

# Central Banking: The Enemy of Sound Money

A Transition from Unsound to Sound Money

DISEASES DESPERATE GROWN,  
BY DESPERATE APPLIANCES ARE RELIEVED,  
OR, NOT AT ALL.

KING CLAUDIUS, SHAKESPEARE'S HAMLET, 1603

## INTRODUCTION: SOUND MONEY, WHAT IS IT, AND WHY IS IT DESIRABLE?

In order to answer the question what is the best way to return to sound money, we must understand what sound money is and why it is desirable. Simply put, sound money is money that retains its value over time. In brief, what you receive today in exchange for a good or service will buy back that same good or service in the future. Furthermore, in order to achieve this simple balance between what you give and what you take over time requires no special financial knowledge.

In other words, you do not have to understand the concepts of present value, compounded interest, or anything at all about the time value of money. Further, you do not have to obtain a college degree, seek out the special advice of a financial expert, or invest your savings in the most popular index fund of a well known international financial investment house that may well go under during the next inevitable financial crisis. You do not even have to put your money in a bank to ensure that the value of what you put aside today will be worth the same when you retire twenty, thirty, or forty years into the future. Indeed, you could simply purchase a large safe that would require a pick-up truck, several people, and a trolley to move, and a master lock-smith to open, if you were not present with the combination when your safe was stolen. For extra safety you could even purchase a semi-automatic hand-gun to keep under your pillow, if your government permits it.

Now, none of this may sound like paradise to you, but it would well satisfy just about anyone with a good primary education and a desire to raise a family, live in peace with his neighbors, and die of old age knowing that he got out of life what he put into it. May we say, more than half of the population of any modern industrial state today?

Now there are those who would argue that sound money is not an issue, so long as its substitute, unsound money, is put to good use. In order to argue in this manner, however, you must also agree that grand theft at the national level is not a criminal act punishable by law, that the routine involuntary transfer of wealth from the many to the few for the good of the many is logically sound, and that such action does not move contrary to the principles of just and proper exchange.

As I am not one of those just described and have no desire to see myself or anyone else become one of them, I took it upon myself to find a way to make the transition from unsound

money to sound money. What I thought would be a difficult task turned out to be relatively easy, because there are many others like me who are largely dissatisfied with the current state of humanity, the global market place, and their own national economy. This paper is dedicated in particular to a brief historical sketch of central banking -- the current producer of unsound money -- and a mechanism of transition away from unsound to sound money. Accordingly, the paper is divided into two parts: the first part entitled *Commercially Unsound Monopoly Privilege and the Revival of Sound Banking Practices* sketches the development of central banking through a brief examination of two epochal moments in the history of banking and the rather mundane beginnings of the Bank of England. The second part entitled *A Method of Transition* combines the work of several authors and proposes a method of transition from unsound to sound money based on the US Federal Reserve System and the writings of those who would like to see it disappear. No conclusion is provided, and it is likely that none will ever be considered until the transition to sound money is finally achieved.

In my presentation at the WEAI Conference in San Francisco last year I introduced my paper entitled "Money Creation and the Revolution" by explaining the statutory legal basis for the current monetary system and its commercially unsound nature. I have not decided on the topic of my next paper and in this regard I hope that you can be of help.

## Commercially Unsound Monopoly Privilege, and The Revival of Sound Banking Practices

In order to begin let me recall for you how the issue of money became the monopoly privilege of government and how this privilege inexorably results in unsound money.

### **A COMMERCIALLY UNSOUND MONOPOLY PRIVILEGE**

A good place to start is 16<sup>th</sup> century Spain under the reign of the Habsburg king, Charles V, for not only did Charles V seize control of his nation's money supply, but he also created the world's first truly global empire that did so. Another good reason to start with the Spanish Empire is in honor of our Japanese hosts, for it was under Philip II, Charles V's son, that Japan's first emissaries of noble rank visited Europe under the sponsorship of the Jesuit Order of the Catholic Church.



