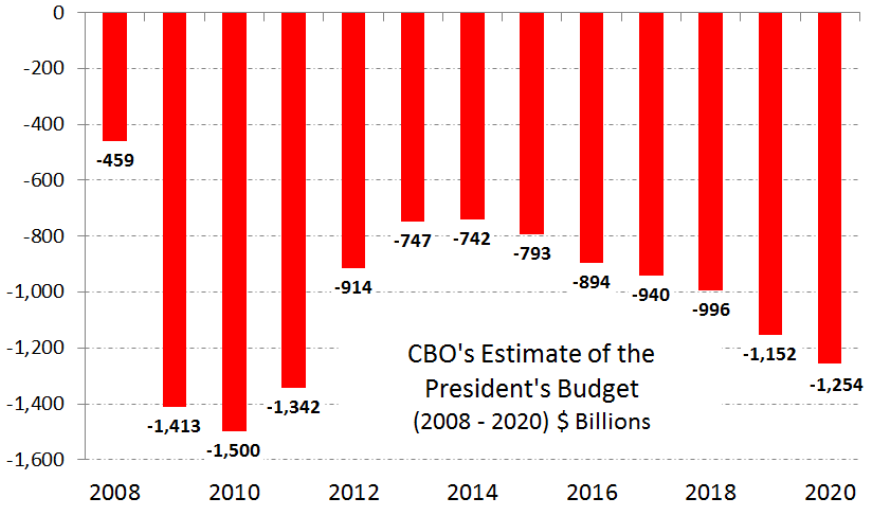


Exhibit 42: Recent CBO Estimate of forecasted deficits; Source: Congressional Budget Office; Office of Management and Budget.

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

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

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

Financial market instability and the best argument against gold

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

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

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

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

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

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

Second, banks told customers that they could get "their" money back "on demand." However, in fact and in law, when people "deposit" money in a bank, it becomes the bank's money to do with as the bank pleases. The bank may loan that money to someone else, invest it in whatever, including illiquid investments, or gamble with it. Further, what banks should have told depositors was that they could get their money back on demand provided: not too many of them wanted to do so at the same time; the money had not been invested in

something that was illiquid and that could not quickly, and without much loss, be converted back into cash; and, finally, that the bank had not lost the money in some venture.

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

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

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

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

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

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

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

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

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

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

Levels of debt

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

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

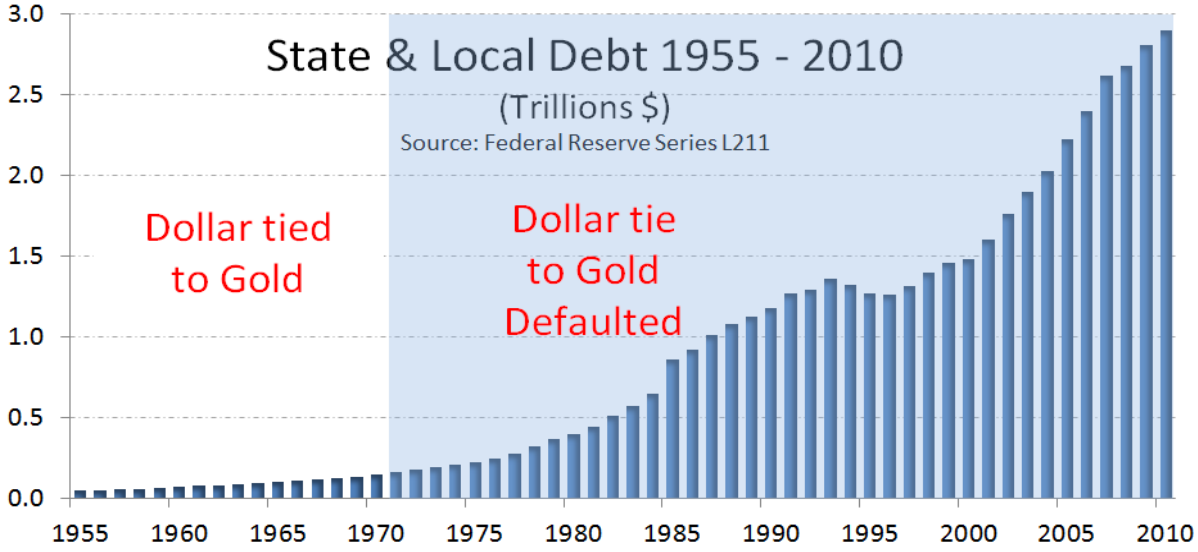


Exhibit 43: State and Local Debt 1955 – 2010: Source: Federal Reserve Flow of Funds

