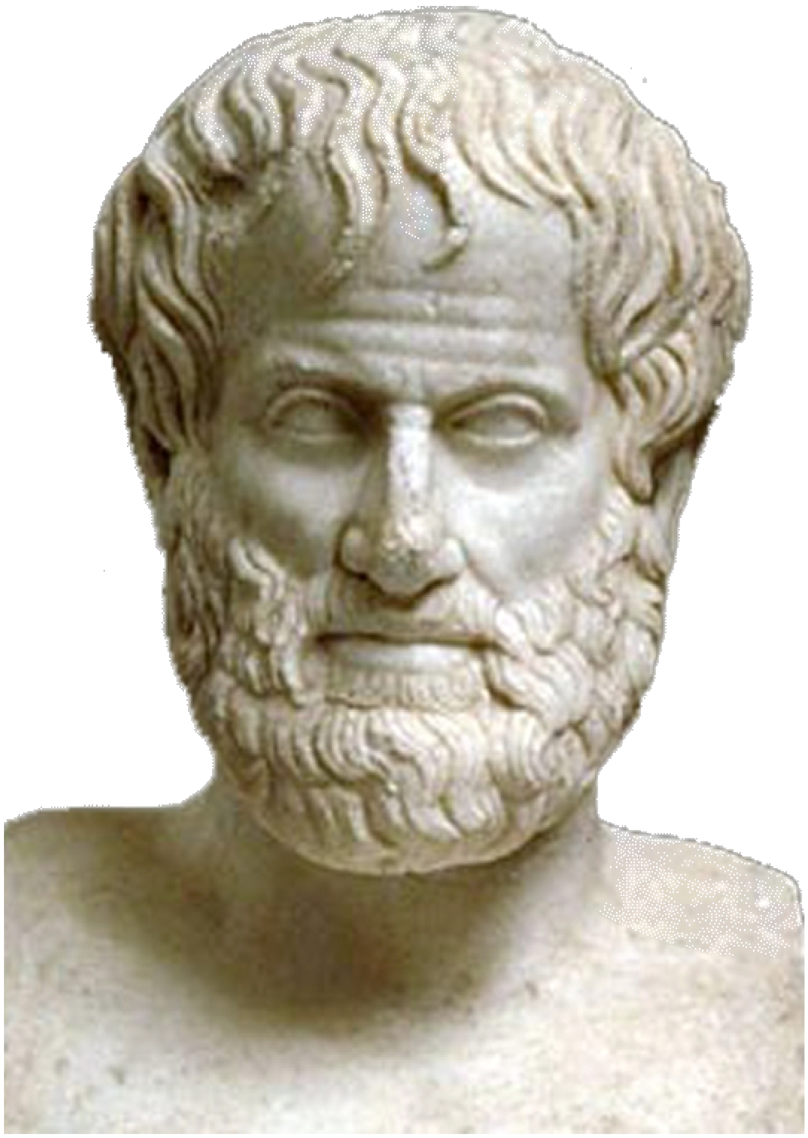
The Forum Hall of Fame

A Special Gold and Monetary Discussion

Aristotles's Commentary



Aristotle (2/7/2000; 7:15:24MDT - Msg ID:24589)

It begins!
-----* Executive Summary -- an Outline of Observations *-----

*** Any monetary system that attempts to coin Gold, or otherwise use Gold as currency will naturally give rise to banks -- for security and quality assurance if for no other reason.

*** History reveals time and time again that this seemingly "perfect" Gold-only system naturally evolves into fractional-reserve lending because *it is what the people want*.

> ((i.e., People want to consume or to own now that which they have not yet saved enough to purchase outright. They are willing to mortgage their future productivity in order to have their house today -- they seek sources of loans. Meanwhile, those that already have a quantity of money are seen to seek a source of income from their wealth...and banks come to be actively sought and employed by both sides to act as the middleman.))

*** While lending depositors' deposits, the efficiency of banking to reallocate fungible funds allows many people to behave as though they all are "owners" of (i.e., have access to) the same original quantity of deposits.

> ((i.e., The bank uses its available, unlent funds to satisfy any depositors' requests for withdrawals rather than the alternative of reminding them that the funds are temporarily unavailable -- because in order to earn interest, the bank lent the money out, as per their agreement.))

*** Through lending (coupled with the phenomenon described above,) the artificial (i.e., man-made) increase in the money supply erodes its per-unit purchasing power.

*** A growing economy (complete with rising prices from a "softer" currency) raises the customers' demands upon the banker's art of money creation, widening the gulf between here and reality...between the vast amount of banking credit and the small original amount of real wealth-deposits upon which it was all built.

*** Because Coin and bank-credit circulate as equivalent, interchangeable currency and means of payment, the value the currency-unit, regardless of form (Gold coin or paper,) falls in accord with the growing supply of bank-credit.

> ((i.e., The many accounts filled with bank-credit "money" gives rise to the wealth-effect built upon the perception of abundant funds. This pressures prices higher and puts the effective purchasing power of the currency-unit severely out of balance with the proper and natural purchasing power that should otherwise have been enjoyed separately by the small quantity of real Gold on hand. In practice, this renders the metal used in the under-valued coins into little more than an artifact of "the good ol' days when things were cheaper."))

*** Thus, when the value of the coin comes in time to be viewed as merely a representation of the abundant supply of credit-money and thereby fails to reflect the value of its metal, from a practical standpoint it might as well be made out of anything at that stage.

> ((i.e., If a paper dollar can circulate at par with a Gold dollar, and the purchasing power of

both is equally dictated by the supply of bank-credit money, then why incur the expense of minting token coins out of Gold??? If simple durability is desired, then copper or nickel would certainly be capable to represent the currency's function every bit as well as the paper does. Therefore, avoiding the expense of Gold in the production of currency for circulation would easily be seen to be an act of prudence, whether the value involved is 1¢ or 100 dollars.))

*** In this progession, the developing concept of "money" gradually loses its originally-perceived meaning along with ties to *real wealth*; it comes to be built upon the thin ice of confidence and good loan/counterparty performance through the banking system.

*** Fixed Gold Convertibility as a currency of the credit on account looms large as a threat to the banking system.

((Keep in mind that it is through natural human activity that banking evolves into an important system for much of society, built by a population that has come to depend heavily upon it. Therefore, a stage will always arrive in which the fixed Gold convertibility in the shape of circulating currency will be purposefully abandoned. It is done to preserve "lifestyle as we know it" in the eyes of those people living at such a stage in a currency time line.))

