Limiting Government With Sound Money: A State by State Approach

by Theodore Phalan

"*I can make more generals, but horses cost money*."
- Abraham Lincoln[i]

Abraham Lincoln had a war to fight, and the realities of war tend to put things into perspective. He knew that he could create generals by fiat, but that titles did not win battles. Horses and bullets, on the other hand, do not bring themselves into being at the command of a president. Men can be fooled, but horses must be fed.

As in all wars the money was running short, and taxing the people to pay for slaughter is not a popular or effective strategy for raising funds. A way had to be found to coerce the people into supplying the horses and casting the bullets such that the cost was not readily apparent. For experience had taught the people to accept only gold and silver, real value, in payment for services rendered, and the government could not exceed these limitations. However, by replacing the Philosopher's Stone with the printing press, and eventually even outlawing what had been lawful money for thousands of years, the government succeeded in freeing itself to grow unchecked. Paper money is the fertilizer of tyranny, and only a return to gold can limit its growth.

A Brief History of Fiat Paper Notes in the U.S.

The exigencies of the War Between the States led the North, under the direction of then Secretary of the Treasury Salmon P. Chase, to issue bills of credit known as "greenbacks." Though the Constitution did not allow for the emission of these "bills of credit," this one dated piece of parchment, four score and seven years old, could not stop the avalanche of paper greenbacks.

In 1870 the Supreme Court, under now Chief Justice Chase, ruled 4 to 3 in the case of Hepburn v. Griswold (1870) that the legal tender laws forcing acceptance of greenbacks for prior debts constituted an illegal takings and thus violated the Constitution. The issue was revisited, however, in Knox v. Lee, Parker v. Davis (1871) the following year. This time an enlarged court ruled 5 to 4 (the former majority having been overruled by the minority's addition of two new members) that it *was* a legitimate power of the government, contrary to the fairly explicit language and history of the founding document. The justification was that this power was necessary for the preservation of the Union during an "emergency." Perhaps this was true, but in so doing they annihilated the document that gave the Union its meaning and legitimacy. The man was murdered to save his corpse.

This should not have come as a surprise, however, as it was not the first time that the new country had experimented with fiat paper money. The expression "not worth a Continental" was not a pejorative aimed at a Revolutionary soldier, but at a force far more destructive: the Revolutionary government's legal tender. Again, as has been repeated throughout history, with war came inflation. The Revolutionary government might be excused for their errors because paper money was a relatively new phenomenon[ii], and they believed that they were at least financing a battle for their own liberation. One is left to wonder, however, why if the cause was so just, did the people not willingly part with their goods and services in aid of their liberators. In any event, first two million paper dollars were issued, then another million, and then again until the money supply of the colonies had been increased 50% within a year[iii].

After their experience with “bills of credit” as colonies, and now as revolutionary states, the people lost their innocence and set out to insure that they would have sound money from that point forward. A vote of 9 to 2 at the Constitutional Convention stripped the new government of the power to emit these bills in the future and the debate appeared to be settled. In fact, many of the states declared that they would leave the convention entirely if this power was *retained* from the Articles of Confederation[iv]. In other words, it was discussed, debated, and ultimately stripped from the new Constitution and rejected as antithetical to the new free society being created. Unfortunately, the concept of sound money is somewhat difficult to understand in the abstract, and when these men had finally passed on their posterity were left at the mercy of a new generation of unscrupulous paper alchemists.

Money: Sound and Unsound

So what *is* “sound money”? What, indeed, is “money”? Money is a commodity, whether cows, oil, gold, or something else generally and voluntarily accepted to overcome the problem of “double coincidence of wants”. To be most effective, it will have the properties of divisibility, uniformity, portability, a high per-unit value, and very importantly, scarcity. The property of “scarcity” is the important distinguishing characteristic between money such as gold, and the paper notes that are circulated by governments today. That they can be created by fiat “out of thin air” leaves their ability to store value and their quality of measurement open to manipulation; that they are not voluntarily accepted but are forced on consumers by force of law disqualifies them as “money” proper, as will be more fully explained later.

Money is said to be a "unit of account" or a "store of value," but these are just corollaries of its main function as the medium of exchange[v]. To be a unit of account, or to be used as a "measure" between various goods, its properties must be consistent and measurable to precision. When the French King died, either the producers or consumers of cloth received a windfall, depending on whether the new king's "foot" was longer or shorter! Now, however, a meter is measured as "the distance travelled by light in a vacuum in 1/299,792,458th of a second[vi]." Thus the progress of civilization is to make measurements more accurate and reliable; but today the measurable value of monies fluctuate wildly from day to day and from country to country.