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

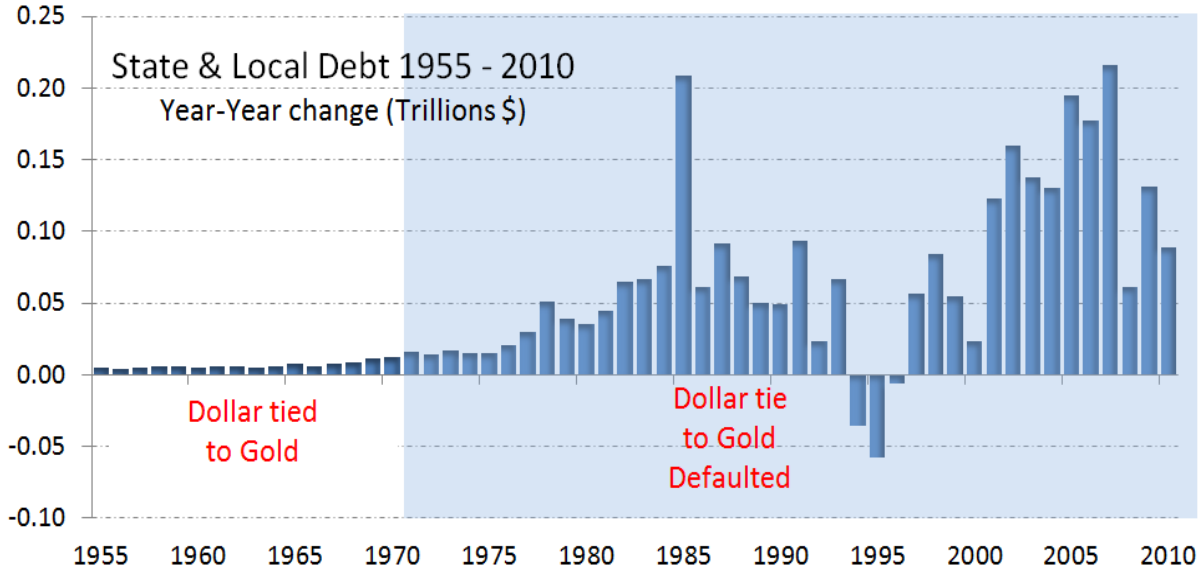


Exhibit 44: State and Local Debt 1955 – 2010 year-on-year changes; Source: Federal Reserve Flow of Funds

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

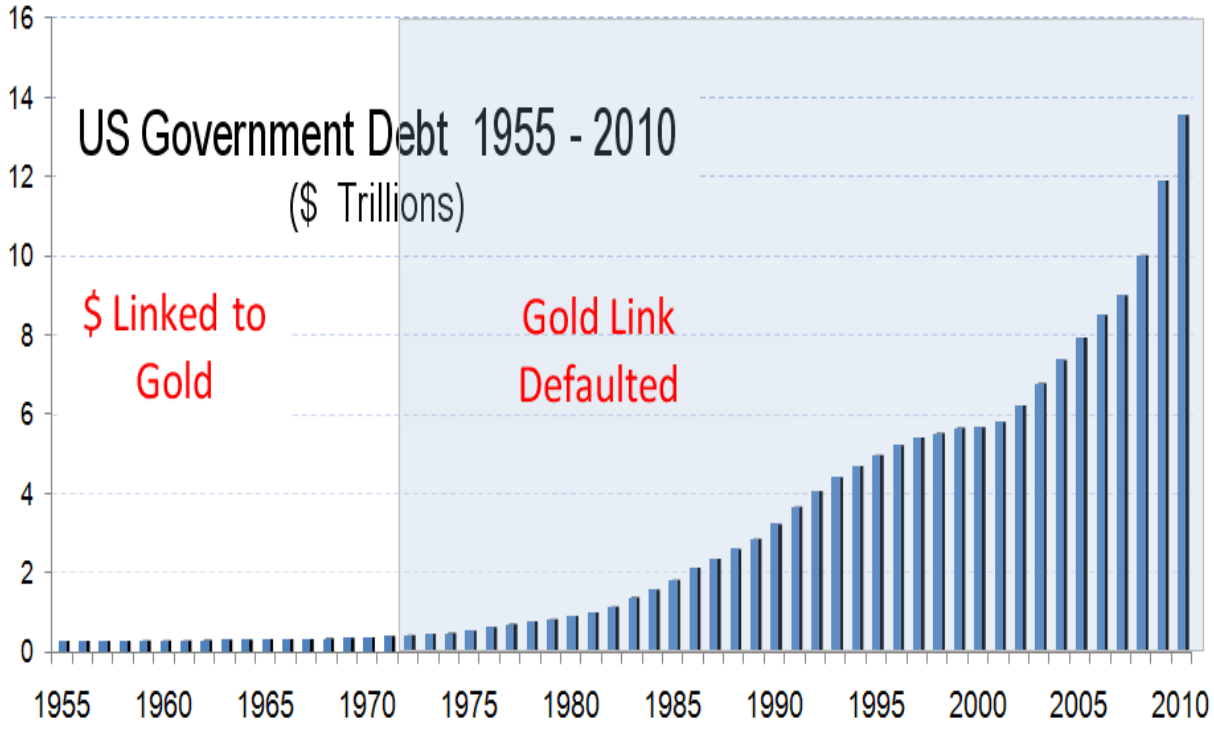


Exhibit 45: U.S. Government debt 1955 – 2010: Source: Federal Reserve Flow of Funds