*** What then is the role for Gold? Gold qualifies as MORE TRUE than money. Among the many national currencies, only Gold *in physical form* fills the three standard monetary criteria (store of value; medium of exchange; and unit of account) without *WITHOUT* the associated risk of default. Gold, therefore, remains the ultimate, sovereign king of them all and subject to none... as long as it isn't attached in any official capacity to the fate or fortune of any one of them. Therefore, the monetary system architecture must be such that Governments find no temptation -- that they are unable to derive any benefit to their own situation through any efforts to "keep a lid" on Gold.

*** Gold must be set free to float, seeking its proper value among the world of circulating currencies/monies; preserved as a *unique* "international currency of wealth" that may NOT be lent (because lending effectively causes a perceived increase in its supply and corresponding decrease in its purchasing power, as outlined above.) Gold must only be bought and sold outright, and must remain free of the attachments of any and all financial derivatives.

*** All people, regardless of nationality, must be free to exchange their national currency for Gold at prices established by an open physical Gold market.

((As I've said before, any system in which a person is denied the liberty to own Gold as a form of savings is both financially and morally bankrupt.))

How will this work, you ask?

*** An extention of Gresham's law predicts that the world's supreme currency, Gold, will not actually circulate in the conventional sense. Gold will be saved (and will appreciate in value absent the lending/leasing of it for interest,) while national fiat currencies will circulate under the needs of the economy. It is these national fiat currencies that will continue to satisfy the demand of borrowers for loans. National fiat currencies will also serve as the means to satisfy the various governments' unrestrainable inclinations to "manage" their economies to the extent that they are able. They, too, will hold Gold in savings (reserves) for the same reason we do.

The supporting chapters are to follow in this commentary -- "Building the Perfect System by Capitalizing on Gresham's Law"

Aristotle (2/7/2000; 8:10:15MDT - Msg ID:24593)

Building the Perfect System by Capitalizing on Gresham's Law

At first cut, people fall into one of two categories: 1) those who recognize the value of an honest monetary system built upon Gold, and 2) those who have not yet given any serious thought to the matter. Proceeding with the small but special population that belong to the first category, my own experience has revealed them to be inclined toward idealism. Good people, to be sure -- I wish we were all that way! But while their general awareness of what makes for a more perfect world should be providing them with fuel for an enjoyable life, instead, this level of idealism often blinds many of them to any shades of gray -- and there is little comfort living in a strictly black-or-white world. I write this with hope in the off-chance that it may help provide a source of comfort to this small group of idealists, offering them some subtle shades of gray that won't completely undermine their idealistic integrity.

While reaching out to my idealistic friends, I also hope to present a "roadmap of thought" for that larger, all-important population which falls into the second category mentioned above -- those that have not tapped into a more thoughtful, enjoyable life which I have seen to be the general hallmark of my few Gold-minded friends (the ones who have themselves avoided the extremist idealistic trappings.) Why do I call this second category the "all-important" population? Because the Many do indeed dictate the terms under which the Few must also live. I must, therefore, grudgingly devote sufficient attention in this commentary to ensure some of the idealistic readers can see this important "shade of gray" regarding majority rule. It is my hope that they will then be prepared to pragmatically accept the terms/constraints under which this *perfect monetary system* must be designed.

In this commentary I shall attempt to clearly lay out what I feel this "perfect" monetary system to be -- the *perfect* system for a consistently *imperfect* world, that is. I am not so bold as to think that the world of human ambition and disposition is something that can be altered to suit the perfection of our preferred (Gold coin) currency's characteristics -- especially the limitations (fiscal austerity) it imposes on its users, the population at large. I therefore resolve myself (and hope you do, also) to the humble thought that our currency system *as a whole* might be artfully developed into a state of harmony with the world in which we do live. The present system, and all failures before it, have been as square pegs in round holes. With the system to be described, I hope to avoid any system that lends itself to the repetition of past abuses and failures.

The Stage Has Been Set; Let the Play Begin...

Those familiar with the popular discussions of monetary thought will recognize the common plea of the idealistic Gold advocate: calling for a return to a 100% fully "backed" and convertible Gold standard currency system. (As if that were somehow the magic pill to cure all that ails us.) The solution is not so simple, and to believe so is tragically naive black-and-white thought. For confirmation of this, look to our past where you will surely see a familiar world, populated with people that were motivated by the same thoughts that motivate us today. In "their" world (fundamentally the same as ours) we have already had a convertible Gold Standard, but, in fact, history reveals that it did not work. Or maybe more correctly stated, modern times reveal that it did not SURVIVE. To be sure, any conceivable system might be seen to work well for a limited span of time--and indeed, history paints a vivid landscape populated by many currency creatures of various lifespans--but true success is determined by who remains to answer the daily roll call. HOWEVER, from where we sit we can gain important wisdom in the observation that, despite the overthrow of the Gold Standard regime, Gold remains an unparalleled reserve asset; carefully weighed, numbered, cataloged, and stacked, resting well-guarded within central bank vaults throughout the world--unmatched in financial staying power even as all else fails.

Having acknowledged this history, there is no point in rashly calling for us to repeat the mistakes of our past. The problems that killed a fully-convertible Gold Standard back then are still with us today. But take heart. The problem was not with the Gold itself. The problem was with the Gold Standard's fit with the prevailing banking/financial "System." If we objectively face the cold hard reality, we realize that we can't very well live with the lack of either one. But paradoxically, history shows us that the two cannot sustainably coexist--at least not under the various system-designs tried in the past. In my usage here, the "System" refers simply to the dynamic interaction between a currency and its users within the context of evolving economic demands for development, commerce, and banking. (Even to the extent of self-destruction, the System is notoriously good at giving the people what they want.) It is the subtle changes to that system that I hope to spell out, revealing not only how Gold can survive society's preference for the current self-serving System, but also how the System can tolerate/survive the discipline of Gold. In fact, the diametrically-opposed System will not only survive in the face of Gold, but will actually be made more functionally viable by Gold.

