**Friday, June 3, 2011**

**[Open Letter to Ron Paul](http://fofoa.blogspot.com/2011/06/open-letter-to-ron-paul.html)**


Dear Dr. Paul,

I would like to share with you what I think is a brilliant opportunity for you to lead the revaluation of the US gold stockpile from its present book value of $42.22/oz. which, as you say in the video below, "makes no sense whatsoever." I think that when a rare opportunity like the one I’m about to describe presents itself, the least we can do is to give it fair consideration.

While watching your recent hearing on YouTube, I was struck that the Fed's General Counsel Scott Alvarez had to explain to you that the Fed doesn’t own any gold. Here's the clip to which I am referring. It should begin automatically at 1:35:

<http://fofoa.blogspot.com/2011/06/open-letter-to-ron-paul.html>

Had you been reading my blog (not that you would be, of course, but maybe now you’ll start ;) you would have known this by at least last October when I published [It’s the Flow, Stupid](http://fofoa.blogspot.com/2010/10/its-flow-stupid.html). Here is an excerpt, and this is important to the opportunity I will present:

Here is something you need to understand about the US gold. The Fed does not own it. The US Treasury does. Following the Gold Reserve Act of 1934, the Treasury gained title to the entirety of the US monetary gold (including $3.5 billion which was currently being held by the Federal Reserve banks). From that point on, the Fed has received [from Treasury] private issues of new-fangled gold certificates in $100, $1,000, $10,000 & $100,000 denominations -- not to be paid out and not for circulation.

So the Treasury took 175 million ounces of gold from the Fed, paid the Fed in DOLLAR-DENOMINATED certificates for this gold at $20 per ounce, then revalued gold to $35 per ounce. So if the Fed had even been able to redeem those certificates for gold in 1935, it would have only gotten back 100 million ounces. The windfall of 75 million ounces of gold ($2.6 billion), in this case, went entirely to the US Treasury and not the Fed.

The entire Treasury windfall was $2.8 billion and was the reason and the funding for the establishment of the ESF, the Exchange Stabilization Fund in 1934. So following the Gold Reserve Act of 1934 100 million ounces of gold were already automatically monetized. The rest of the US gold was eventually monetized through the Fed. The way this happens is the US Treasury issues fancy new non-negotiable, dollar-denominated gold certificates to the Fed and the Fed credits the Treasury account with dollars.

Today, all of the US gold has been "spent" in this way, but only at the price of $42.22 per ounce. That's 261,511,132 ounces of gold monetized at roughly $11 billion, money that was spent long ago.

So you see, the Fed cannot mark the US gold to market. It cannot even revalue the US gold. **Only Congress can.** And even if Congress DID revalue the gold, it would not change the Fed balance sheet by one penny. The Fed only holds dollar-denominated certificates worth $11 billion, payable in gold, but not really. It's kind of like Aramco in 1945 who owed the Saudis $3 million, payable in gold.

If Congress DID decide to mark the US stockpile of gold to market today it would find it had a new stream of revenue. At today's price of $1,328 per ounce, the US gold would be worth $347 billion. Subtract the $11 billion already on the Fed balance sheet and Congress could immediately ask the Fed to credit the US Treasury with $336 billion new dollars to be spent.

Here is a little more background from a couple of my more recent posts. Hopefully it'll start to be clear where I'm heading with this. This next one comes from January in my post, [RPG - Update #1](http://fofoa.blogspot.com/2011/01/reference-point-gold-update-1.html):

*"Meanwhile, due to the woefully outdated paradigm established by the US Congress for gold held by the Treasury Department, the gold reserves of the United States are effectively anemic and bedridden upon the books of The Federal Reserve System, where they exist only in certificate form — valued at a static $42.22/oz., forming a paltry $11 billion stake."*

That's right! The Fed doesn't even have actual gold on its balance sheet that can be used as a reference point. It has "gold certificates" issued to it by the US Treasury from the past monetization of US Treasury gold at $42.22/oz. I suppose, technically, if the US Treasury wanted to revalue its gold to the market price today, the proper yet antiquated process would be for the Fed to credit the Treasury's spending account with new dollars representing the difference in price. Today that would be about $355 billion fresh dollars for Congress to spend. Yet there would still be no existing mechanism to automatically account for the new and emerging Reference Point: Gold. Something technical is going to have to change!

Did you notice that I underlined $355 billion? And farther above, which was from back in October, it was "only" $336 billion. Well, here's an excerpt from my very recent April post, [RPG - Update #2](http://fofoa.blogspot.com/2011/04/reference-point-gold-update-2.html):

Rather than **selling** the gold, why don't you just value it like the rest of the world? Why not just mark it to the market price of gold on the Treasury books? If you, Congress, are going to insist on an honest accounting of America's liabilities, why not properly account for her ASSETS as well?

And then… the US Treasury, under the daft guidance of [Geithner], can issue new gold certificates to the Federal Reserve. As anyone with even a rudimentary understanding of double-entry bookkeeping knows, the balance sheet must balance. For every asset there is a liability, and vice versa. This is basic stuff. You don't need to be a banking "expert". And so far the Fed only carries $11 billion of the Treasury's gold on the asset side under the gold heading. Today we have room to add $370 billion more, and that means fresh Fed liabilities—also known as US dollars—accruing as fully paid-up credits to the Treasury account for the government to use however it deems appropriate.