Surely, the precious metals that flowed into Spain from the New World during this era played an important role in Charles V's ability to maintain and expand the Holy Roman Empire across Europe, but this was not the only source of imperial finance, as the sudden increase in purchasing power was neither constant, nor inexhaustible, and the costs of maintaining a global empire were relentless and frequently spiked with sudden and costly military adventures. In addition, the rapid influx of new money led to widespread price inflation throughout Europe and severe hardship in Spain for all, but the Spanish crown, local banks, a rapidly growing, well-travelled, Spanish merchant class,

and last, but not least, the Catholic Church. Imperial revenue short-fall was typically met with increased taxes on the local Spanish population and bank loans obtained from large prosperous European trade centers in Italy, the Netherlands, and Austria. These loans were often guaranteed with the promise of imperial land in the event of default.

The precious metal that flowed into Spain from the New World was quickly minted into gold and silver Spanish coin and found its way into the Spanish and European economies through the purchase of labor, soldiers, materials, and equipment required by the Crown to maintain, expand, and consolidate its power. Much of this coin ended up in local Spanish banks for safe-keeping where it became an important source of specie for the imperial household when its outstanding loans fell due. Unfortunately, this specie did not belong to the Spanish crown; rather, it was the property of the banks' individual depositors. In an emergency, however, it was much easier for the Crown to confiscate this specie, than it was to levy still more taxes on an already heavily burdened local population. The confiscation was not entirely unilateral as the banks were issued promissory notes in return.

As the Spanish Crown was able to offer a secure return on these involuntary exchanges that was backed by its authority to tax and transfer land title, the banks surrendered their specie without a fight. Moreover, so long as these acts of plunder could be justified as noble sacrifices on behalf of church and state, the Catholic Church remained silent. What followed, however, forced even the Catholic Church to take a stand, as the wrath of the market showed no mercy.. The trouble began when Spanish banks, in an effort to avoid having their coffers plundered by the imperial household, began investing their depositors' specie in more lucrative, but less secure private ventures -- the targets of which were often the very same high-risk overseas expeditions that served as the Crown's principal source of repayment.

Unfortunately, this practice of placing at risk the deposits of others for the sake of one's own profit was only a very workable relationship so long as the investments were kept hidden and the banks were able to meet the liquidity demands of their unsuspecting depositors. Indeed, what made common sense to Spain's local banking community, made no sense to their depositors who had entrusted their hard earned savings with the banks for safe-keeping. In short, bankers who defaulted on their customers' demands were deservedly considered no less than thieves and severely punished unless the church or state stepped in and provided them with safe-passage out of the country.

Although the Church understood that prudent banking practices could forestall individual bank default, the Church failed to understand that individual bank prudence was not a cure against the market forces unleashed by all banks engaging in the same practice at the same

time.<sup>1</sup> Understood was that the lending of bank deposits increased the money supply and brought about inflation. Not understood was the inevitable busts that necessarily take place



in the wake of a sudden increase in the money supply -- this, despite a long series of documented bank failures of Spain's most prestigious banks after the nefarious practice of fractional reserve lending had begun.<sup>2</sup> As a result, the Catholic Church was split: on the one hand, it could understand the banks' desire to avoid the plunder by the imperial household; on the other hand, it was necessarily sympathetic with the many angry depositors who lost their savings. This indecision allowed the practice to persist and set a bad moral and legal precedent for centuries thereafter.<sup>3</sup> The important lesson for us today in the 21<sup>st</sup> century is that fractional reserve lending -- the contemporary name for this 16<sup>th</sup> century

banking practice -- was not the result of a gradual evolution in sound banking practices; rather, it developed as a defense against corrupt state intervention by governments that failed to balance their budgets!

#### **A RETURN TO SOUND MONEY: IT HAS ALREADY ONCE OCCURRED!**

Unfortunately, plundering local banking communities of their depositors' specie has not been the only unscrupulous, covert, financial trick employed by governments to rob their citizenry of their hard-earned wealth. Before paper fiat was introduced by the Scotsman, John Law, in 18<sup>th</sup> century France the local authorities' most popular trick was a combination of legal tender laws and currency debasement. Typically governments would award themselves the monopoly right to mint coin and restrict the use of other coin within their political jurisdiction. Once the coin minted by the local authority was entered into circulation it would be collected back in the form of taxes, melted down, and minted again with less precious metal content than the previous issue. It would then be spent back into circulation, as if it were of the same worth.