As for storing value, the difference between commodity money and fiat paper notes is stark. From 1879-1897, for instance, when the country was on the gold standard, the exchange value of money that was saved, even in a shoebox, rose. Someone putting away for their retirement could safely hold onto their earnings until they felt they were needed. In contrast, choosing any 18 year period since the creation of the legal tender fiat paper regime of the Federal Reserve System (FRS) banking cartel would show a decline in the purchasing power of any savings[vii]. This loss of purchasing power affects the poor, elderly, and those on fixed incomes the most, either driving them further into poverty, reducing the real value of their monthly stipends, or forcing them to risk speculation in the stock market in an attempt to preserve their wealth. To be clear:

> *"In the absence of a gold standard, there is now way to protect savings from confiscation through inflation. There is no safe store of value. If there were, the government would have to make its holding illegal, as was done in the case of gold[viii]."*

In a rough sense, the exchange value of a type of money at any one point in time is determined by the quantity of the money units compared to the goods available on the market[1]. Thus, any commodity being used as money faces physical laws that govern its expansion or contraction. When production increases, the amount that a unit of commodity money will purchase also rises; this increase in the purchasing power of the money unit incentivizes the production or discovery or more e.g. gold. When the gold supply, in this example, is increased enough to bring it back into balance with the new level of production, the gains from finding more diminish (due to a sinking relative value) and the costs rise (due to the bidding up of the factor prices used in e.g. mining) until it is no longer profitable to produce more money. A natural equilibrium is reached and only rare natural shocks, largely outside of the control of man, unduly disturb this balance. Conversely, when men at negligible cost can manipulate the supply of money for political or financial gain, shocks are inevitable and the chance for a steady equilibrium is lost. In fact, in his efforts to destroy the gold standard, former president Franklin Roosevelt was even known to manipulate the value of the dollar based on what he considered to be "lucky numbers[ix]." Such are the dangers of taking control of society's money from the free market and placing it in the hands of men.

"Sound money," then, is that money which truly fulfills these requirements of a medium of exchange, and because it is meant to "convey price signals in a free economy," it must necessarily be "a reference point independent of the government[x]." The government *may indeed* have the best interests of its subjects in mind, but it is still composed of fallible men who lack the relevant local knowledge of subjective and

[1] Other factors are not considered here but are also important e.g. velocity at which the money is spent, and money hoarded.

objective criteria by which market participants discover the relative value of the money commodity. For the money unit to mean anything its exchange-value must be determined by the parties to a trade, not by the whims of far-away bureaucrats or the feckless manipulations of state-sponsored bankers and their printing presses. Without a generally accepted commodity money, men would never have managed to escape primitive barter and would still of necessity be self-sufficient and desperately poor; the division of labor, long-range planning, and high levels of exchange would have remained impossible[xi]

The Dangers of Inflation

Counterfeiting can be done to any type of money, and the counterfeiter may be a lowly private citizen or the highest government official. It is, however, orders of magnitude more difficult to counterfeit commodity money than fiat paper notes. For example, lead may be painted to appear as gold, but the weight, feel, and even sound when dropped will differ. A counterfeit note, however, may be nearly undetectable to almost anyone; and in the case of officially sanctioned, legal counterfeiting by the government or one of its monopoly privileged money producers, the counterfeiting is indistinguishable.

Let us examine the case of the private counterfeiter. Why does society frown upon this practice? Under normal circumstances to trade a piece of money for a real good, the money in question must have been acquired through a previous exchange of a real good[2]. Because of this fact, all money in circulation "is ultimately a claim on some tangible asset[xii]" or service, and to acquire it one must provide a useful good or service in

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[2] Although this seems to imply an infinite loop, Carl Menger on the origin of money, and Ludwig von Mises' "regression theorem."

return. As such exchange with money is moral and sustainable. When someone innocently accepts the private counterfeiter's wares, however, there has been no new production of desirable goods or services to offset the consumption of resources. This counterfeit money will be passed on until finally discovered by a more alert market participant, at which time it immediately loses its value, leaving the last person holding it with nothing; his wealth has been "redistributed" to the counterfeiter. In the case of private, illegal inflation, the winner and loser are obvious, and the harm to society at large is minimal (of course, by no means insignificant to the man left "holding the bag"!)[xiii].