Again, I realize this doesn't solve *any* of the big problems, but it does buy some time. And furthermore, it is not a bad or reckless thing to do. It is the ***right*** thing to do! America has an untapped asset. You can use it without selling it for gosh sake! And just like the old gold certificates, the new ones will NOT be redeemable by the Fed or any other banks in physical gold. They will simply be an accounting entry on the Fed balance sheet. In the future, that gold *can* be mobilized, if necessary, in defense of the US dollar. **But only with the approval of Congress.** The physical gold remains the property of the United States. It will simply be monetized by properly revaluing it as the monetary reserve asset that it is, and placing it—at its proper valuation, updated quarterly—on the asset side of the central bank's balance sheet, just like the ECB.

That's right, it jumped again. From $336 billion in October, to $355 billion in January, to $370 billion in April. And guess what it is today. $390 billion! That's the amount of untapped equity the US Treasury has in its gold today. And that equity can be monetized without selling the gold, by the simple act of Congress ordering the revaluation of the gold.

This is simple logic, Dr. Paul. It doesn't take a room full of lawyers to figure out if it is feasible. It is plainly obvious, which is why it is so stunning to me that Tim Geithner is playing the ridiculous juggling game that he is today, essentially plundering retirement accounts ("disinvesting intragovernmental debt") by $66 billion to keep feeding the big government Frankenstein monster:

*"Since May 16, the debt subject to the debt limit has been $14.293975 trillion each day, showing that Treasury has $25 million in breathing room under the debt ceiling.

"...it's not completely transparent how Treasury is managing the debt versus the debt limit on a daily basis... We do know that Treasury has used three of the tools available: Suspending G-Fund reinvestments, redeeming investments of the Civil Service Retirement and Disability Fund (CSRDF), and suspending new CSRDF investments.

"...The ultimate day of reckoning comes when Treasury runs out of cash, not when it runs out of room to issue new debt. Many in Congress and the press appear to confuse the two, and Treasury hasn't worked that hard to draw a distinction..."* [[1]](http://www.zerohedge.com/article/treasury-continues-dip-retirement-accounts-prepares-take-out-66-billion-chunk-make-space-new)

Perhaps there is another "tool". One that doesn't require raiding the retired and disabled.

The gold certificates on the asset side of the Fed's balance sheet are not even paper certificates with fancy fonts and pictures. They are electronic book entries representing the dollar-denominated amount of $11 billion. They no more represent the US gold by weight than they are redeemable in that gold. They are a nominal dollar token accounting entry.

The Fed's "Fisher" was wrong [[here](http://www.gata.org/files/FedMemoG-10Gold%26FXCommittee-4-29-1997.pdf)] when he said, way back in 1997, that a revaluation of the gold would require selling off other assets to balance the Fed's books. Firstly, if Congress were to revalue Treasury's gold, that would not automatically revalue those "certificates". **They have no market value because they are irredeemable, non-negotiable and obviously unmarketable!** Secondly, even if it were to automatically affect the Fed balance sheet in some cartoon universe, selling off other assets is not the only way to balance a gold revaluation. The more logical way is for the Fed to issue new Fed liabilities, aka dollars, to the owner of that collateral that is rising in value.

Think back to when house prices were actually rising. If you bought a house for $250K and it was suddenly worth $350K did that revaluation automatically appear on your bank's balance sheet as an additional $100K asset? ***Of course not!*** But you, as the homeowner, could put it on the bank's balance sheet with a HELOC or a second mortgage.

Maybe you could call this gold revaluation a GELOC to tide you DC spendaholics over until you can get your act together later this year. And that (soon to be) $400 billion "bridge loan" will not even be debt in the traditional sense, and it certainly won't be "debt subject to the debt limit" any more than Bernanke's QE is subject to limit.

Honestly, the Eurozone is so far ahead of you DC guys on this it's not even funny. They mark their official gold reserves to the market price every quarter, and they just voted to make gold a system-wide acceptable collateral asset. [[2]](http://online.wsj.com/article/SB10001424052702304520804576345551431026850.html)

*"The European Parliament's Committee on Economic and Monetary Affairs Tuesday agreed unanimously to allow clearing houses to accept gold."*

OMG! Can it be that a collateral asset that is consistently ***rising*** in ***free market value*** makes boatloads more sense than ones you have to prop up with quantitative easing and open market "print to purchase" operations??

One last thing. If you start to marking to market the effects of all this money printing, it will not only at least bring some benefit to the country, but it will also highlight the growing value of gold reserves for every American to see and learn from. Perhaps a few will even "save their savings" before it's too late. All those peeps you save might even nickname RPG "Ron Paul Gold!"

Okay, I promised myself I'd keep this post short since it is an open letter to an important and (I'm sure) busy man. And as my readers know, some of my posts tend to run a little bit on the long side. That said, Dr. Paul, I'd like to also invite you to read my last post, which is titled [The Return to Honest Money](http://fofoa.blogspot.com/2011/05/return-to-honest-money.html). It's about you, and Rothbard, and Menger, Mises and Hayek as well as a few more. I think you'll like it. But at least it might be worth your fair consideration.