By prohibiting the use of "foreign coin" local residents were assured that everyone traded in the same unit of account. What local residents did not seem to understand was that the value of their local coin was being undermined by the same authorities that were "protecting" local residents from the use of suspect "foreign coin". Then too, perhaps these

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<sup>2</sup> Ibid. De Soto.

<sup>3</sup> Ibid. De Soto. Chapters 1, 2, and 3.

residents understood all too well, but found it easier to be the victims of quiet, massive, surreptitious theft at the government mint than to be physically confronted by local tax collectors demanding ever higher taxes at their doorstep. After all, currency debasement was no secret, to the Catholic Church, as it was already well documented in the 14<sup>th</sup> century writings of the French Catholic bishop, Nicholas Oresme, who described the practice as morally repugnant and commercially unsound.<sup>4</sup>

No matter, during the 17<sup>th</sup> and 18<sup>th</sup> centuries this practice was so widespread that small trading nations such as the Netherlands found it difficult to conduct business.<sup>5</sup> In response, the governing council of the port of Amsterdam created an Exchange Bank (Die Wisselbank) in 1609 and a standardized unit of account for the bank's depositors. Upon receipt of



suspect domestic and foreign coin and bullion, the bank extracted its precious metal, reconstituted it in the bank's unit of account, and deposited the reconstituted coin and bullion in the owner's name. Paper was issued on demand against the owner's deposit and used to conduct business beyond the walls of the bank on the open market. Merchants with accounts at the bank could simply transfer money between their accounts. These kinds of transfers would eventually become known as gyro banking. By creating a standardized, reliable, and convenient means of payment the city of Amsterdam became famous and wealth

poured into the city and *Die Wisselbank* from around the world. The bank's fame led to specific mention in the works of historic figures such as Adam Smith, David Ricardo, and David Hume. The bank would eventually become a model financial institution for other banks, and many of today's modern banking practices can be traced back to this bank.

The bank came to true prominence through its repeated ability to survive financial crisis including the infamous episode of Tulipmania (1634-37).<sup>6</sup> This ability lay, of course, in its 100 percent reserve banking policy. As early as 1657, some fifty years after its founding, there were signs that it, too, was falling into temptation. It took, however, an additional 100 years before the bank was systematically engaging in the risky lending of its depositor's wealth to large commercial entities and the Dutch government. By 1819 the bank was compelled to close its doors, for it had lost all customer confidence. The wrath of the market had once again responded.

The Bank of Amsterdam was the last bank of its caliber to maintain a 100 percent reserve ratio for a significant part of its existence. Unfortunately, like all European banks since the

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<sup>4</sup> Jörg Guido Hülsmann. 2008. *The Ethics of Money Production*. Auburn, Alabama: Ludwig von Mises Institute.

<sup>5</sup> Stephen Quinn and William Roberds. No Date. "The Big Problem of Foreign Bills: The Bank of Amsterdam and the Origins of Central Banks". Monograph.

<sup>6</sup> Doug French. 2006. "The Dutch Monetary Environment During Tulipmania". *The Quarterly Journal of Austrian Economics*, Vol. 9, No. 1 (Spring), pp. 3-14.

founding of the Spanish empire, the Bank of Amsterdam had trodden down the path of unsound money and was eventually forced to close its doors.

### THE BANK OF ENGLAND - THE EARLY BEGINNING OF CENTRAL BANKING

The Bank of Amsterdam was not the first attempt on the part of local government to control the production and maintenance of a local currency, but it was by far the most well-known and successful attempt on the European continent. Unfortunately what followed was very different. Rather than local governments devising competitive mechanisms with which to defeat the corrupt minting practices of neighboring governments and private counterfeiters, the private sector joined hands with governments across Europe in an effort to obtain special lending privileges. These privileges were often obtained in exchange for the funding of mismanaged government offices that were able to guarantee repayment with the threat of force and taxes levied on the offices' clients.