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

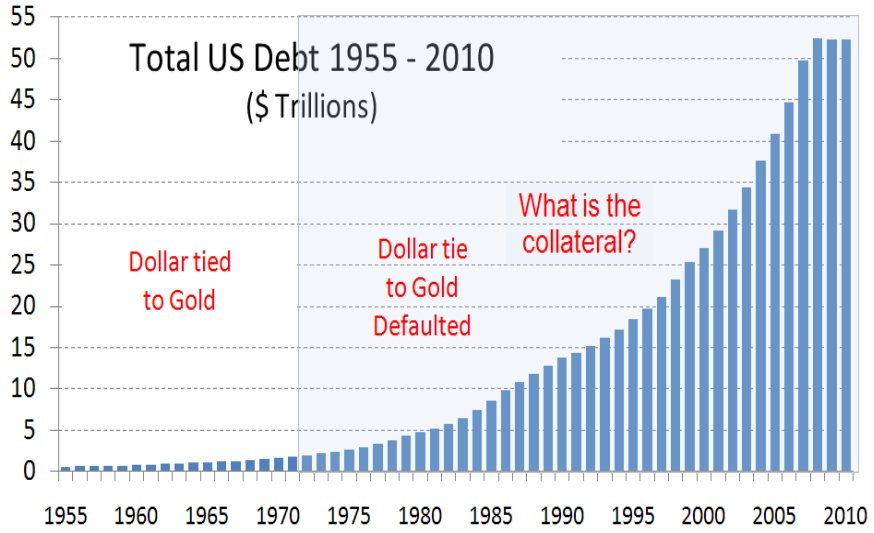


Exhibit 46: Total U.S. Debt 1955 – 2010; Source: Federal Reserve Flow of Funds

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

Long-term interest rates

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

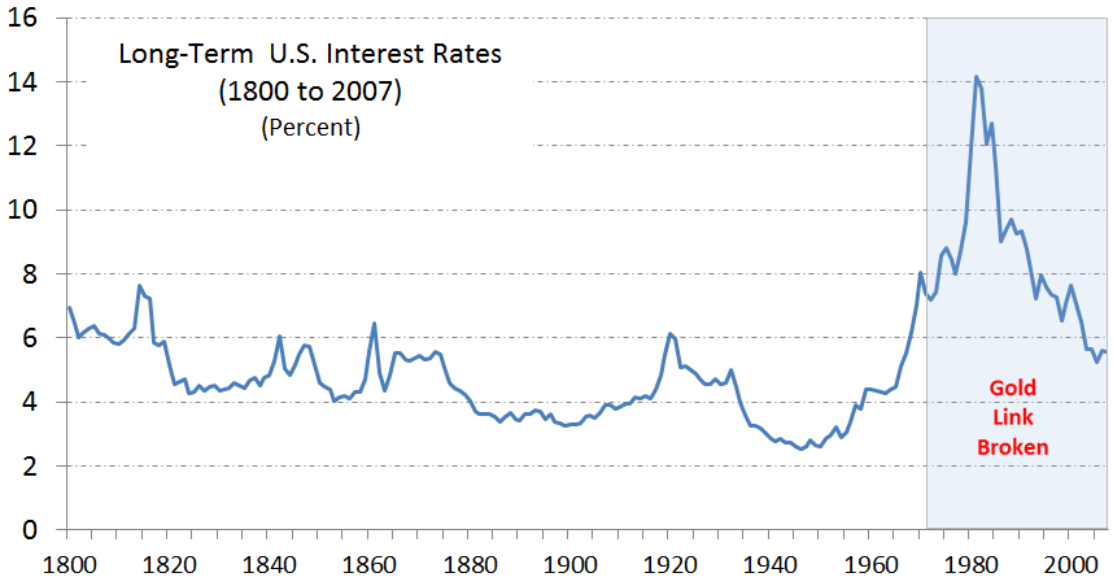


Exhibit 47: Long term U.S. interest rates 1800 – 2007; Source: http://www.measuringworth.org/datasets/interestrates/result.php