Sincerely,
FOFOA

[1] [Treasury Continues To Dip Into Retirement Accounts, Prepares To "Take Out" $66 Billion Chunk To Make Room For New Bond Issuance](http://www.zerohedge.com/article/treasury-continues-dip-retirement-accounts-prepares-take-out-66-billion-chunk-make-space-new)
-Zero Hedge
[2] [Bid to Use Gold as Collateral Advances](http://online.wsj.com/article/SB10001424052702304520804576345551431026850.html) -WSJ

Posted by FOFOA at [2:21 AM](http://fofoa.blogspot.com/2011/06/open-letter-to-ron-paul.html) [98 comments](https://www.blogger.com/comment.g?blogID=4490468598422095060&postID=8975675587966920110&isPopup=true) [Links to this post](http://fofoa.blogspot.com/2011/06/open-letter-to-ron-paul.html#links)

**Wednesday, May 25, 2011**

**[The Return to Honest Money](http://fofoa.blogspot.com/2011/05/return-to-honest-money.html)**


What is honest money?

And what does it mean "to return to honest money?"

The most common answers to these questions have roots in the Austrian School of Economics, developed and made famous by the Austrian economists Carl Menger (1840-1921), Ludwig von Mises (1881-1973) and Friedrich Hayek (1899-1992). At least the most common answers today come from modern followers of the Austrian School. And modern practitioners will tell you that gold and silver are honest money, and that the way to return to honest money is to make money harder and/or to limit or eliminate fractional reserve banking.

But this meme of honest money has been canonized in such a simplistic way that its proliferation has become a bit of a credibility problem for those that promote it, and a source of confusion among their more credulous followers. So I have a slightly different take on honest money that I'd like to share with you.

My definition is that honest money is simply money that does not purport to be something it is not. I'm sure this doesn't seem any simpler than saying gold and silver are honest money, at least not on the surface. But I think that once we explore this subject a little more deeply, you'll find that mine is a much more elegant view of a very important topic.

As you will see, I'm not here to challenge the Austrian forefathers, Menger, Mises and Hayek. In fact, my view is perfectly compatible with theirs. Where it differs is with some of the modern gold standard advocates and promoters. In my view they have improperly reconstructed the money concept that was deconstructed by their forebears.

I realize that some of you already have your defensive wall up as you sense that I am about to attack the dogma with which you identify. But I invite you to bear with me here. The view is quite nice from where I sit. As Aristotle wrote, "it is the mark of an educated mind to be able to entertain a thought without accepting it." Costata took some flak in the last post for asking the reader to suspend disbelief. But this is all he meant. Try thinking in terms of the principles and concepts I will present, and then you can apply that view to both my conclusions as well as your own established beliefs. This is the proper way to take in a new view, and then you can decide to either accept or reject it, but at least you will have seen it.

I do believe that we are in the process of returning to honest money. I believe this transition is necessary, natural and inevitable (unstoppable). And that last part is why I sit back as an observer, rather than getting all worked up as an activist. To my way of thinking, all you can do now is take action to preserve your own wealth as we roll onward into this [brave new world](http://www.oesquema.com.br/trabalhosujo/wp-content/uploads/2009/07/aldous_huxley_vs_george_orwell.jpg).

**Sell the Gold in Fort Knox?**

Congressman Ron Paul is one of the leading proponents of a return to honest money and a return to the gold standard. He is also a firm believer in Austrian economics and has authored six books on the subject. There was a curious headline on Drudge the other day that read, "RON PAUL: Sell the gold in Fort Knox." Here's the [link](http://www.nysun.com/national/selling-gold-at-fort-knox-emerges-as-next-big/87350/) and a quote:

*The next big question on the federal debt limit could be whether to start selling the government’s holdings of gold at Fort Knox — and at least one presidential contender, Ron Paul, has told The New York Sun he thinks it would be a good move.

The question has been ricocheting around the policy circles today. An analyst at the Heritage Foundation, Ron Utt, told the Washington Post that the gold holdings of the government are “just sort of sitting there.” He added: “Given the high price it is now, and the tremendous debt problem we now have, by all means, sell at the peak.”*

Mish then came out with a [post](http://globaleconomicanalysis.blogspot.com/2011/05/ron-paul-says-sell-gold-no-chance.html) saying that Ron Paul had not said this. He wrote that the Sun must have gotten it wrong:

*People have been sending me an article all evening that says Ron Paul proposes selling gold to pay down the national debt. The article is nonsense and it took me all of 5 seconds to spot the error.

Somehow the New York Sun confused Ron Paul with some clown I have never heard of named Ron Utt, or the Sun misrepresented a statement Paul made.

[…]

Addendum:

I have read the Sun article several times now looking for other possibilities. The only other thing I can come up with is the possibility Paul may have said something to the effect of wanting the government to mint and sell more gold coins, but that does not equate to selling gold reserves to pay down debt.

Thus, I keep coming back to the thesis that the Sun is inadvertently mixing statements of Ron Paul with Ron Utt or the Sun has misinterpreted or worse yet, hugely misrepresented a statement Paul said.*

I'm not trying to make a big deal out of this story, but I wanted to bring it to your attention because it got me thinking about Ron Paul and his honest money ideas. I'll admit that I'm not an expert on Ron Paul's ideas like Mish is, but I could certainly think of a few reasons why Dr. Paul might make that statement, not the least of which being that the gold that was nationalized in 1933 needs to get back into private hands.

Gold does the most good for any currency zone being in the private ownership of its productive citizens rather than the public ownership of big government. Remember that I, too, made a "crazy proposition" for the US gold with regard to Treasury's cash funding running out in [Reference Point: Gold - Update #2](http://fofoa.blogspot.com/2011/04/reference-point-gold-update-2.html). So I'm not sure Mish got this one right. Perhaps it will have been clarified by the time I publish this post.