By way of example, the Bank of England -- the bank heralded as the world's central bank par excellence in the last third of the 19<sup>th</sup> century -- opened its doors in 1694, because the British government was in need of cash.<sup>7</sup> Its colonial settlements in North America were already taking root, and British merchants were largely dependent on the Dutch maritime navy to carry their sea cargo. King William III, Charles II's successor, sought to correct British dependence on the Dutch fleet. To his chagrin, however, Charles II, the last of the Stuart Kings, had defaulted on the Crown's debt to local creditors only two decades earlier, and the memory was still fresh in the minds of the British public. In order to raise money the British Parliament agreed to the formation of a private banking corporation called the Bank of England with special lending privileges. The founding capital of this bank would be none other than a loan to the British Crown. Interest on this loan would be secured by a tonnage tax on British trade with the colonies. The health of the local business community, the soundness of the nation's money supply, and the financial safety of the general public were simply not important issues in the foundation of this bank.<sup>8</sup>



### CENTRAL BANKS - THEIR RAISON D'ÊTRE

Another century would pass before the collusive relationship between private sector banks and the governments of Europe began taking on their modern form. Indeed, the first recorded mention of the concept of "lender of last resort" -- the bank at which all banks could obtain liquidity in times of crisis -- did not appear until 1797 in a work entitled *Observations of the Bank of England* by Sir Francis Baring.<sup>9</sup> The two most authoritative works on central banking up until the middle

<sup>7</sup> Thomas Humphrey. 1989. "Lender of Last Resort: The Concept in History". *Economic Review*. (March/April), p. 8.

<sup>8</sup> Eugen von Philippovich. 1885. *Einleitung zur Bank von England: Im Dienste der Finanzverwaltung des Staates*. By the end of the 19<sup>th</sup> century Philippovich was the leading authority on the development of the Bank of England. Joseph Schumpeter was a student of Eugen von Philippovich.

<sup>9</sup> Sir Francis Baring. 1797. *Observations on the Bank of England*.

of the 20<sup>th</sup> century were those of Henry Thornton and Walter Bagehot.<sup>10</sup> In his classic work written in 1802 and entitled *An Enquiry Into the Nature and Effects of Paper Credit in Great Britain* Henry Thornton outlined the principle functions of modern central banking. Walter Bagehot's *Lombard Street*, the second most authoritative text on central banking, did not appear until 1873 nearly three-quarters of a century later. These guiding principles were relatively consistent in time and uniform across nations; they included the preservation of the value of the national currency, long run stable monetary growth, a preference for the entire financial system over individual banking institutions, and transparency with regard to the implementation of central bank policies. Although these principles appeared on the surface to be both worthy and noble, in practice they achieved and continue to achieve today quite different ends.

Whether on or off the world's gold standard our world's central banks are designed to mitigate the effects of the financial crises that they create, rather than to prevent them in the first place. Whether on or off the gold standard central banking funnels wealth from the many to the few without the explicit permission of the many. Whether on or off the gold standard central banks encourage debt over equity and socialize risk to the detriment of the many and to the benefit of the few. Whether on or off the gold standard central banking places the focus on the accumulation of new wealth, not through the creation of real goods and services, but through the transfer of the ownership of wealth that has already been produced. Finally, whether on or off the gold standard, money becomes a political end that leads to unlimited government and the gradual erosion of individual freedoms.<sup>11</sup>



When our world's national governments unceremoniously abandoned the gold standard in 1971 things began to change, and what before was a corrupt system that offered mixed results became an incorrigible machine of economic destruction, political and military oppression, and ever-growing income disparity.

#### WHAT MAKES MONEY UNSOUND

Before we can begin to wrestle with the political challenges that the introduction of sound money anticipates, we must have a clear idea of what sound money might look like in the 21<sup>st</sup> century, and the financial mechanism by which we can make the transition away from unsound money with a minimum of disruption in the real economy, if only the political will were present. Hopefully the historical background provided above has given us important insight into what the future might bring.

In quick summary, the Spanish economy and the Spanish banking system appear to have been doing quite well before gold and silver began flowing into the Iberian peninsula in the

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<sup>10</sup> Thomas Humphrey and Robert Keleher. 1984. "The Lender of Last Resort: A Historical Perspective". The CATO Journal. (Spring/Summer). Vol. 4, pp. 275-318.

<sup>11</sup> Ron Paul. 2009. *End the FED*. The Foundation for Rational Economics and Education, Inc. New York: Grand Central Publishing.