Now that you see what we are in for, it seems appropriate to launch my endeavor with this quote from John Kenneth Galbraith: "*Most things in life--automobiles, mistresses, cancer--are important only to those who have them. Money, in contrast, is equally important to those who have it and those who don't. Both, accordingly, have a concern for understanding it. Both should proceed in the full confidence that they can.*" It is in the spirit of that assurance that the playing field has been made level for a such a Little Leaguer like myself that I shall embark on this attempt at passing along my own view of the monetary system. We are told above that everyone should share a common concern for understanding it. Actual experience reveals that few people can muster a basic tolerance for any meaningful dialog on the subject (money.) To be sure, they can be seen to talk at great length on the various schemes for making more of it, but not a word is to be had on the design of it. For that reason, I am thankful that USAGOLD provides this dedicated roundtable of guests to serve where the general population fails to pursue this line of monetary discussion.

Before I go further, I must confess that the map I see before me for the proper delivery of this presentation reveals a path I nearly fear to tread. (Although this view may not match theirs precisely, I have been encouraged to see that some of these same thoughts have also been touched on by PH in LA, FOA, Solomon Weaver, Journeyman, and ORO, to name a few that come to mind. They are seeing the shades of gray.) As I've already hinted, it will likely go against the grain of thought among the staunchest of Gold advocates. But hopefully my long pro-Gold track record will buy me their indulgence as required to read and absorb the thoughts contained in this post with some remnants of objectivity rather than outright dismissal. Herein lies the thorn: for the reader to have any hope of finding merit in this commentary, he must admit--even if only temporarily--that fiat ("paper") currency (i.e. dollar, euro, peso, yen, etc.) is not "completely worthless"...regardless of the enduring popularity of that notion among Goldhearts. Please bear with me; I'm sure you'll like the ending--even if you've already decided that you don't like this ominous beginning.

It doesn't matter who I am, but...

A brief introduction may be called-for to help you to better understand my position, and thereby evaluate whether or not my own thinking behind this commentary is clouded beyond the best attempt on my part at objectivity. So, who is Aristotle? You will know me better for my actions than from any other detail. I seek to recognize both the benefits and the failings of our existing monetary system, and strive to live life for full enjoyment in accordance with each. As such, you should be made aware that I already live "in tune" with what I am about to describe as the perfect financial system within an imperfect world.

I fully realize that I live in a world of fiat currency. Specifically, mine is a fiat dollar world, though not by my individual choice. It's what the majority wanted and dictated, and it's beyond any of us to deny its existence and credibility. Recognize that, and recognize also its failings, and you are poised to enjoy the best life you can possibly muster. Fail to recognize either side in this day and age, and you are either shorting yourself now (by somehow feeling miserable that paper dollars actually work,) or you will be shorted later (by the inevitable rude discovery that paper dollars weren't quite as good as Gold after all.) I comfortably walk the line of this understanding that dollars work for a purpose, but are not as good as Gold.

I live and work in the real world of fiat currency--there is no point in trying to be circumventive about it. As I work I am paid by others with fiat currency, and I quite happily pay my own bills with fiat currency. I manage my expenses responsibly, and so there is always some fiat currency left over at the end of each month. This I exchange for Gold without fail--to serve as my savings for a later time. No doubt this arrangement will appeal to you in equal measure with your understanding that Gold is the ultimate money; with your sense that it won't/can't be manipulated into extinction; and with your appreciation for the notion that a person, on average, can produce over a lifetime more than he consumes. That final element should also hold true for a group of people (such as a nation,) and no magic of accounting can alter that long-term necessity. Establishing a reliable "accountant" for your life's period of productivity should be enough for any honest person, and Gold serves that role better than any other. I believe those who share this view are among the fortunate few that are ahead of their time--even as the world is rushing to catch up. This will be clearer in time as I explain.

Greed is the one trait that would preclude the successful enjoyment of this present position--a position one step ahead of the following financial evolution. It is a trait that I thankfully find myself lacking--perhaps due to deficiency of imagination. Greed (and arrogance too, I suppose) would entice one to attempt to capitalize on investment leverage and timing of the markets to maximize their gains for the precise day that the world awakens to a new reality. I am far too dull-witted to know the unknowable, so such a strategy of leverage and market timing is prone to unfold as a spectacular failure. Also, I find life to be full enough without the added burden of losing sleep at night worried about such risky investments. Only through the virtue of patience--in the understanding that we are for this historically brief time one step ahead of the world--will we find in the end that we are among the few who participate in the rewards of a world that suddenly wants to be where we already are. Hopefully this doesn't strike you as the rantings of an irrational star gazer, so with that view of the author let's now move on to the heart of the matter.

Aristotle (02/07/00; 10:52:39MDT - Msg ID:24602)

Part Three -- A Test of Your Monetary Maturity

The vagaries of the economic process in the real world make it infeasible to give this matter a comprehensive treatment in this format (nor would I be mentally capable!) so of necessity I will only build upon the most fundamental core principles throughout this commentary. With that caveat out of the way, let's tackle this fiat currency issue right now so that we may sooner breathe a sigh of relief that the bitter pill has been swallowed and that recovery is at hand. How often have we all rallied at one time or another around the Goldhearts' battle cries: "The Fed (or banks in general, or government) simply makes this fiat currency from thin air!" "Fiat money is worthless!" "Fiat currency is the Fed's (or banks', or government's) tool to keep the poor man down." Well, a cold hard reality is that contrary to this line of thinking, while I do indeed fit the description, I certainly have not been kept "down." Have you? Further, and directly to the point, fiat currency isn't "worthless." Have you ever tried to buy anything with it? Did you succeed? I'm sure that you did, so what does that lesson tell you? As a general rule, a person rarely gets "something for nothing." Therefore, the fiat currency must certainly be "*something*," and that "something" can't BE worthless.

There is a subtle but important distinction here between being "nothing of value" versus being no **thing** of value. A dollar (or any other fiat currency) is certainly no longer a *thing* although it once was (back in those days of yore when it was defined as a certain weight of Gold.) But it does in fact have value--a value it finds in measure of the success with which it retains the original Concept of value it represented at the time of its origination...at loan creation. This "Concept" is built on a unit foundation of arbitrary size, to be sure; and there can be no doubt that this remains a fundamental weakness for it to serve properly as money (medium of exchange, store of value, and unit of account.)

