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Gold and Freedom, Part 1

by Jacob G. Hornberger

Among the major threats facing the American people today is out-of-control spending at the hands of the U.S. government. It is a grave danger that people have faced throughout history from their own governments. After all, let's not forget the oft-repeated claim by U.S. officials about how they brought down the Soviet Union — by causing the Soviet government to spend itself into bankruptcy and ruin.

When the Framers were deliberating over the Constitution, they were fully aware of the dangers to people's freedom and well-being posed by a profligate government. As British subjects, they had experienced firsthand the ever-increasing taxes imposed by their king to finance his ever-growing expenditures. As revolutionaries, they had also experienced the ravages that come with the inflation of a currency to finance government expenditures. That's what "Not Worth a Continental" referred to. As citizens living under the Articles of Confederation, they knew the damage that irredeemable paper money can bring to a society.

The first thing to keep in mind about the Constitution was its dual purpose: to bring into existence the federal government while, at the same time, protecting the nation from it. While the Framers understood the need for government, they also understood that that same government constituted the greatest danger to their freedom and well-being.

Thus, by its own terms the Constitution limited the powers of the federal government to a small number of powers that were enumerated in the document. To make certain that U.S. officials got the point — that the federal government was considered to be the greatest threat to the freedom and well-being of the American people — our ancestors demanded quick passage of 10 amendments to the Constitution. Naming the federal government as the primary threat to their freedom, the Bill of Rights expressly prohibited U.S. officials from infringing fundamental rights and expressly guaranteed important procedural protections as a prerequisite to searching, arresting, incarcerating, or otherwise punishing people.

Our ancestors realized that not only was the U.S. government the primary threat to such fundamental rights as free speech, freedom of religion, peaceable assembly, and gun ownership, it

was also the major threat against personal wealth or private property. That's why, for example, the Bill of Rights expressly prohibits U.S. officials from taking people's property without due process of law or without just compensation.

The threat of inflation

The Framers also understood that there was an insidious, even fraudulent, way that government officials could seize people's privately acquired wealth — through an indirect monetary method known as inflation. To protect themselves from that threat, they again used the Constitution.

First, while the enumerated powers that the Constitution granted the federal government included the power to borrow money, they did not include the power to issue paper money or to make paper money legal tender.

Second, the Constitution expressly prohibited the states from issuing paper money (i.e., "bills of credit") and from making anything but gold and silver coin legal tender.

Thus, from the inception of our nation our American ancestors intended for the United States to operate under a precious-metals monetary system or, more specifically, under a monetary system in which people used gold and silver coins rather than paper money as the media of exchange.

What is vitally important to keep in mind is the reason our American ancestors did this: to protect the nation from the federal government and, specifically, from the ravages of out-of-control federal spending financed by ever-increasing amounts of freshly printed paper money.

Historically, among the most effective ways that governments have plundered their own citizens has been inflation. Directly taxing people gets them upset and even angry. Such anger can be threatening to government officials, especially when it spills over into rebellion or revolution.

Long ago, government officials figured out that it was much easier to seize people's property through inflation, in large part because people lacked the astuteness to figure out what the government was doing to them. Even better, when the effects of inflation would begin manifesting themselves through rising prices, government officials knew that the propensity of people was to blame the problem on private businesses that were raising prices rather than on public officials who were inflating the currency. Best of all, government officials knew that as prices began rising, they could appear as saviors to the people by imposing price controls on those greedy businesses.

The inflation scheme had been going on long before the invention of the printing press. Here's how the process worked:

As people engaged in the process of trading with one another, they found that barter could be a less-than-satisfactory mechanism. For example, suppose John is selling a bushel of wheat that Joe wants to purchase. Joe offers John a bushel of apples in exchange for the wheat but John isn't

interested in apples. He wants oranges. So Joe has to go out and find someone who has oranges before he can trade with John to acquire his wheat. But there's no guarantee that the person who has oranges is going to be interested in Joe's apples either.

Thus, over time people began using commonly traded items not only for their substantive use but also as a medium of exchange. Consider, for example, tobacco, an item that has sometimes served as money. Joe would go trade his apples for a bundle of tobacco, not with the intent of using the tobacco but solely as a way to purchase John's wheat. While John wasn't interested in Joe's apples, he would be willing to accept the tobacco because he knew that other people would be willing to accept it in exchange for purchases he wished to make.

Gradually, people began turning to precious metals for this purpose. Businesses would be willing to sell an item for an ounce of gold because they knew that everyone else would be willing to do the same. Although gold supplies could increase owing to new discoveries, thereby lowering the purchasing power of gold, people felt that, by and large, the commodity held its value. Other advantages of gold were that it was easily transportable and easy to hide.

But weighing out a quantity of gold each time a trade took place was cumbersome. In response, private minters began minting coins with a fixed amount of gold in them. To facilitate trades, various gold coins would be minted, each one containing a different quantity of gold — e.g., 1 ounce, 1/2 ounce, or 1/4 ounce. For smaller transactions, silver coins were used, and even copper ones.

As in any other business, people turned to those minters who developed a reputation for honesty and integrity. Coins minted by those minters would be more readily accepted in the marketplace as containing the amount of gold represented to be in the coin.