16<sup>th</sup> century. This rapid increase in the money supply caused widespread inflation not only in Spain, but throughout the Holy Roman Empire. Whereas some people benefited greatly from this inflation many others did not. Without this rapid influx of new money the Spanish empire would likely never have come of age, but neither would have its collapse. Indeed, sound money is not a creation of the state, but unsound money is.

Secondly, cheating appears to be a natural human phenomenon, and the only way that we can correct for it is with constant vigilance of our fellow human beings. Certainly, no one individual or human institution has a monopoly on fair play, and never should we think that they do.<sup>12</sup> In fact, when it comes to money, the biggest cheaters throughout history have been those who have claimed to be the guardians of our money supplies -- namely, the state and private banks. The act of currency debasement was well recognized by the Catholic Church in the 14<sup>th</sup> century, but the Church remained silent so long as it could profit from its implementation. In fact, we can find numerous examples of debasement since nearly the first appearance of money in historical records. This appears to be the very reason that the early coinage of money was not the province of the state or even private enterprise, but rather that of religious institutions.<sup>13</sup>

Thirdly, the Bank of Amsterdam is a clear example of where the state once intervened to eliminate cheating and was momentarily quite successful. So successful, that the intervention led to a whole new method of commercial accounting and transaction that would eventually become the basis for modern commercial banking transactions. Unfortunately, like the Spanish empire before it, the Bank of Amsterdam also ended in defeat as it withered on the vine of banking malpractice -- lending out the wealth of the many for the profit of the few and thereby socializing the risk of the borrowers while making a handsome profit for having done so.

Finally, the pinnacle of central banking collusion, theft and deception has surely been the creation of the Federal Reserve System of the United States -- a private banking cartel that issues money *ex nihilo* in exchange for interest bearing debt that it then sells on the open market in order to pool money created by private banks through the fractional reserve lending system that it underwrites as the lender of last resort. In turn, this money is lent out to various central banks and governments around the world where it is further multiplied many fold by still other fractional reserve systems that issue still more money *ex nihilo* in the form of interest bearing debt. It is estimated that since the creation of the FED the value of the US currency has depreciated by between 95 and 97% of its worth in 1913.<sup>14</sup> As a result

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<sup>12</sup> Alexander Hamilton, John Jay, and James Madison. 1961. *The Federalist*. Editor: Jacob E. Cook. Middletown, Connecticut: Wesleyan University Press. Library of Congress, THOMAS <<http://thomas.loc.gov/home/histdox/fedpapers.html>>

<sup>13</sup> Op cit. Jörg Guido Hülsmann.

<sup>14</sup> Federal Reserve Bank of St. Louis. 2012. Economic Research Division. Federal Reserve Economic Data. [online data retrieval] Consumer Price Index 1913-2011. Wage Earners and Clerical Workers (CWUR0000SA0R) and All Urban Consumers (CUUR0000SA0R) Downloaded 15 June 2012. <<http://research.stlouisfed.org/fred2>>

of this system of debt-backed currency and corrupt lending practices, not only has the United States undergone several major economic crises at home, but it has sent tidal waves of economic destruction across the globe on more than one occasion.



Now, there are those who would advocate that this collusion, theft, and deception is necessary in order to bring about the kind of rapid economic growth that benefits all of humanity. The standard measure of this benefit is the amount of human activity that can be passed through a cash register, recorded into a ledger book, and reported to a tax collector. Whether the recorded transaction involves the cleaning up of a mess brought about by another recorded transaction makes no difference -- both good and bad are bundled together as *good*. The primary interest of these advocates appears to be the packaging, pricing, and trading of taxable goods and services without which the principal and interest on the freshly issued and old debt of the central banking systems could never be repaid. It were as if, humanity never existed or prospered until the invention of the cash register and national tax codes. In the end, one cannot help but stand aghast in the complete lack of imagination, total self-deception, or blatant culpability of those who support such a system in the name of human progress.