Nonetheless, the value in any given currency-unit originates in the terms of the loan contract in which the borrower has promised to repay these units of currency to the lender. And while it seems that these currency units are indiscriminately created out of thin air, each of the many trillions in existence today were created through the joint cooperation of a lender AND a borrower. It takes two to tango. Want to find value in a dollar? Simply track down a new homeowner who toils each workday to pay off his mortgage. (Is he *evil* for borrowing money from "thin air"? More on this later.) It's easy to convince yourself that people will provide goods or services in return for dollars--either because they themselves are in debt and in need of the currency to repay their outstanding debts, or else because they believe with near certainty that these same dollars will be useful to them as a medium of exchange when they encounter somebody else who is burdened with outstanding debts.

A Commonly-stated Problem With Fiat Currency

All in all, the system works about as well as any other manmade thing. Unfortunately, taken as a whole, dollars retain their original value only as reliably as wage-earners and price-setters remain content with past pricing levels. And that is influenced in large part by the perceived ease with which additional dollars may be obtained or loans defaulted on. If a significant number of borrowers will not validate the dollars they borrowed through some manner of equivalent production, then the foundation of its value is eroded. Our own Federal government for example, in its consistent failure to balance its operating budget, has effectively become a significant collective of borrowers that refuse to service their debt--they don't pay back their loans. The government is thereby failing to validate its many trillions of borrowed dollars; and the currency system suffers. The dollar value falls and prices generally rise.

The flip side of the coin regarding money supply is where loans are being paid back more rapidly than new loans are written to keep the outstanding money supply expanding with the prevailing growth rate of the real economy. In this circumstance, increased competition for dollars during this relative contraction in the money supply generally results in an increase to the dollar's value; prices would generally fall. The problem with these expansions and contractions, these inflations and deflations of the currency supply, is that in business and in private life both, people tend to enter into long-term contracts. Because earning power, prices, and wages are subject to this variability over time due to changes based on business cycles and money supply, the act of entering into long-term contracts becomes a mixture of faith and gambling.

As I've stated in an earlier post, people have generally been more comfortable to see monetary supply inflation erode the purchasing power over time. The coping mechanism is to renegotiate for pay-raises--and to face paying higher prices. They are less willing and less happy to renegotiate lower rents and wages and lower prices received for goods resulting from a currency that gains value over time. Due to the prevailing inability of people and businesses to accommodate a currency that gains purchasing power over time, the fallout is harsh. Instead of adjusting the price of contracts downward, the reaction is typically to reduce production and cut back on labor when business profits yield fewer currency units. Economic recessions/depressions are frequently the undesired effect of currency supply that either fails to grow as fast as the economy demands; or worse, a currency supply that actually contracts. This has traditionally been the impetus for a well-intentioned government to attempt various degrees of monetary interventions to bring about more desired economic conditions.

<u>A Solution?</u>

No doubt you are familiar with these problems, and tend to agree with our intrepid forefathers whose anti-banking, anti-fiat currency pronouncements are legendary. In all frankness, these were a handful of exceptional men living at an exceptional time and who accomplished an exceptional feat -- the birth of a new Republic. It should not, therefore, come as a surprise to anyone that the opinions and desires so expressed by the likes of Thomas Jefferson and John Adams raised the bar for performance so high that practical performance by their multitudes of mortal descendants could not do but fall woefully short of their lofty vision. (In light of their exceptional life and times they desired perfection -- and why not? -- they thought they had set the world itself into a state of perfection!) I am not saying that perfection is not a worthwhile goal, but I am saying we must at least be rational about what can and can't be done in a real world populated by...well, just look around you.

Please for give my haste when I don't look up the exact quote here, but I seem to recall the great Thomas Jefferson once voiced his conviction which after all these years still has appeal and finds ample support among Gold advocates: "If banks are allowed to control the money supply first through inflation, then deflation, our children will wake up homeless on the continent their fathers conquered." The implication is that banks will issue their credit from "thin air" in return for a pledge of collateral against the return of that credit, drawing in everybody such that currency values fall, prices rise, and people seek ever more loans in their desire to buy before prices rise further, with the added benefit of paying off the loan with devalued currency. But then, in their nefarious desire to rule the world, the bankers would cause the money supply to deflate, making it difficult for everyone to successfully obtain the cash needed to repay their loans. The bankers then walk away with the collateral, leaving the borrower with nothing but a bad credit rating to show for the experience. On the face of it, this seems to be a noble enough assessment, and gives rise to the equally noble suggestion that our problems would be solved if banks could simply be done away with...these institutions that were once said to be "more dangerous than standing armies." So there you have the perfect inspiration for the monetary system of your dreams, worthy of any true patriot....you suggest we eliminate banks--and with them goes the inflation-threat from the paper money they create--leaving us with only Gold coins as currency.

Not So Fast, Sport Shoes...(you'd better rethink your advice)

Ok, for the sake of indulging this off-the-cuff "perfect" solution, let's be optimistic and assume that we could indeed suddenly find ourselves in a system in which banks are non-existent, and only physical Gold coin is currency. In our euphoric pursuit of perfection, we need only to roll the clock forward from this "perfect" starting point to see that we've rashly and incorrectly assumed that our modern problems could be avoided. First come the banks out of necessity, and then the fractional-reserve lending phenomenon naturally evolves into existence-- whether or not it was deliberately intended from the outset. Are you skeptical? Consider this: it would be a mistake to give thought to monetary matters without due consideration of the weave of our social fabric--examined through the magnifying lens of history.

In the real world, banks are necessary. We need only to look at the circumstances surrounding the appearance of the first significant public bank as documented nearly two centuries after-the-fact by Adam Smith in his "Wealth of Nations," written as America was just a newborn pup. The setting was Amsterdam, a bustling international trading center as the 1500's gave way to the next century. As Adam Smith describes it, the bank was formed and thrived by filling a specific market niche: addressing the corruption of the currency. In settlement of trade, Gold and silver coins from many countries and many mints (public, private, and some disreputable) were in circulation, and as is ever the case, the coins of inferior alloy or those clipped of proper weight were always the first to be offered to the merchants. In addition to the money-changing manuals that served to document the metal (money) content of the coins from the various known mints, the merchants had scales to verify the sum of coins offered as payment. However, the good quality and reputation of these scales was seen as suspect in the eyes of the shopper even as the coins were seen in the eyes of the merchants. Smith wrote: "*In order to remedy inconveniences, a bank was established in 1609 under the guarantee of the City. This bank received both foreign coin, and the light worn* [and other debased] *coin of the country at its real intrinsic value in the good standard money of the country, deducting only so much as was necessary for defraying the expense of coinage, and other necessary expense of management. For the value which remained, after this small deduction was made, it gave a credit on its books.*" Here you see the coins naturally coming out of circulation in favor of "mathematically certain" bank accounting.