**Ron Paul and Honest Money**

In any case, I know that Ron Paul advocates returning to "honest money," and to him that means some kind of a gold standard. So, because I'm not a Ron Paul expert, I did a little research. I wanted to get a general handle on what realistic and actionable ideas the gold standard crowd has today for returning us to their concept of "honest money," other than the simplistic dogma: ldo, gold and silver is honest money.

My hope is that if we can come to an understanding of the realistic propositions of the gold standard advocates, we can then compare them to Freegold in terms of practicality (feasibility), level of honesty (in terms of the money concept) and probability. And then I also hope to compare both concepts, gold standard and Freegold, to the words of the Austrian masters in their deconstruction of the money concept. One would expect them to be more consistent with the ideas of modern Austrian School hard money advocates than with the thoughts of the anonymous ANOTHER and FOA. I guess we'll see about that.

What I learned about Ron Paul from my research is that he sort of has two overlapping ideas about how to move forward into a gold standard. Over the last four decades he has somewhat gone back and forth between these two ideas based on the political climate of the time. The first one can be summed up as "End the Fed."

Ron Paul first became interested in economics in the early 60s when he read the warnings of Austrian economists predicting that the US would not be able to maintain the gold standard at $35/oz. because it was printing too much paper. He was skeptical but still interested for the next ten years while the gold price somehow stayed fixed at $35, despite what he had read. But then, in 1971, the Austrian economists were proved correct when the US suddenly abandoned the $35 gold fix and the entire gold exchange standard in one fell swoop.

This revelation is what got Ron Paul interested in politics, and even more interested in economics. During the 70s he became a proponent for ending the Fed and in 1976 he ran for congress and served (that time) until 1984. But then during the 80s and 90s we had "Paul Volcker saving the dollar" and [Credibility Inflation](http://fofoa.blogspot.com/2010/08/credibility-inflation.html), which changed the political climate somewhat. It was during this time that Ron Paul seems to have developed his second position, which can be summed up as "competing currencies."

**Competing Currencies?**

The idea with competing currencies, since the political will towards ending the Fed had pretty much dried up in the 80s, was to make it legal for gold and silver to trade as currency. With gold and silver contract settlement supported by the courts, "obviously" (presumably) they would win out over fiat in the currency competition of the free market.

It was during this "competing currency phase" in the 80s and 90s that Ron Paul spearheaded the American Eagle gold bullion program by presenting the idea to Reagan's Gold Commission which led to the Gold Bullion Act of 1985. You might remember the video I used in my [Indicium](http://fofoa.blogspot.com/2011/03/indicium.html) post that was a 1983 debate between Ron Paul and Fed Governor Charles Partee. In it, Congressman Paul argues for the gold standard while Partee explains the value of a ***floating*** gold price:

In the video Partee said that he wanted the Gold Eagle coin as an "indicium of public attitudes toward financial conditions in the country" and that "you destroy that 'indicia value' when you have a gold standard." What do you think? Does this sound at all like Robert Zoellick's recommendation to use gold as a "reference point?"

Indicia—plural for indicium—comes from Latin for "sign," "clue" or "indication." In law it is sometimes synonymous with "circumstantial evidence." Partee elaborated saying he wanted gold to be an "indicator" and therefore the price needed to "vary" [Me: float].

Here's the clip as I posted it, set to start at 19:30 referencing the following two minutes:

<http://www.youtube.com/watch?v=kcm8VvBcUdE&feature=player_embedded>

I imagine that Ron Paul viewed the American Eagle gold coin program as merely a step in the right direction. But when he spoke of allowing a gold-backed currency to compete with the dollar, he was not necessarily talking about physical gold coins circulating. He was more interested in a paper or electronic currency that would be fixed to gold by weight, just like Bretton Woods, but redeemable to anyone, and possibly run by a private enterprise like American Express (which he mentioned).

His idea was that as long as you allowed the courts to enforce contracts essentially denominated in gold by weight, this hard currency would win out in the free market. Here is a clip from a 1995 interview with Ron Paul in which he explains that there is "no way they are going to go back on the gold standard now" and eschews the idea of a Central Bank sponsored gold standard. So the way he wanted to address that reality was to legalize a "parallel standard" that would allow the use of a private gold standard in the marketplace. It is set to start at 4:50 and my reference runs for five minutes until the end of this segment:

<http://www.youtube.com/watch?v=Q-M8En38oFQ&feature=player_embedded#at=298>

At 7:55 is where Ron Paul mentions Amex as the host of a possible private market money, backed by gold, and also backed by the government guaranteeing the fulfillment of contracts denominated in this hard, free market money. From there he is prompted by the interviewer to talk about money as "wealth". This is a key distinction that the modern hard money movement does not understand: the distinction between ANY circulating transactional currency and wealth.