#### WHAT MAKES MONEY SOUND

Some of the most prosperous periods in US history occurred when gold and silver were legal tender. There was a time in US history when banks were divided into two kinds: savings banks and merchant banks.<sup>15</sup> Saving banks would typically hold a depositor's wealth and only lend it out in exchange for secure collateral such as a mortgage on a piece of real property or other large physical asset that would make the loan transaction profitable to the banker. The bank never lent out more money than what was deposited in its vaults, and all money that it did lend out was secured by a physical asset that the banker could claim upon failure of the borrower to make good on his debt. Merchant banks, like saving banks, would never lend out more money than they collected, but the risk of retrieval of both principal and interest was substantially higher as the collateral that these banks received was often merely temporary title to the current assets of the firm and the market reputation of the firm's owners. Indeed, a piece of machinery that produced nothing that anyone wanted after the firm went under was for all practical purposes worthless. Moreover, the reputation of the individual was only important to the individual.

What both of these banks shared in common was their inability to change the total money stock. They either held the money in their vaults or they placed it temporarily into circulation by lending it out. During times of crisis the money would be hoarded and prices would fall. During times of prosperity the money would be put into circulation and prices would rise, but never so much as they could fall, because more money in circulation likely

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<sup>15</sup> Rothbard, Murray N. 1994. *The Case Against the Fed*. Auburn Alabama: Ludwig von Mises Institute. pp. 29-40.

meant new production. The amount of money that went into circulation was asset-based and never amounted to more than already existent wealth. Only the most imprudent of banks would ever crash and their owners and managers would be dutifully punished for their lack of prudence. In the absence of a rapidly fluctuating money stock brought about by the nefarious practice of lending money into existence, wide spread bank panics rarely, if even ever occurred. Growth was rapid, government was small, and workers could feel relatively secure that the value of their hard earned savings would buy tomorrow at least, if not more, than what they forewent today. This is because new technology was forever being invented and would increase the number of real goods and services relative to the money stock. There were few worries about where to place one's savings or the interest that one might receive on it, because persistent inflation did not exist and the imaginary threat of deflation spirals was indeed imaginary.<sup>16</sup> Of course, the money stock was made up primarily of coin and bullion, and there were ups and downs in the quantity of precious metals that were mined, refined, minted, and traded. These sudden changes would bring about momentary havoc, but rarely did it result in the massive real economic damage that we have experienced in recent history.

Certainly it would not hurt to return to the gold standard and credit money -- namely, paper money backed by the amount of precious metal held by the issuing bank. But, is it even necessary? Besides, precious metal, like any other commodity, is subject to price manipulation by those who produce and hold it, and the livelihoods of the many should never be held hostage to political and market manipulations of the few.<sup>17</sup>

### A Method of Transition

In order for a successful transition to take place, not only must we have a clear notion of what the world might be like in the absence of central banking, but we must also be able to resolve the problems that the current system of central banking has created -- namely, massive government debt, bloated government budgets, and a difficult to resolve income gap.

As not all central banking systems are constructed the same we should hesitate to think that that the same solution will work for everyone, for surely it will not. This said, there appears to be enough similarity across systems that focusing on one system will likely prove useful as an example of what others might do. As the Federal Reserve System of the United States is by far the world's largest central banking system, and as it is the system with which I am the most familiar, I will focus my attention on it, and hope that others might learn from it.

#### **PHASE ONE: FIXING SEVERAL PROBLEMS SIMULTANEOUSLY**

Money typically enters into the US economy in three ways: through the issue of new debt by the US Treasury, through lending in the private sector in excess of fractional reserves, and more recently through the sale of new financial instruments called derivatives -- namely, the issue of "risk reducing" new paper that is constituted from repackaged old paper.

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<sup>16</sup> Jörg Guido Hülsmann. 2008. *Deflation and Liberty*. Auburn, Alabama: Ludwig von Mises Institute.

<sup>17</sup> This is not only a personal moral judgement that I find very easy to defend, but it forms the basis of the theory of exchange.

Now, if the US government were to recall all domestically-held, federally-issued debt in exchange for US debt-free notes issued by the US Treasury while simultaneously raising the federally prescribed reserve ratio from its current level to 100 percent, then the vast majority of outstanding debt could be eliminated with no increase in the general price level. This is because the large influx of new money into the system would be absorbed by private banks where it would be held in the form of mandatory 100 percent reserves.<sup>18</sup> Now, as old bank loans were retired, new bank loans could be issued, but the total amount of lending would be restricted to the total money base held on deposit by the issuing banks.