In this way, much of the effort and cunning that went into adulterating the coinage by men of low integrity was thereby rendered unprofitable. This system worked well for all parties involved in trade, and the popularity gave rise to similar banks in the nearby trading centers of Delft, Middlebourg, and Rotterdam, and then to other countries. (I've got to work Rotterdam into every long post...have you noticed?) History also records that "banks" have also come into being for the purpose of the security against theft. Early metal smiths also became early bankers by virtue of the security offered by their strongboxes. What practical-minded person would deny the modern need for a similar service in the event of a return to a strictly Gold-based currency system...for safekeeping and for quality assurance?

Yesterday's Performance is no Guarantee on Tomorrow in the 'Business World'

The Bank of Amsterdam was said to work well for a full century, with a man's deposits remaining his on actual deposit until such time as he transferred the money in payment to another man's account. The money (Gold) was not lent out, and so when Louis XIV's French army approached Amsterdam in 1672, causing the depositors to rush to the Bank in fear for the safety of their money, those panicky depositors all discovered that their money was indeed on hand for immediate withdrawal. The fear-induced bank run gave evidence of yet another universal truth about the nature of mankind--that when satisfied as to the apparent safety and availability of their deposits, they no longer desire to follow-through with the actual withdrawal of their funds, remaining content to let the bank serve as the guardian. And so we have the seeds of the eventual fall of the Bank of Amsterdam, and many thousands of its successors. The Bank's ownership by the City of Amsterdam gave rise to close associations with the Dutch East India Company by virtue of the same men often involved in the governing or management of both operations. Due to the nature of their business, when literally waiting for their ship to come in, even while still a solid company with solid profits, the East India Company would from time to time need a short term provision of credit. In a precursor of what modern banks would come to call their bread-and-butter business, the Bank began to provide these loans to the Company out of depositors' accounts. When business profits turned south for the East India Company in the late 1700's as many ships and cargo were lost in the war, the loans increased; the City government itself also came to rely on the bank for loans.

During the first century of operation, merchants preferred to receive payment in bank deposits instead of the uncertain quality of the coin of the day. But as the loans of the Bank increased, and as the Bank began to put limits on withdrawals or transfers to accounts at other banks, merchants began to cast a wary eye upon payment made in bank deposits, and they raised their prices to reflect this growing uncertainty, discounting the value of the bank money. As you might expect, when a bank can't be counted on to reliably provide your money on demand, its days are numbered. And so it was for the Bank of Amsterdam--the doors were closed in 1819. It should also come as no surprise that similar scenes were played out many times on a smaller scale by the metal smiths mentioned earlier. After being sought out for the security of their strongboxes, and after a period of reliable service, many smiths would observe the willingness of their depositors and citizens in general to leave the Gold under lock and key, opting to circulate the receipts of ownership instead. The more unscrupulous among them would come to grant loans to others for profit, or else grant loans to themselves through the issue of receipts for more Gold than they held. When rumor brought about sufficient alarm to bring in an abundance of receipts for redemption all at once, the game was up and justice was swift--though to be sure, this righting of the wrong on the inevitable day of reckoning was COMPLETELY unsatisfactory to the good citizens left holding worthless Gold-receipts from the bank after the Gold ran out.

Aristotle (02/07/00; 13:14:18MDT - Msg ID:24610)

Part Four -- Outright Bank Fraud IS Black and White, but this gets Very Gray Very Quickly...

You have likely identified the problem in both of these examples: the entity providing the banking service began issuing loans using their customers' deposits without the consent and cooperation of the depositor. Let's consider an example in which the bank is of the most noble character and management, simply offering safe storage and quality assurance of the Gold currency. It is human nature that those with wealth--such as we might find among those having deposits in our hypothetical Noble Bank--might seek to generate some income with their wealth. They might play an active role in this attempt as a venture capitalist, offering their money directly to entrepreneurs in return for some profits after personal negotiations convince them of the viability of the prospect.

But not all would-be-lenders and borrowers are well suited to negotiate and organize such arrangements themselves, particularly the smaller would-be lenders seeking an income, and the smaller would-be borrowers seeking funds for such things as small business expenses. The Noble Bank easily develops the in-house expertise in evaluating those borrowers that represent a good credit risk, and can organize the formal loan arrangements on behalf of their depositors. And rather than matching up a depositor/lender with a borrower on a personal, individual basis, the Noble Bank would come to pool the depositors' funds into an anonymous operation in which the profits from the lending of capital are then provided to the depositors (minus the Bank's own profit for providing this service) according to the amount of funds the depositor put into account with the bank. This provides the flexibility demanded by the banking depositor to generally be able to access his funds as needed.

It's like this. Assume that you, me, and someone else have all put $10 in Gold coin on deposit with the Noble Bank for safe keeping, with the added hope to earn a return on the Bank's ability to lend it at a profit in the meanwhile. Let's say a shoe cobbler needs to buy leather and a new sewing machine in order to make new shoes, so the bank lends him $18 of the $30 available. The cobbler takes his borrowed Gold, makes his purchases, and sets to work in order to repay the bank $19 from his anticipated profits within the coming months. In the meantime, you incur unanticipated expenses, and need to obtain your $10 deposit back from the Bank. Because this Bank wants to keep you happy, and to retain your future business, it doesn't tell you that $6 of your account is currently unavailable (out on loan) as per your wishes for the bank to earn you an income, and that the cobbler will be returning it (along with the profit you sought) in regular installments over a period of time. Instead, the Noble Bank gives you $10 of its remaining $12, and hopes that neither me or that third depositor will want to reclaim our own deposits anytime soon.