**FOFOA's Dilemma**

There will be much more on this later, but very quickly I'd like to share with you a new "dilemma" coined by one of my readers. It is in the spirit of Triffin's dilemma which I wrote about in my post coincidentally titled [Dilemma](http://fofoa.blogspot.com/2010/11/dilemma.html). The fullness of *this* post will hopefully explain the following in detail, but here it is in short, from my South African friend calling himself The Motley Fool:

*FOFOA's dilemma: When a single medium is used as both store of value and medium of exchange it leads to a conflict between debtors and savers. FOFOA's dilemma holds true for both gold and fiat, the solution being Freegold, which incidentally also resolves Triffin's dilemma.*

Yes, thank you MF! This *must* be viewed in the context I laid out in [The Debtors and the Savers](http://fofoa.blogspot.com/2010/07/debtors-and-savers.html). It is not only important, it is the key that unlocks the view. There is an interesting nuance in modern society that many miss. And it is that there is a significant number of people that are both debtors *and* savers. They have loads of debt through their mortgages and credit cards, but they also have saving in their IRAs, company 401Ks and union pensions. These camp-straddlers, on average, have a zero net-worth as their debt cancels out their savings. But they are useful, conceptually, in viewing how the future monetary and financial system will work.

Today **we denominate both transactions and savings in dollars: the dilemma!** So the dollar's collapse, today, will wipe out both their savings *and* their debt. Net-worth will remain zero. Remember that this is a conceptual exercise, a thought experiment to help you see. Now if you take the deflationists' view you must imagine their savings being wiped out but their debt remaining. They will be broke and owing. And somehow, the deflationists think, this will keep the dollar not only functioning transactionally, but make it even stronger.

Okay, here's the meat of the thought experiment. I want you to imagine the opposite; that these debtor/savers had their debt wiped out, but their savings remained intact. So their net-worth would go from zero to high, and their lifestyle would improve. How would this affect the bankers? That's right, it would not make them happy. And this is exactly how Freegold works to keep the currency honest and the banks chained to prudence. More on this in a moment, because I can hear some of you screaming disbelief.

**Back to Ron Paul**

So during the 80s and 90s the idea of ending the Fed had lost some of its political appeal and Ron Paul went for the more Libertarian idea of letting the people choose their own money in a free market. But then, lately, the Fed has been taking more popular heat, so Ron Paul has gone back in that direction with the 2009 release of his book titled 'End the Fed'. But even so, Paul is still hedging his position with the competing currencies idea because he is smart enough to know that you can't just end a 100-year monetary tradition without some seriously disruptive economic and financial consequences for which he obviously doesn't want to be blamed.

Here is Ron Paul in 2009, prior to the release of 'End the Fed', talking about competing currencies. And he's talking about a hard currency to compete **with the Fed's dollar**. This is obviously a secondary idea and a hedge to the popular "End the Fed" idea.

Here's a little bit of the transcript, beginning at 1:25:

***Ron Paul:*** *…and now we have a bigger problem. The transition would be pretty tough, and I've written and talked a lot about this and you’d have to devise a system where there would be a transition where maybe* ***you could have a gold standard competing with a paper standard and then obviously gold would win out****.****Reporter:*** *Well sure.****Ron Paul:*** *People would eventually go to gold because the paper, we’re getting down to the bottom right now. The last thing before they really rush to gold is the Treasury bill.

[…]****Reporter:*** *This is a silver certificate that was issued, I guess they stopped issuing it about thirty, forty years ago something like that. But is this what you are envisioning? …there it says, “Silver certificate for gold or silver.” Is this what you want again?****Ron Paul:*** *To some degree, but there’s been a lot of writings about how you might do this in the private market and not have a government monopoly, because* ***we did have shortcomings in our gold standard because we had bimetallism and we had artificially fixed prices between gold and silver. You don’t want that, you either have to be on a gold standard or a silver standard****, but you could… Hayek has written about baskets of currencies and having this work in the private market. A competing currency could be private but, yes, eventually what you’d want to do, a lot of people say, “Oh we don’t want no gold, we can’t carry all that gold around in our pockets."****Reporter:*** *Right.****Ron Paul:*** *No, I think your point that you’re making is right. You’re still going to have certificates or you’re going to have electronic entries. There are people today who are trying to promote this idea through electronic gold, but the problem is the legal tender laws force us to use dollars in all settlements, so one of my goals in Washington to move in that direction would be to repeal legal tender laws. Actually, all we need to do is obey the Constitution because it’s still very clear it hasn’t been repealed that only gold and silver can be legal tender. Believe it or not, they don’t even obey the Constitution anymore.*

**Two Monies**

I couldn't agree more with Ron Paul above where he said, "we did have shortcomings in our gold standard because we had bimetallism and we had artificially fixed prices between gold and silver. You don’t want that, you either have to be on a gold standard or a silver standard." What he's talking about is a fundamental mistake that was made in the Coinage Act of 1792 that haunted the American money system on a few occasions over the next 200 years. From Ron Paul's book, [The Case for Gold](http://mises.org/books/caseforgold.pdf):

*The Coinage Act established a bimetallic dollar standard for the United States. The dollar was defined as both a weight of 371.25 grains of pure silver and/or a weight of 24.75 grains of pure gold—a fixed ratio of 15 grains of silver to 1 grain of gold. Anyone could bring gold and silver bullion to the Mint to be coined, and silver and gold coins were both to be legal tender at this fixed ratio of 15:1. The basic silver coin was to be the silver dollar, and the basic gold coin the 10-dollar eagle, containing 247.5 grains of pure gold.*

The mistake was price-fixing the two metals to each other, and this error cost the US Treasury a lot of gold 100 years later, leaving it to be bailed out by none other than [JP Morgan](http://en.wikipedia.org/wiki/Panic_of_1893). Now I want you to pay attention to this recurring concept of **two monies**, be it gold and silver erroneously price-fixed, or Ron Paul's hard currency competing with (floating against) the Fed's dollar. This is an important concept that will keep coming up, so I just want to draw your attention to it at this point.