In the case of state-sanctioned and enforced counterfeiting, however, this process is carried out on a massive scale, though under a commodity standard it is greatly hampered. Under a fiat paper system the theft is far easier. The new bills will be indistinguishable from those in circulation, and their harm to society limited only by the scruples and restraint of the counterfeiters. Unfortunately, whatever restraint the printers might bring with them, they are operating under "the sociological law that, once turned on, the engines of paper inflation accelerate as the clamor mounts for shares in the new cornucopia[xiv]." In this case the counterfeit inflation will lead to a general rise in prices as the new notes bid against the old for the unchanged amount of goods and services available. The effects are spread across three groups: Group 1, who receive and spend the new money before prices have risen, obtaining a windfall; Group 2, the theoretical group that receives the new money at about the time when the prices have risen and come out even in the event; and Group 3, those who receive the money through higher wages only *after* prices have risen[3]. Those on fixed incomes may be termed Group 4, and unless

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[3] I have to give credit for this terminology to Dr. Thomas Rustici of George Mason University.

their stipends are indexed to the price inflation, or raised out of "compassion," they will only suffer from this event. When the effects are finally realized, most will be unable to recognize the true cause, and will perversely blame their neighbors, shop owners, or other some disfavored group; anyone but the actual perpetrators and beneficiaries.

Many societies have been torn apart by the greed or incompetence of those who have taken charge of their money. Whether to finance wars or the welfare state, to benevolently guide society or to rob it blind, the tiger of sustained inflation[4], even grasped firmly by the tail, eventually escapes and makes a feast of civilization. Although it is not strictly necessary that consumer or producer prices rise[5] for inflation to do its insidious damage[6], the most common and obvious effects are a diminution of purchasing power and a redistribution of wealth from the poor to the rich, or more accurately, to those with first access to the new money from those who receive it last. And again, although inflation is not strictly necessary for the prosecution of a war or the maintenance of a welfare state, it is the favored and indispensible tool of governments who wish prolong wars and welfare schemes beyond what would be tolerated by a society fully cognizant of the costs.

The cases of Weimar Germany, and of Argentina, are hardly unique, but are well known. The government of the Weimar Republic, under pressure to pay reparations and to support its own welfare system, "discovered" the magic of fiat paper inflation; during the years 1920-23 the German mark depreciated from one "gold mark [being] worth about a dollar in 1920," to being, "in November 1923 […] replaced by a new gold-

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4 "Inflation" is here defined as an increase in the money supply.

5 For instance, the inflation of the "Roaring '20's in the U.S. was disguised by productivity gains, and the "price level" remained relatively stable.

6 The issue of "business cycles" will not be discussed here.

backed mark, at the rate of 1,000,000,000,000 (one trillion) old paper marks to one new gold mark[xv]." The Germans were relatively lucky, however, as they were accustomed to using the currencies of their European neighbors and when they were busy burning their worthless marks in their fireplaces for warmth they were able to keep their society from utter collapse by using British pounds, Italian lira, and others.

Argentina was once in the ranks of the world's most wealthy countries, as the dated expression, "as rich as an Argentine" will attest. They too, however, experienced hyper-inflation and a collapse of their currency. In their case it was due to the promises of politicians desperate to stay in power and using massive wealth redistribution and welfare schemes propped up by the printing press to achieve this end. At the end of the day they were forced to adopt the U.S. dollar as their currency, as the international community and their own people had lost complete confidence in the peso[xvi]. Again, however traumatic and damaging were the results of the destruction of their currency, the Argentines can count themselves lucky that they were accustomed to using the U.S. dollar, and that it was available to fill the void left by the disgraced and depreciated peso.

The Current Case of the United States

An in-depth study of the possibility that the United States may face the horrors of hyper-inflation and the destruction of the dollar is beyond the scope of this article; however, even the most optimistic appraisal of the actions taken by its nominally private central bank, the FRS, would leave any honest observer with at least the suspicion that it is possible and becoming more so with every new round of "Quantitative Easing" and "Toxic Asset" purchase. At this point, spending by the Federal Government is rapidly spiraling out of control, with yearly deficits surpassing 10% of GDP[xvii] and expected to rise almost exponentially as the "baby boomer" generation begins to retire and demand the entitlements written in stone into the Federal Budget. Economist Laurence Kotlikoff, in a paper entitled "Is the United States Bankrupt?[xviii]", argues that the unfunded liabilities of the U.S. government top $65 trillion, or almost five times the GDP[7]. The majority of Americans opposed the bank and auto bailouts of 2008[8], and the taxes necessary to fund them would have been political suicide, but with the Federal Reserves digital printing press were accomplished without a struggle. Years of unemployment benefits and universal healthcare are being offered, a massive, bloated "Homeland Security" program is being created, and two wars are being fought, yet taxes are not increased; and through manipulation of the Consumer Price Index (which excludes food, fuel, and housing), it is claimed that we have *deflation* to fear! These are not the actions and statements of a government in touch with reality, or one that recognizes any limitations on its power.