Here you can see that no money was created out of thin air. But the size of the Noble Bank grows as a good track-record of management attracts ever more deposits in which withdrawals don't threaten the remaining funds on reserve, and the depositors all come to perceive through their good experience that the entirety of their account is available to them should they need it. The bank would accommodate this concept of reality by shuffling the credit distribution among accounts to provide the depositor's money on demand. This creates the illusion of money being in more than one pocket at the same time through no *fault* or evil intent of the Noble Bank. This is what the users of the System wanted, and this is what we got. And as the cobbler's leather supplier deposits the cobbler's Gold payment into the neighboring Honest Bank in order to earn a return, the process may continue yet further. The economy seems to experience an abundant money supply, and the purchasing power of all funds are thereby diminished by rising prices as the actual goods offered for sale are then held more dearly than the money which has suddenly become so easy to come by.

Please note that in this example, I didn't once use the term interest in connection with the lending of money. A great many of the over-zealous Gold advocates try to equate the lending of money at interest with the evils of usury, so I purposely avoided that trap which has become a mental stumbling block in their thinking. While they might be inclined to say rightly or wrongly that lending at interest should be banned in order to eliminate the "sin" of usury, they certainly can't make that claim against the form of venture capitalism that I laid out above. And if the banks come to define the terms of providing venture capital from their available pool of deposits as a standard low interest rate rather than higher claims on profits that vary from borrower to borrower, what's the harm?

Too Much of a Good Thing

A quick historical note is in order here on the position of famed economist David Ricardo, who was a strong supporter of the Bullion Committee and its position in favor of the Gold Standard in monetary discussions hosted by the Bank of England in the early 1800's. The purpose of the discussions was to get to the root of the problem regarding rising prices, including [the price of] uncoined Gold bullion. The center of the debate was whether bank notes--which by that time had formed the bulk of circulating money supply--were losing value, or was Gold simply rising in price? Given the observation that other prices (such as bread) were rising, the verdict was against the bank notes, just as it was in the latter years of the Bank of Amsterdam when the merchants had diminished faith that the bank could successfully redeem its credits for Gold coins. In the course of the debates, Ricardo described in his works "*it was most justly contended that a currency, to be perfect, should be absolutely invariable in value.*" While conceding that precious metals couldn't be held to the desired level of perfect invariability, they remain the best-suited item we have discovered. And yet while holding this position, Ricardo was not completely opposed to bank notes, finding them to be economical and convenient, so long as they were always fully exchangeable for metal upon demand.

I'll say again, if the Noble Bank could legitimately tell a rational depositor that a portion of his deposit wasn't immediately available for withdrawal, then things would likely be closer to OK, with the bank notes in circulation representing the Gold allocated to the borrower and properly held aside for redemption of the note as Ricardo would have it. While this sounds good initially, there would still be some perception of an abundant Gold supply due to the borrowed funds hitting the marketplace, and there would still tend to be the resulting diminution of the currency's purchasing power. And further, the banks would always try to accommodate the depositor's desire to withdraw funds by reallocating their available resources, leading to a false (and eventually fatal) sense of security in the general nature and supply of money.

As you can see from everything above, it begins innocently enough. The depositors' money is physically distributed (unlike the ledger creation of credit-money used today,) but it would not be long before the depositors who had thus risked their deposits for a return came to have faith that their full deposit would be returned with interest, and acted on faith as though the Gold was actually still at their immediate disposal. But inevitably, the day always comes when confidence is in short supply, and depositors rush en masse to reclaim their deposits, feeling that money in-hand is more desired than the prospects of any returns that the bank may have to offer, or perhaps fearing for the viability of the bank itself and its ability to provide Gold for the quantity of funds in account.

And as it begins innocently enough, it ends innocently enough, too. The availability for the common man to get a loan serves as an undeniably equalizing force in society. It allows a poor person with time and energy to participate in the economy on par with a man who has his own capital. Through the credit obtained from the banks' pool of deposits, a borrower is able to gain possession of land, buildings, tools, raw materials, or other goods and facilities with which to become a farmer, manufacturer, or merchant--using the profits from his time, energy and know-how to earn a living for himself and to compensate his lenders for their extension of credit. The poorer and more wretched a man might be, the more he might wish for the presence of a bank of low standards willing to extend credit to the likes of him.

The Same Old Arguments have Always Been With Us...

But despite this common desire for banks, even from the very beginning there has always been an element of society that for one reason or another saw banks as fraudulent means of transferring the wealth of honest workers to an elite group (the lenders) with agendas to rule the world. In a letter to John Adams about his own fear and loathing over the proliferation of banks and their issuance of paper credit, Thomas Jefferson wrote in 1814: "*I have ever been the enemy of banks; not of those discounting for cash; but of those foisting their own paper into circulation, and thus banishing our cash. ...these are to ruin both republic and individuals. This cannot be done. The Mania [of borrowing and lending] is too strong. It has seized by its delusions and corruptions all the members of our governments, general, special, and individual.*" But in contrast to Jefferson, in a little-publicized footnote of history, Benjamin Franklin was a strong supporter of paper money. He saw that a national paper money provided a "general benefit" of facilitating alternatives for a government against the dual "horrors" to its citizenry of taxation and deflation. And as mentioned in the preceding paragraph, very "specific benefits" were seen on an individual basis by those who sought loans of any form of bank money (Gold, paper, credit, whatever) in order to improve their position in life.

Because the "little guy" clamors for loans just as the "big guy" who pursues bigger projects, and because the banks (which were naturally established to help the marketplace maintain the safety and quality of its original Gold currency) come to naturally play the middleman between the population with money to lend to the population seeking to borrow, the blame for all that follows is hard to pin on anyone specifically. Almost everyone in modern society comes to rely on the continuing and smooth operation of the banking system. As outlined throughout this commentary, you can see that as civilization advances and as the economy expands and the population grows, the general trend is for the apparent money supply to expand, even if the banks themselves do nothing more than efficiently reallocate deposits as needed to keep everybody happy. The threat of a bank run grows with the growing disconnect between what is perceived as the fair value contained in the underlying Gold contained in the coin that originally defined the currency unit, versus the witnessed purchasing power of the same currency units as dictated by the apparently swollen supply as borrowed and efficiently allocated by banks. Due to the unacceptably disruptive nature of bank runs on society, and the hurt inflicted on those who were late to the doors and therefore left holding worthless receipts of a newly failed bank, the inevitable outcome (generally tolerated by most) is two-fold. First, for the officially-sanctioned (government) regulation or development of a national central bank to bring more order to the hodgepodge of wayward private banks, and second, for the eventual officially-sanctioned termination of Gold convertibility for the abundance of circulating bank notes and bank deposits on account.