**End the Fed?**

Even though Ron Paul is clearly a practical thinker, he is also a politician who enjoyed a groundswell of support in 2008 from the "End the Fed" crowd. Here is the opening of a 2009 [speech](http://www.lewrockwell.com/paul/paul504.html) to the US House of Representatives in support of the [Federal Reserve Abolition Act](http://www.govtrack.us/congress/billtext.xpd?bill=h111-833) in which Paul implored Congress to end the Fed and reinstate the gold standard, without offering much elaboration on how that would happen:

*Madame Speaker, I rise to introduce legislation to restore financial stability to America's economy by abolishing the Federal Reserve…

…Abolishing the Federal Reserve will allow Congress to reassert its constitutional authority over monetary policy. The United States Constitution grants to Congress the authority to coin money and regulate the value of the currency. The Constitution does not give Congress the authority to delegate control over monetary policy to a central bank. Furthermore, the Constitution certainly does not empower the federal government to erode the American standard of living via an inflationary monetary policy.

In fact, Congress' constitutional mandate regarding monetary policy should only permit currency backed by stable commodities such as silver and gold to be used as legal tender. Therefore, abolishing the Federal Reserve and returning to a constitutional system will enable America to return to the type of monetary system envisioned by our nation's founders: one where the value of money is consistent because it is tied to a commodity such as gold. Such a monetary system is the basis of a true free-market economy.

In conclusion, Mr. Speaker, I urge my colleagues to stand up for working Americans by putting an end to the manipulation of the money supply which erodes Americans' standard of living, enlarges big government, and enriches well-connected elites, by cosponsoring my legislation to abolish the Federal Reserve.*

Today it seems that Ron Paul is publicly more guarded with his 'End the Fed' specifics, but he wasn't always that way. In the following paper, Murray Rothbard (1926-1995) describes Ron Paul's ideas during his first stint in Congress (1976-1984) which included liquidating "the Fed's gold" (perhaps not so far off from the recent statement Paul reportedly made to the New York Sun about liquidating Fort Knox):

[Rothbard](http://mises.org/rothbard/genuine.asp): *Abolition of the Federal Reserve would mean that its gold supply now kept in Treasury depositories would have to be disgorged and returned to private hands. But this gives us the clue to the proper definition of a gold dollar. For in order to liquidate the Federal Reserve and remove the gold from its vaults, and at the same time tie gold to the dollar, the Federal Reserve's gold must be revalued and redefined so as to be able to exchange it, one for one, for dollar claims on gold. The Federal Reserve's gold must be valued at some level, and it is surely absurd to cleave to the fictitious $42.22 when another definition at a much lower weight would enable* ***the one-for-one liquidation of the Federal Reserve's liabilities as well as transferring its gold from governmental to private hands****.

Let us take a specific example. At the end of December 1981, Federal Reserve liabilities totaled approximately $179 billion ($132 billion in Federal Reserve notes plus $47 billion in deposits due to the commercial banks). The Federal Reserve owned a gold stock of 265.3 million ounces. Valued at the artificial $42.22 an ounce, this yielded a dollar value to the Federal Reserve's gold stock of $11.2 billion. But what if the dollar were defined so that the Federal Reserve's gold stock equaled, dollar for dollar, its total liabilities—that is, $179 billion? In that case, gold would be defined as equal to $676 an ounce, or, more accurately, the dollar would be newly defined as equal to, and redeemable in* ***1/676*** *gold ounce. At that new weight, Federal Reserve notes would then be promptly redeemed, one for one, in gold coin, and Federal Reserve demand deposits would be redeemed in gold to the various commercial banks. The gold would then constitute those banks' reserves for their demand deposits. The abolition of Federal Reserve notes need not, of course, mean the end of all paper currency; for banks, as before the Civil War, could then be allowed to print bank notes as well as issue demand deposits.****This plan, essentially the one advocated by Congressman Ron Paul (R.-Texas)****, would return us speedily to something akin to* ***the best monetary system in U.S. history, the system from the abolition of the Second Bank of the United States and the pet banks, to the advent of the Civil War.***
Rothbard then proceeds to expand a bit on Ron Paul's early plan, taking it even further, which might set off a few warning bells amongst some of my fine readers:

*We could, however, go even one step further. If we were interested in going on to 100 percent reserve banking, eliminating virtually all inflation and all bank contraction forevermore.

[…]

To go over immediately to 100 percent gold, the dollar would be newly defined at 1/1,696 [1/696 probably] gold ounce. Total gold stock at the Federal Reserve would then be valued at $445 billion, and the gold could be transferred to the individual holders of Federal Reserve notes as well as to the banks, the banks' assets now equaling and balancing their total demand deposits outstanding. They would then be automatically on a 100 percent gold system.