> *"Their plan – like all the plans of all the royal looters of the past – is only that the loot shall last their lifetime. It has alwayslasted before, because in one generation they could not run out of victims. But this time – it will not last."* *- John Galt, Atlas Shrugged*[xix]

The Plan

Gold is not the only option, but it is the best. It has been used as money for thousands of years and by civilizations across the globe[xx]. It is recognizable, people understand it, and it has a long history even here in the United States[xxi]. It has always been a limiting force on government, and it can serve not only this purpose again, but

[7] This number has been revised drastically upwards, with many claiming that it is over $200 trillion.

[8] One politician was said to have noted that 50% of those who called his office said "no" to the bailouts, and the other 50% said "hell, no!"

also as a fallback in the case of the destruction of the dollar. And it is the only (along with silver) thing mentioned as being eligible to be declared legal tender in the Constitution[xxii]. Although it would be inadvisable in the extreme to do away with the FRS and its legal tender fiat notes overnight[xxiii], establishing a series of individual, alternative, concurrent state (e.g. New Hampshire, Montana, etc.) gold currency systems is necessary to not only insulate and protect the prudent from a possible hyper-inflationary bust in the near-term, but as an effective means to limit the Leviathan that is the United States Federal (Welfare/Warfare) Government in the long-term[9].

The plan would be relatively easy to implement, and here we will lay it out in its simplest form. The several states that comprise the United States, being quasi-sovereign entities, are Constitutionally allowed to mandate gold and silver coins be legal tender within their borders and may use privately minted or even foreign coins for this purpose (though they are not allowed to mint their own)[xxiv]. A state would pass legislation mandating that some percentage of its taxpayers (likely only large corporations at first) pay their taxes in gold, that all of its citizens create an electronic gold account[10] (though they would not be obligated to use it), and that businesses begin indicating the price of their goods and services in both a standard Federal Reserve Note (FRN) price, and its gold equivalent. All fines and other payments to the State would also be paid in gold, and as the state increased its holdings it would begin to transact more and more in specie until only its direct dealings with the Federal Government were being transacted in

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[9] This idea/proposed legislation is the product of Dr. Edwin Vieira, Jr., though any changes, mistakes, misinterpretations, or inaccuracies are purely my own.

[10] There are several companies that provide this service, and are capable of measuring and transacting gold in increments down to 1/1000th of a gram, which is the equivalent of approximately $0.05 at today's gold price of nearly $1400 per oz.

FRN's. This gold inflow would then be paid out by the State to those of its creditors desiring payment in specie as opposed to FRN's, and to its citizens for all state services.

Over time, the citizens of the states participating in this plan would see prices climbing in terms of FRN's, and perhaps even falling in terms of gold. This would induce more to join, eventually reaching a critical mass and making it the default position. To the extent that the people are able to completely opt out of the FRS and its depreciating currency, they would be protecting themselves not only from the potential collapse of the entire system, but the reduced demand for FRN's would put pressure on the Federal Government to reduce the amount of FRN's in circulation, and change its profligate ways lest it lose its *own* purchasing power. The fewer and fewer citizens that accept and transact in FRN's, the less power the Federal Government has to expropriate wealth by stealth and fraud, and the more it must come to terms with the reality of its promises and liabilities. If the dream of limited government is to be realized, it will found down the yellow brick road.

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[i] (Lincoln, 2011)
[ii] (Rothbard M. , http://mises.org/books/conceived4.pdf, 1999)
[iii] (Rothbard M. , http://mises.org/books/conceived4.pdf, 1999, p. 55)
[iv] (Vieira, 2010)
[v] (Rothbard M. N., 2005, p. 29)
[vi] (Fekete, 2011)
[vii] (Rothbard M. , The History of Money and Banking in the United States: The Colonial Era to World War II, 2002)

[viii] (Greenspan, 1967, p. 107)
[ix] (Vieira, 2002)
[x] (Shelton, 2010)
[xi] (Greenspan, 1967, p. 101)
[xii] (Greenspan, 1967, p. 106)
[xiii] (Vieira, 2010)
[xiv] (Rothbard M. , http://mises.org/books/conceived4.pdf, 1999, p. 55)
[xv] (Fucetola, 2009)
[xvi] (Salerno, 2002)
[xvii] (Cantill, 2011)
[xviii] (Kotlikoff, 2006)
[xix] (Rand, 2005, p. 679)
[xx] (Rothbard M. N., 2005)
[xxi] (Rothbard M. , The History of Money and Banking in the United States: The Colonial Era to World War II, 2002)
[xxii] (U.S. Congress , 1998)
[xxiii] (Vieira, 2010)
[xxiv] (U.S. Congress , 1998)

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