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

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

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

Interest rate and foreign exchange rate volatility

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

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

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

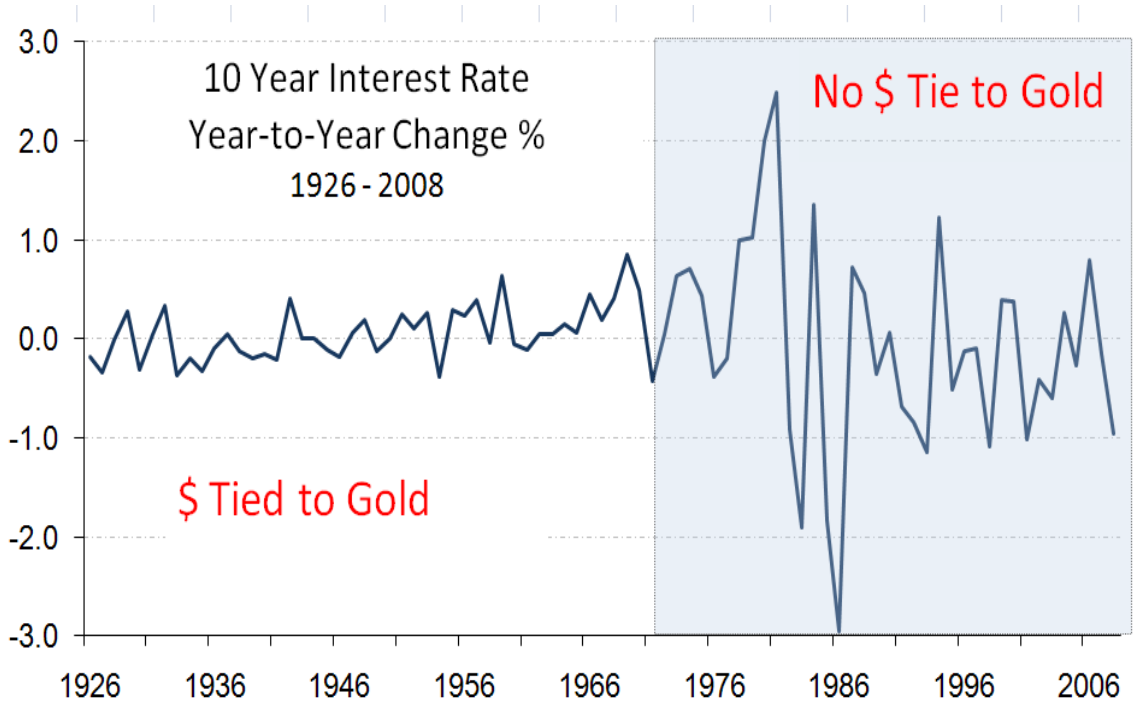


Exhibit 48: U.S. 10-year bond year-on-year interest rate change; Source: Federal Reserve

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

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

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

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

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

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

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

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

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

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

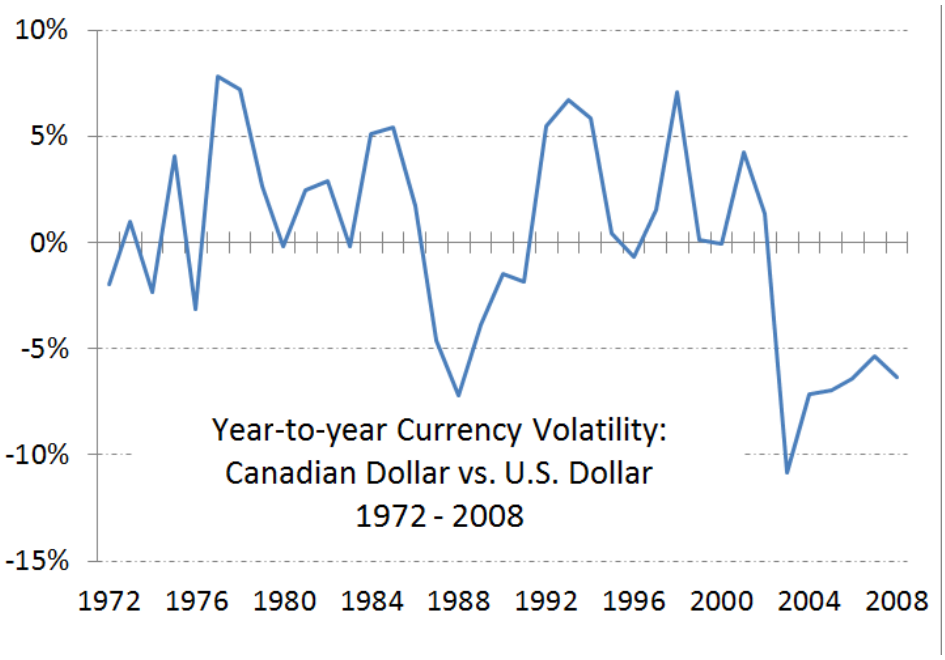


Exhibit 49: Year-to-year currency volatility: Canadian dollar vs. U.S. dollar 1972 - 2008