From the standpoint of the free market, there is admittedly a problem with this transition to 100 percent gold. For the Federal Reserve's* ***gold would be transferred to the commercial banks up to the value of their demand deposits by the Federal Reserve's granting a free gift of capital to the banks by that amount****. Thus, overall, commercial banks, at the end of December 1981, had demand deposits of $317 billion, offset by reserves of $47 billion. A return to gold at $1,696 [696 probably] an ounce would have meant that gold transferred to the banks in exchange for their reserve at the Federal Reserve would also have increased their reserves from $47 to $317 billion, via a writing up of bank capital by $270 billion.* ***The criticism would be that the banks scarcely deserve such a free gift****, deserving instead to take their chances like all other firms on the free market. The rebuttal argument, however, would stress that, if a 100 percent gold requirement were now imposed on the banks,* ***their free gift would do no more than insure the banking system*** *against a potential holocaust of deflation, contraction, and bankruptcies.*

**Getting to Hard Money**

As I have mentioned, Ron Paul's honest money ideas have evolved since these early days. In fact, in many ways he is quite a bit closer to Freegold today than he was in the early 80s. He is still stuck to the idea of a fixed price for gold, but he seems to have evolved from a one-time government price-fixing to more of a market-based "decision" on how high the price of gold should be fixed. He still wants to denationalize the US gold hoard and get it into circulation, but he seems to have evolved to more of a Hayekian competition of privatized currency, which begs the question of how to denationalize the gold.

Basically, it seems that over the last 30 years he has evolved his ideas from strictly "end the Fed and institute a new gold standard" as described by Rothbard above, to a more measured approach of "allow a competing currency to circulate which will (presumably) win the day and weaken the Fed and lead to its end." But even still, I think Rothbard's description above reveals some important issues that are still lacking clarification; issues that I have written about on this very blog.

For one thing, as I have written [several](http://fofoa.blogspot.com/2011/04/forum-201.html?showComment=1303097097356#c7502113410434845011) [times](http://fofoa.blogspot.com/2011/04/reference-point-gold-update-2.html), **the Fed does not own the US stockpile of physical gold**. It is a common misconception, even among some scholars, that in 1933 the gold was taken *by* the Fed when, in fact, it was taken ***from*** the Fed and placed in collective ownership via the United States Treasury. The gold had previously been base money inside the banking system (the Federal Reserve System) and was removed from the Fed and placed in the Treasury. In fact, today the Fed is custodian of only 5% of the Treasury's gold (418 m/t). **The rest (7,715 m/t) is in the custody of the US Mint, which is part of the Treasury Dept., held in Fort Knox, West Point and Denver.** So ending the Fed hardly implies the necessary denationalization of the gold.

(On a side note, I just noticed that Gary North came to Ron Paul's defense in saying the US should sell its gold to pay down the debt. Gary says Ron Paul is right, and he ends his [short piece](http://lewrockwell.com/north/north983.html) with this: *"The gold bugs honestly trust the Federal government to restore a gold standard someday. There has not been one since since 1933 that any government on earth will do this, but somehow, the gold bugs believe, it will do it in the future."*)

A few other thoughts that are addressed here at FOFOA but not above, and not in the hard money circles of today, are how do you define gold? Should we include paper gold like Bullion Bank liabilities, futures contracts, mining forward sales and ETFs in the new gold standard? And how do we define the link between the dollar and gold? How do we fix the price and then defend that fixed price? In the past we did that by running down the gold reserves from 22,000 tonnes to 8,000 in 20 years. And lastly, how will we transition from the dollar being the global reserve currency, held in bulk overseas, to defending a new fixed price of gold in dollars? These are tough questions, and I think I have a few of the answers.

**Fractional Reserve Banking**

There is another angle to Ron Paul's honest money ideas that deals with fractional reserve banking (FRB). There is a debate within the Austrian/Libertarian movement between those that say FRB should be illegal in a Libertarian society and those that say we should just institute a "gold standard" and let the free market take care of the FRB issue. Paul is Rothbardian in that he falls on the side of making it illegal. They believe that FRB (for demand deposits) as well as borrowing short and lending long (for time deposits) is fraudulent and creates the Austrian Business Cycle of booms and busts. You can listen to the very beginning of [this](http://www.youtube.com/watch?v=fL4-Th1PpL4) for a quick view of the debate from Walter Block, another Rothbardian. And from Paul's [End the Fed](http://mises.org/daily/3687):

*Rarely do people ask what the fundamental source of instability really is. For an answer we can turn to a* [monumental study published in 2006](http://mises.org/store/Money-Bank-Credit-and-Economic-Cycles-P290C0.aspx) by Spanish economist Jesús Huerta de Soto.[[1]](http://mises.org/daily/3687#note1) *He places the blame on the very institution of fractional-reserve banking. This is the notion that depositors' money that is currently in use as cash may also be loaned out for speculative projects and then re-deposited.

[…]

The institution of fractional reserves mixes these two functions, such that warehousing becomes a source for lending. The bank loans out money that has been warehoused — and stands ready to use in checking accounts or other forms of checkable deposits — and that newly loaned money is deposited yet again in checkable deposits. It is loaned out again and deposited, with each depositor treating the loan money as an asset on the books.

In this way, fractional reserves* ***create new money, pyramiding it*** *on top of a fraction of old deposits...*

This is obviously a problem, but I'm not going to spend much time on this FRB issue because there is a very simple and elegant solution that the remainder of this post will explain. Do you remember earlier when I drew your attention to the recurring concept of "two monies," be it gold and silver bimetallism or Ron Paul's hard currency competing with (floating against) the Fed's dollar? Well, we can apply this "two monies" concept to the term "fractional reserve banking" as well.