People would use such coins not only to purchase goods and services but also to pay their taxes. They were the money that people used in their day-to-day transactions.

Clipping the coin

Ever-increasing government expenditures and ever-increasing resistance to high taxes caused government officials to look for other ways to raise revenues. The most effective method they came up with was inflation or what was called "clipping the coin."

What government officials first did was take over the business of minting the coins. It wasn't enough for government to simply enter the gold-minting business in competition with the private minters. That would obviously leave people free to choose between coins minted by private businesses and those minted by the government.

So the government would decree a monopoly on the minting of coins. That meant that only the government — or a private business appointed by the government — could mint coins. Every other minter was required by law to close down his operations, and new entrants into the minting business were prohibited.

As people paid their taxes with the government's coins, government officials began shaving off a slight bit of gold around the edges of the coin before returning it into the marketplace in payment of goods and services. The total amount shaved off the coins added significant amounts of money to the state's coffers.

Obviously, as government officials shaved off the edges of the coins, what was represented to be a 1-ounce gold coin was no longer a 1-ounce gold coin. As a result of shaving, the coin contained less than 1 ounce. Gradually, people began figuring that out, especially as the coins became smaller and smaller in size.

At that point the coin would begin trading at a discount in the marketplace. That is, a businessman selling an item for a 1-ounce gold coin would require not only the shaved coin but also, say, a couple of silver coins to compensate for the smaller amount of gold in the gold coin.

Needless to say, government officials didn't like their coins' being treated in such a shabby manner. It was an affront to the king. It was questioning his honor and integrity. The solution was to make the king's coins legal tender, regardless of how much gold they contained. What that meant was that people were required by law to accept the government's coins at face value for all economic transactions, including the payment of debts and the purchase of goods and services.

Inflation and the printing press

The invention of the printing press greatly facilitated the ability of government officials to seize people's wealth through inflation. Here's how the process worked. Let's say the government needed an additional one million gold coins to finance its ever-growing expenditures. Reluctant to tax the citizenry, the government went into the marketplace and borrowed the gold coins from the citizenry. The loan would be evidenced by a promissory note, or "bill of credit," promising to pay a fixed quantity of gold, e.g., a 1-ounce gold coin.

So far, so good, at least insofar as inflation was concerned. The government might be spending wildly but the money being spent was coming from either taxes or borrowing.

People began realizing that the government's notes could be used as easily as gold coins to facilitate trade. That is, sellers would be willing to accept a government note promising to pay a 1-ounce gold coin because they were certain that the note was as good as gold. All that anyone had to do was demand that the government redeem the note by paying him the gold coin, and it would be done.

Then the problem started. Government officials, ever in need of more money to finance their ever-growing expenditures, figured out that only a certain percentage of people holding the notes would appear and demand their gold at any one time. Most of the notes would continue to circulate as money.

So government officials began cranking up their printing presses and printing lots of government notes that they then used to pay for goods and services in the marketplace. They had

little concern that everyone would show up at the same time demanding redemption of all the outstanding notes.

For example, let's say that on December 31 the government plans to receive tax revenues of one million 1-ounce gold coins. On January 1, it goes out and borrows one million gold coins, evidenced by the delivery of one million notes with a maturity date of one year, each one promising to pay the bearer a 1-ounce gold coin. On the following December 31, the government receives the million gold coins in tax revenue and the following day is prepared to pay off all the notes it issued when it borrowed the money.

However, on the maturity date government officials notice something important. On the maturity date, only 10 percent of the notes are offered for redemption. The other 90 percent continue being used to facilitate trade in the marketplace, with everyone's having the assurance that he can cash in the note whenever he wants.

Realizing this, the government issues, say, 100,000 additional notes that it uses to pay contractors and suppliers. Those notes begin circulating in the marketplace just like the other ones. But there is now a significant difference: If everyone appears at the gold window and demands redemption, the government can't make good on its promises. It has only the 1 million in gold that it collected from the taxpayers, not the 1.1 million that it has issued in notes.

As people begin discovering that there are more notes in circulation than the government is able to redeem, there is a rush for the gold window. Everyone wants his gold. No one wants to be stuck with a promise to pay gold if the promise cannot be fulfilled.

Moreover, the government's notes start trading at a discount in the marketplace. That is, suppose a seller is selling an item for 1 ounce of gold. When a buyer offers him a government note promising to pay 1 ounce of gold, the seller demands the note plus a bit more to compensate him for the risk of default.

Just like the regimes of old, modern-day governments become outraged when people question their integrity and honor. Refusing to accept government notes at face value is considered a grave insult, one even akin to treason. That's where legal-tender laws came into play. Under threat of severe punishment, government officials require people to accept their notes at face value, without any discount, no matter how many notes have been issued and no matter how serious the risk of default.

That sets the stage to examine the monetary system of the United States, a system that began with precious metals and has ended up with irredeemable paper money known as Federal Reserve Notes, a process that endangers the well-being of the American people and that threatens their nation with bankruptcy and ruin.

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This article was originally published in the April 2009 edition of *Freedom Daily*..