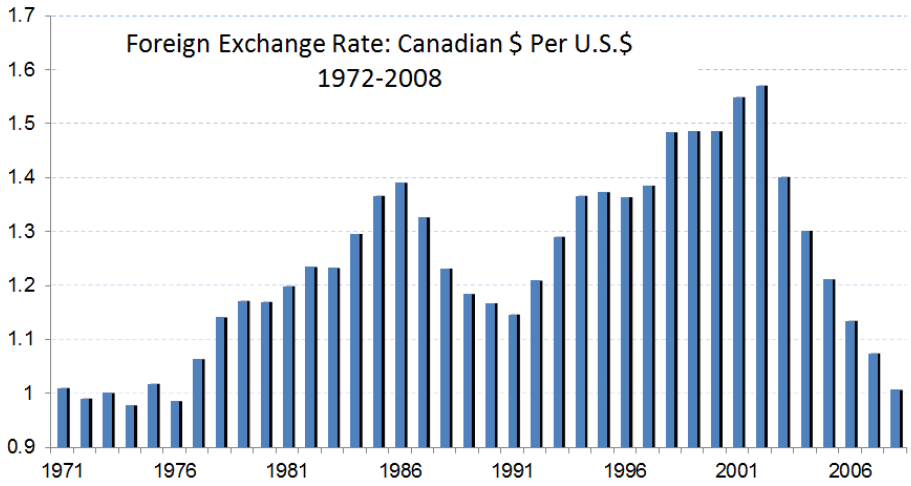


Exhibit 50: Foreign Exchange Rate: Canadian dollar per U.S. dollar

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

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

Wall Street and the banks

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

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

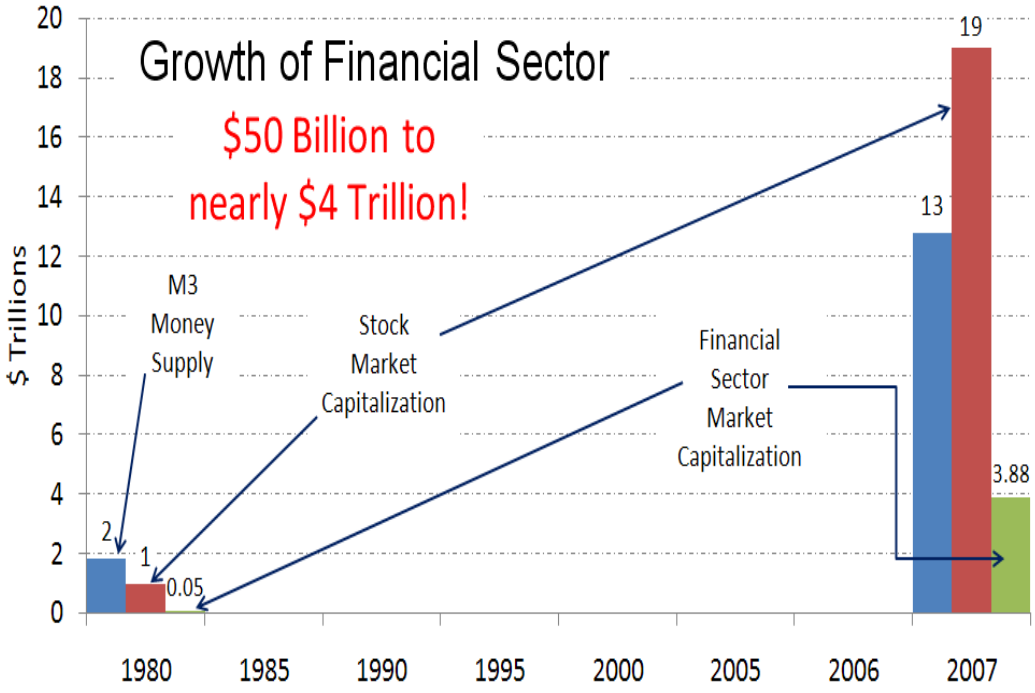


Exhibit 51: Growth of the Financial Sector

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

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

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

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

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

Here is another way of looking at the data:

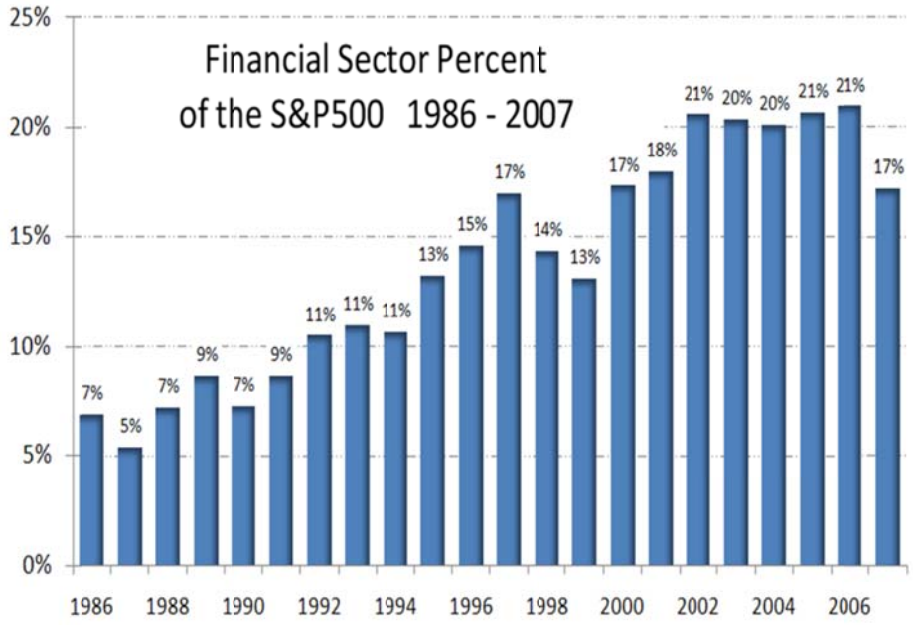


Exhibit 52: Financial Sector as percent of S&P500; Source: Standard & Poor's

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

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

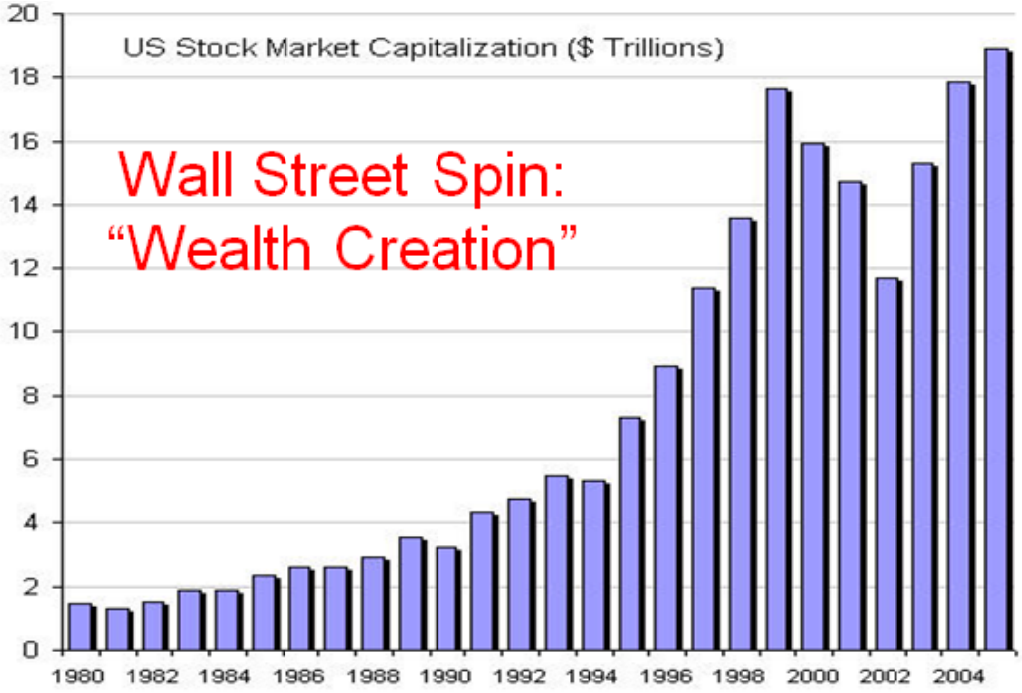


Exhibit 53: U.S. Stock Market Capitalization 1980 - 2005

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

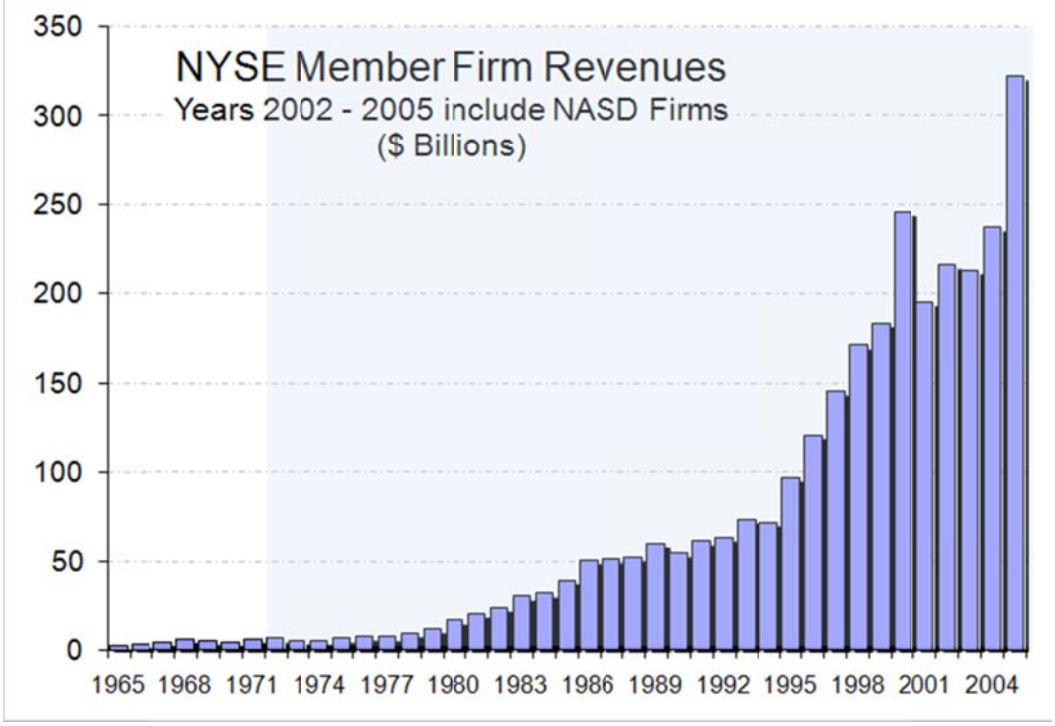


Exhibit 54: NYSE Member Firm Revenues 1965 – 2005; Source: SIFMA

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

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

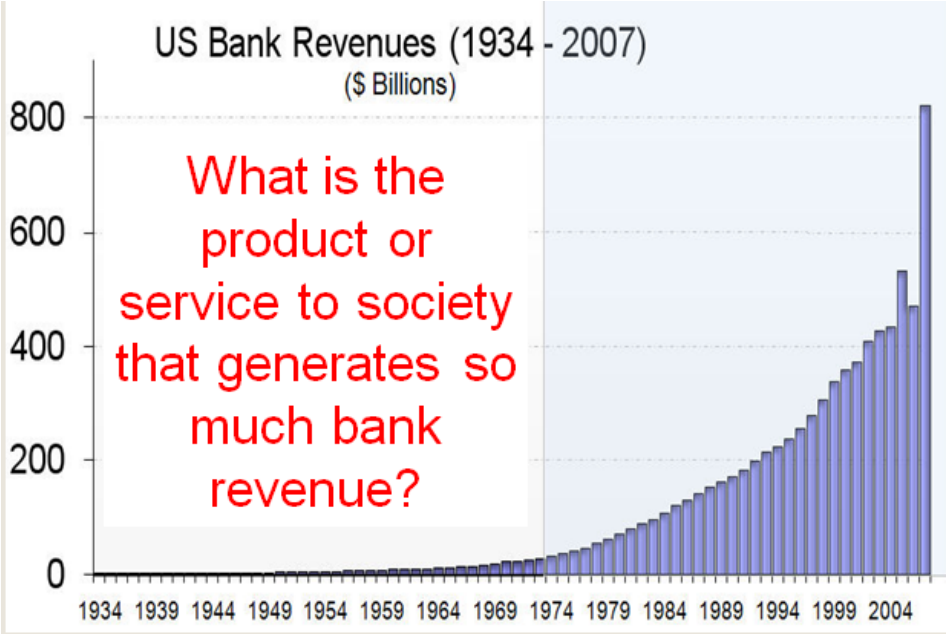


Exhibit 55: U.S. Bank Revenues 1934 – 2007; Source: FDIC

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

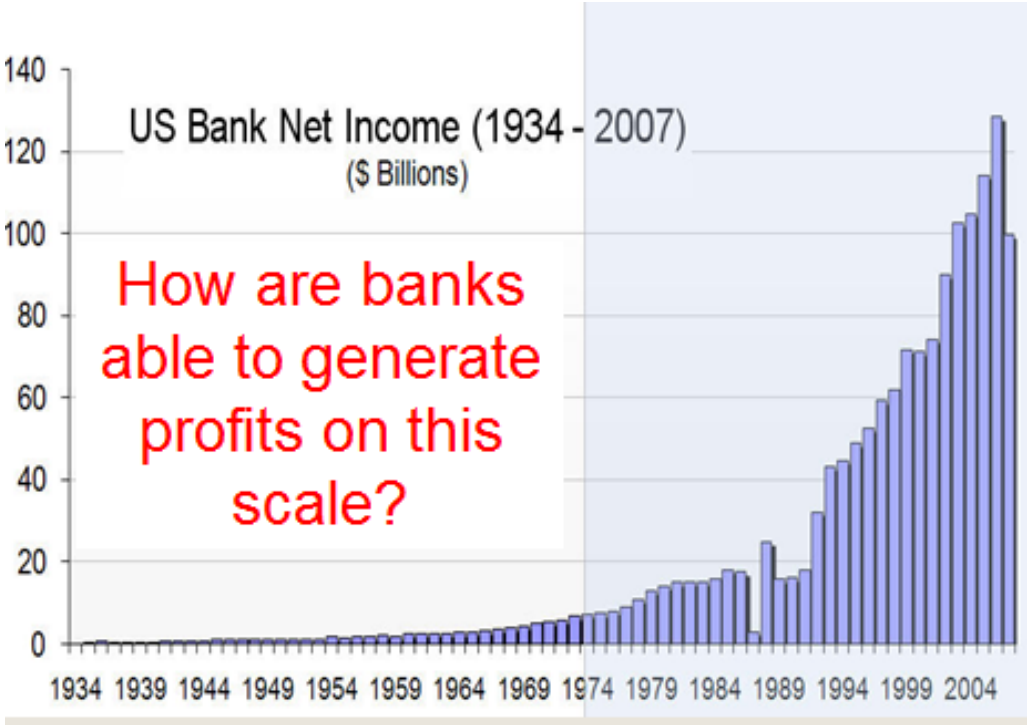


Exhibit 56: U.S. Bank Net Income 1934 – 2007; Source: FDIC

Consider the tradeoffs between commodity money and legal tender irredeemable paper-ticket-electronic money for banks. With commodity money, such as gold or silver, the role of bankers is limited to: (1) storing money for safekeeping; (2) acting as intermediaries between savers and credit-worthy borrowers; and (3) facilitating the payments transfer system. with legal tender irredeemable paper-ticket-electronic money, bankers