Aristotle (2/10/2000; 3:37:44MDT - Msg ID:24877)

Part Five "Building the Perfect System by Capitalizing on Gresham's Law"

Who's to Blame When the System Fails?

Perhaps it would be clearer if I rephrased that question. "The System" as I've defined it is the ever-changing monetary principles, policies, and practices seen in the course of satisfying the real demands of conducting business and commerce among real people. At any given moment, the System is undergoing change from one form to another, generally smooth and gradual, but occasionally abrupt and painful. But never in the largest sense can the System itself be said to "fail," although parts of it certainly prove troublesome and are altered from time to time as economic efficiency dictates. Did the old Gold Standard era System "fail" when there was a bank run at one institution or another? Well, if you were a depositor who didn't get your deposits out before that particular bank closed its doors, you might indeed be inclined to say that the System failed. But more specifically, it failed YOU. Meanwhile, your contemporaries who lived half a continent away might say that the bank closure was a healthy adjustment to the system, weeding out a weak bank. As such, System "failure" might be viewed as any time YOU were legitimately dissatisfied with its performance. Therefore, it would probably be more appropriate to ask this question instead: "Who is to blame when the System *disappoints you*?" An important thought to consider in this regard is whether any conceivable System could please all of the people all of the time.

Let's briefly examine the dissatisfaction of the typical Goldheart. In his mind the System has failed because he is dissatisfied all the time--so long as Gold is not the circulating currency, apparently. How irrational is that? Romantic, to be sure, but completely irrational. This superficial desire will never be the impetus for a change to the System as we know it. Even in the "good ol' days" the coins quickly gave way to bank notes as the circulating equivalent. There simply must be more at stake than the whimsical preferences of an individual in order to inspire change.

Something to rally around...

Here's the key factor as detailed earlier in this commentary which ultimately argues forcefully for the proper role of Gold in the monetary system's architecture. In what has been revealed as a misplaced goal, with Gold as the circulating currency, artificial inflation of the Gold supply is the unavoidable consequence because money will always be lent by somebody to somebody else who wants to borrow. As a result, under any past System architecture, there has never been a truly satisfactory means to safely and reliably escape the ravages of inflation and deflation. Having Gold attached either directly or indirectly to the circulating currency (or Gold itself subject to being lent independently as we see today), the proper valuation of Gold is always understated by the market due to the perception of of an increased (artificial) supply. Truth be told, it is this element that gives rise to my own dissatisfaction--that Gold is not at all points in time held near to its honest physical-based monetary valuation as it should be. This is true at nearly all points in time except for those brief and historic moments when the adjustment inevitably comes and Gold reaches an entirely new price plateau. This proves unacceptable for those who live in the interim periods as they strive to protect their personal wealth...those holding Gold during these past 20 years, for example. (Although make no mistake, the extent of currency depreciation in various non-OECD nations would paint a more normal looking picture for citizens holding Gold within those countries.)

As the number of people increases who are dissatisfied with the System's performance at any given moment in time, the greater the pressure mounts to effect some degree of change. Similarly, the greater the level of dissatisfaction, the greater the impetus to effect some rectifying change. For those who are yet clinging to the notion that we need a Gold Standard with fixed convertibility of the currency, please forgive me as I verbally try once again to shake you out of your mental stupor. Under a Gold Currency-based system, any time someone borrowed money they would in essence be participating in a Gold loan (much as we see happening today--an act that is ill-tolerated by those who can rightly recognize its depressing effect on the value of that same Gold/Money.) For the hundredth time, because people will always have a desire to borrow money to meet their business or personal needs at one point or another, you would always be dissatisfied by any Gold Standard that allowed these (Gold-) loans to occur. Meanwhile, everyone else would be dissatisfied by such a Gold Standard System that specifically pleased you in which money (which would be Gold) could not be borrowed as needed.

Accepting the constraints of the real world...

Any properly functioning monetary system in the real world must accommodate those seeking to borrow funds. And if I've made no other point but one, we should all see from the extensive commentary (bludgeoning) presented earlier that such a system cannot sustainably coexist with a Gold Standard which has a fixed convertibility. Inflation is always a consequence, and then so are bank runs, a phenomenon unique to any such Standard of fixed convertibility. There can be little denying that those bank runs are the ultimate monetary catastrophe experienced on an individual basis. Think about it. If you were among the depositors left with unhonored deposits of metal on account at a failed bank, you might just as well be located in a modern-day Third World nation when its currency loses value...your life's savings have been wiped out through no fault of your own.

Examining this case of a bank run, everything was working fine for you and your currency-units yesterday, but then suddenly your world fell apart today. In truth, to witness that a bank run was "justified" by the bank's obvious (after the fact) shortfall of Gold necessary to honor all of the deposits reveals with abundant clarity that a goodly portion of the system's funds were actually "unbacked" currency. And since these same unbacked currencies were seen to be functioning well prior to the pain of the bank run, it makes little sense to those left holding the bag in a bank run. And as hard as it is for these unfortunate citizens to fathom fundamentally why these currencies could work yesterday but not today, it is even harder for them to grasp why the same currency could function properly at the front of the bank line, but not for those in the back end of the line. It is this kind of pain, especially when bank runs become an epidemic, that compel significant changes to be made to the System architecture. History reveals that a natural starting point to ease this pain is national regulation of the scattered and various independent private banks.

This leads to a united-we-stand, divided-we-fall solution in which resources are managed among the banks so that individual hemorrhages can be addressed without leading to domino-style bank failures. But ultimately, the whole system is put at unacceptable risk from bank runs inspired by the realization that the bank-money inflation has rendered a currency value that is less than the metal value in the system's few coins. Again, the institutional thinking goes, "Since all this unbacked paper worked yesterday, let's just get rid of the inspiration for bank runs--the Gold coins." Those finding themselves in the back of the lines certainly would welcome this. Their currency would not only remain just as good as the currency held by those in the front of the line, but it would also be not significantly different than it was yesterday.

OK, so who IS to be blamed for our disappointment with the System as it is?