So, as to stop all other forms of *ex nihilo* money creation, the creation, sale, and purchase of all derivatives and derivative-like financial instruments must be prohibited by law. In an effort not to disturb the global economy and to maintain US credit worthiness overseas US debt held by non-US citizens and foreign governments would be exempt from this exchange. Previous holders of "risk-free" US national debt would seek new interest bearing paper in the private sector or purchase overseas risk-bearing sovereign debt. The entire global economy would be buoyed. Finally, the absence of interest income to the previous holders of the national debt would, of course, be a revenue loss to those who could not find new sources of investment. Their loss, however, would be just compensation to the general public for their having supported a corrupt system. In order to prevent a reoccurrence of inflation and new boom and bust cycles the US Treasury's issue of new money would be limited to that of the purchase of domestically held, nationally issued US debt.

Although the cost of banking and other forms of financing would likely rise temporarily as large money scrambled to find new sources of revenue, the immediate benefit to the national economy would be enormous. The ever increasing volatility in the nation's boom and bust cycles would be eliminated, as every potential source of new money-issue above what is represented by real assets with the exception of one -- namely, the US Treasury -- would be eliminated.



#### PHASE TWO - THE REINTRODUCTION OF FREE BANKING

Although the US Treasury would be constrained during to issue new paper only equal in amount to the outstanding domestically-held, federally-issued debt, the problem of future money production would not be resolved in phase one. Indeed, paper wears thin over time, and few people want to carry around heavy coin. Moreover, the

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<sup>18</sup> Patrick Carmack, J.D. 1996. Monetary Reform Act. <<http://www.themoneymasters.com/monetary-reform-act/>>

The proposed legislation contained herein does not address the issue of foreign-held, federally-issued debt, and it proposes the establishment of national body to control the US money supply. I reject this suggestion for the reasons provided by the Nobel Laureate, Friedrich A. Hayek, in his 1976 work *The Denationalization of Money: The Argument Refined*.

To the best of my knowledge this legislation has never been voted on in Congress.

problems created and resolved by central banking are only partially, but significantly addressed in phase one. In his seminal work *The Denationalization of Money: The Argument Refined*<sup>19</sup> Friedrich Hayek describes in substantial detail not only what a free-banking system might look-like, but how it might evolve and solve the unsolved and solved problems of central banking, if only legal tender laws were repealed.

Partick Carmack's proposed legislation to recreate central banking under still another guise is probably misguided. History has taught us that neither government, nor privileged banks are to be trusted with the issue of money. What certainly could evolve in the absence of legal tender laws and a government monopoly on the issue of new money is a system of competitive currencies in which governments and private banks would compete for the issue of the most stable currency. Nationally, this would require the elimination of domestic legal tender laws at home; internationally, it would require the elimination of barriers that limit the operation of foreign banks on home soil. National governments could still issue their own currency, but their currency would compete with the currencies of other governments and the private sector on their home soil. Some sort of global treaty would not be required to achieve this on one's own home soil.

The desire on the part of everyone to trade in the same currency would gradually lead to dominant currencies that would be judged by the market not for their ability to obtain special monopoly privileges to prop them up, but by the ability of their issuers to maintain a stable value over time. How each issuer would achieve this goal would surely vary from region to region; important is that everyone would be privy to the relative value of each currency and that these currencies would be interchangeable based on their market established value. This would, of course, require clearing houses and open markets, but these problems have



already been solved in the trade of existent foreign exchange and should pose no problem in domestic markets. All cash registers could be equipped with the latest up-to-date market information, and mobile phone carriers would be able to access and distribute this same information easily to their users. Would all of this take effort? It surely would, but certainly no more effort than what it has taken to adapt to the new age of information.

Best of all for the economist is that he would no longer have to waste his valuable time trying to outguess the activities of corrupt central bankers, but he could now spend his time looking for the best basket of truly relative prices that private bankers of all kinds could use to maintain the stable value of their respective currencies.

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<sup>19</sup> Friedrich August Hayek. 1976. *The Denationalization of Money: The Argument Refined*. London: The Institute of Economic Affairs.