have a greatly expanded role: they sell instruments to hedge interest rate and foreign exchange volatility; and they create fiat money (in the form of credit) for which they get the interest and fees. In effect, banks' traditional role as intermediaries between savers and borrowers decrease, and the banks become the equivalent of hedge funds whose downside is guaranteed and subsidized by ordinary working people. The euphemisms for these guarantees are called the "lender of last resort" bailout facility at the Federal Reserve, and so-called Federal Deposit Insurance, which is not insurance.

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

Exhibit 57: Citibank stock from about 1979 to about 2009

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

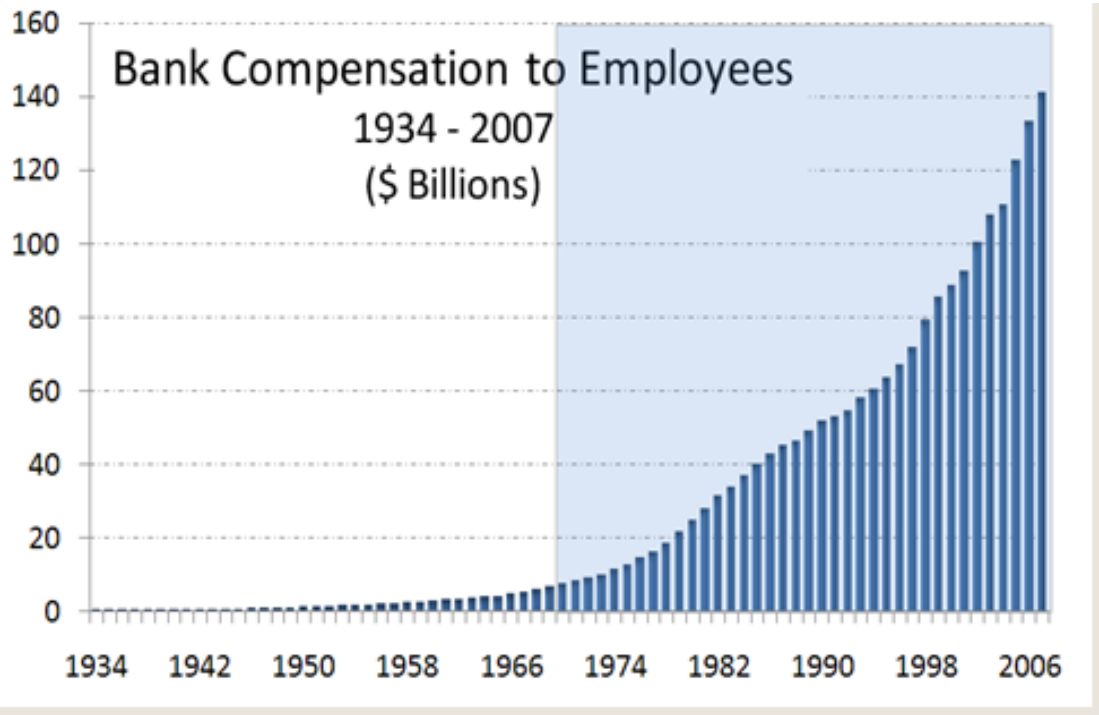


Exhibit 58: Bank Compensation to Employees 1934 – 2007; Source: FDIC

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

Special privileges for banks and other financial players

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

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

Taxes on money

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

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

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

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

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

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

Summary and Recommendations

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

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

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

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

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

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

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

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

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

After the Civil War experience with Greenbacks, to protect against the depreciation of paper money, for long-term transactions, e.g., real property leases, long-term loans, bond issues, people inserted a "gold clause"

in their contracts.[37] This provided that future payments should be made in gold at the same weight and fineness as were current at the time that contracts were entered into.

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

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

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

Other recommendations that are not addressed by the proposed Act:

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

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