The lesson to be learned is not to blame the push for fiat currency upon "the few and powerful" men of wealth of the world. While inflation can be bad even under a Gold Standard (along with the pain of bank runs for those who fail to rescue their deposits), inflation has the distinct opportunity and track-record to be much worse within a system built upon a fiat currency. The truth is, inflation hurts those with money (it erodes their purchasing power), and helps those with debts (it makes loan repayment easier.) David Ricardo said it eloquently: "*The depreciation of the circulating medium has been more injurious to monied men...It may be laid down as a principle of universal application that every man is injured or benefited by the variation of the value of the circulating medium in proportion as his property consists of money, or as the fixed demands on him in money exceed those fixed demands which he may have on others.*" He said further that the farmer "*more than any other class of the community is benefited by the depreciation of money, and injured by the increase of its value.*" This is likely for the dual reason that farmers as a general rule were often in debt to begin with, and because their annual creation of crops (from thin air!) could then be sold for more currency units in each subsequent year, even if the net real-world value of the product being offered remained entirely unchanged.

Don't waste energy on laying blame...

And so we can see, with more people in society having common wealth than uncommon fortune, it is distinctly the case that democracy proves to be the greater threat to a convertible Gold Standard than does even the unmanageable expense of war. I faintly recalled some historical figure who made the astute observation that in a democratic society, when the people come to realize that they can vote "largess" for themselves from the public treasury, they will do so, and hence bring about their system's collapse. And in researching this matter further (thanks Journeyman, ji, and RossL for your help) it seems that there actually have been a number of figures echoing this same sentiment through time. But regardless of the precise citation of this quotation, one look at the growing national debt in America (serving as the substitute for the taxes that would otherwise be necessary to fund our chosen social programs) gives credence to this assertion. Simply put: the people (the masses) get what the people want--and the people apparently want easy money. Even outside of a democracy, over time, the forces of the population always win out over the forces of the few men of power. And in the end it matters not which group is on the side of good, and which is destructive--the many prevail over the few.

So, what is the proper role of Gold in the monetary system architecture?

At this point, the staunchest Gold supporters are likely gnashing their teeth and forming a posse to hunt me down for a proper lynching, I'm sure. After all, I have made no bones about the need to cut Gold out of any ties whatsoever with the various national currencies. Due to inflation and deflation that naturally arise through variations in the rates of borrowing, payback, and growth of the economy, currency fluctuations lead to bank runs which are frankly too disruptive and are not to be tolerated. Fortunately, they are rendered completely meaningless under a fiat currency regime. National fiat currencies allow governments to manage their own national economies to the extent that that are able, and to take whatever efforts needed to avoid falling into those most destructive currency deflations that wreak havoc on economies.

Gold must be removed from these currencies so that governments are not tempted to manipulate its perceived value in order to give a boost to their own currency. The goal would be that sudden value shocks will be avoided because at all points in time the currencies will be fairly valued against Gold--there won't be an inevitable and recurring "day of reckoning" in which the pent-up false perceptions are unwound amid calamity and crisis of confidence. Gold must also be removed from any element of the monetary system that would seek to make loans using Gold because, as we've seen, these confound Gold's ability to reach its true physical-based fair market value. Gold derivatives must also be done away with for the same reason. Gold must remain a pure monetary asset, bought and sold and owned outright--nothing else would be allowable. National fiat currencies will ably serve the market's various needs to borrow funds...after all, that's how fiat currency is born in the first place.

Although I've seemingly cut Gold out of the monetary system, that is not the case at all. Gold qualifies as the only true money; being able to function as a unit of account, as a medium of exchange, and as a store of value. A fiat currency only meets the first two elements, but they fail as a store of value. Therefore, Gold will be be the money of savings, while national currencies will be the currency of commerce. They will all float relative to each other, and constantly seek out their proper value. Kept with special status as an independent and unlendable currency, Gold will be the ever-rising North Star of the monetary system. Central banks would be inclined to hold only Gold in reserves of any significant size--because Gold is not the liability of any other nation, and its real-world value would continue to grow over time. As said before, quantities held in other national currencies would be done only to the extent that they facilitate trade between active partners. Individuals across the Earth would also choose to hold Gold as their savings; their life's productivity forever protected from inflation and deflation, and from reliance upon another person's (or nation's) liability.

The beauty of reserving Gold as an unmanipulated monetary asset is that individual local currencies can still be "managed" by the government in whatever manner is seen befitting that specific country, without having an adverse effect on the meaningful wealth held in reserves (in the form of Gold savings) among other nations and local citizens alike. No single national currency need ever be held by another nation as a reserve currency (which "unfairly" allows the nation that issues the reserve currency to export its inflation.) However, a nation might choose to hold another's currency in a quantity simply because it makes for expedient trade.

The reassurance of Gresham's Law...

Perhaps a short lesson is in order for those new to this realm of thought. In 1558, Sir Thomas Gresham made his observation that whenever there was latitude in tendering payment (as could be seen in the major medieval cities where coins from many lands came together in the course of trade--as we covered in the case of Amsterdam,) inevitably the money of poorest quality was offered while the better money was retained. In describing the circulation of currency, Gresham's law says that bad money drives out good. (The inferior money circulates, while money of superior quality is held.) In our new system herein described, paper currency will circulate while Gold money will be saved.

Pause for a moment to fully consider this practical notion of saving Gold on one hand, while on the other, borrowing and spending paper just as we always have in our lifetimes (and know of no other reality from personal experience.) This is in perfect tune with Gresham's law. Given our own limited history, this accord with Gresham's law provides a very comforting reassurance for predicting the success of this system. Why? Because Gresham's law is arguably the only economic law that survives beyond challenge--an echo of the universal and enduring truth that given a choice, people will choose the option that serves their own needs best. Gresham's law predicts that the world's supreme currency, Gold, would not actually circulate in a conventional sense, though it would move from the hand of one saver to another as individual circumstances might require. Sure, you could use it outright as money if you insisted, but nodding to Gresham's law, wouldn't you rather keep your Gold for the rainy day and spend your paper instead? This system will enhance the transparency of national economics and financial positions, rewarding those with good fiscal policy and balanced budgets, and giving none an exorbitant privilege over another through reserve currency status. It will allow the citizens a natural avenue to protect themselves against depreciation of the national currencies (which will inevitably inflate until the end of time,) and to actually gain a no-risk real "return" by simply holding the metal without the self-defeating aspect of lending it out for interest.

Gold. Get you some. ---Aristotle