In this iteration of the concept, the "fractionals" are the easy paper notes circulating as currency and the "reserves" are the store of value for those paper notes. We solve the issue by simply cutting the parity fix between the two and allowing them to float in value against each other. Fractionals can then always be exchanged for an equal value of reserves and vice versa, but the floating reserves are never lent. More on this concept in a moment.

The debate mentioned above within the Austrian/Libertarian community boils down to a free market solution versus a government dictate against FRB. But either way, all Austrian Economists agree that the real issue is credit expansion, which is at the heart of one of Mises' greatest insights – the Austrian business cycle theory (ABCT).

Briefly, ABCT blames the boom-bust economic cycle on *fractional-reserve banking*, or the expansion of credit without an actual act of saving by someone in the economy. When credit is expanded beyond reserves, the resulting drop in interest rates is an artificial (i.e. not due to actual increase in loanable funds). This sets in motion an unsustainable boom period of malinvestment and erroneous capital consumption that sows the seeds of the inevitable bust. This process is supplemented by government intervention to protect privileged bankers from being “caught” short by the market and allows credit to expand far more than it would without such intervention. This practice of absolving privileged bankers of their legal obligations via intervention was institutionalized in 1913 with the creation of the Federal Reserve.

And an understanding of ABCT provides the context for understanding why Freegold is unfolding. Freegold simply offers a different way of controlling credit expansion that is more effective than the modern Austrian suggestions of making money harder and/or limiting or eliminating fractional reserve banking. There is no need for all that convolution, just separate the store of value so it cannot be fractionalized and then non-productive credit expansion will be as limp as a eunuch (which comes from [this comment](http://fofoa.blogspot.com/2010/10/open-forum.html?showComment=1286851188337#c822565524931588526) by yours truly). Snippet:

*But debt itself is not the cause of our problems today. Today we have a situation where the vast majority of excess production value (excess capital) is enabling massive amounts of global malinvestment through new debt creation. That has peaked and is now contracting. But the problem is not the debt itself. The problem is the enabling effect of excess capital not having* ***a viable alternative that floats against the currency****. The problem is the lack of the adjustment mechanism of Freegold.* ***There is no viable counterbalance against uncontrolled debt growth today. So we are only left with credit collapse and hyperinflation of the monetary base to clear the malinvestment from the system****.

It is easy to blame this on debt as a principle, but unless you don't mind being wrong, there are some deeper explanations out there. Debt under Freegold will not reach such destructive levels. "Easy money" thinkers may or may not get their debt-free money, but if they do they will suddenly realize the flaw in their reasoning. Oops!* ***That it can only have expandable value (needed for the welfare state) if producers are willing to hold it while it expands.*** *Without that, socialist welfare expansion will simply dilute the value of the currency and be as limp as a eunuch.*
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Sidebar:

For more about why FRB and time deposit maturity transformation are not the root of the problem—the root is simply the lending of the monetary reserve, a problem that would still exist even with Rothbard's 100% reserve banking—please see my [Reply to Bron](http://fofoa.blogspot.com/2011/02/reply-to-bron.html). Here's a short excerpt:

\*\* Spending Gold into the marketplace, whether by the owner or by a borrower, would tend to result in prices "that weigh more"--cost more Gold, that is.

\*\* As ever more Gold is borrowed out of other people's savings to be spent into the economy, the Gold's purchasing power is lessened from what it otherwise would be...hurting those who have elected to hold their Gold instead of risking it by lending it out as a source of income.

[notice in the above that we have all the bad devaluation effects without a single bank entering the equation!]

\*\* For Gold to find its truest value, all savers must retain their Gold for their own use. Its properly retained value will more than make up for the foregone interest income. **Gold must not be lent!** [Gresham's law alone is adequate to achieve this.]

And for a brief explanation of how Freegold-RPG is different than what we have now, see [How is that different from Freegold?](http://fofoa.blogspot.com/2011/02/how-is-that-different-from-freegold.html):

…it will be stable because of two main factors:

1. SUPPLY - Gold will trade on a stable supply of above-ground physical gold in the absence of external influences like "paper gold" (Bullion Bank "BB" liabilities that can be created on demand by a mere book entry on a BB balance sheet, etc.).

2. DEMAND - Gold will also trade on a stable demand due to the global clarity that will emerge as to gold's best and highest function—being only a physical wealth reserve asset and nothing else.

How we get there is easy to visualize. As the physical reserves within the BB system are all moved into allocated accounts, at some point the remaining claims will simply have to be cash-settled. At that point all paper gold markets will cease to exist and all that will be left is the stable supply of above-ground physical gold in the absence of external inflatable (or deflatable) influences.
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**Two Monies – The Separation of Monetary Roles**

If you would like, you can think of my "two monies" concept as "the recurring duality of money" because it will recur throughout this post as we deconstruct the money concept. What we'll find is that even with many *potential* monies in play, we'll always naturally end up with two that attain "monetary status" in different **time-related** roles through the forces of regression, the [network effect](http://fofoa.blogspot.com/2010/11/dilemma.html), game theory's [focal point](http://fofoa.blogspot.com/2010/12/focal-point-gold.html) and a dash of legal tender dictate.

Back in October of 2009 I wrote a series of posts called Gold is Money.

[Gold is Money - Part 1](http://fofoa.blogspot.com/2009/10/gold-is-money.html)
[Gold is Money - Part 2](http://fofoa.blogspot.com/2009/10/gold-is-money-part-2.html)
[Gold is Money - Part 3](http://fofoa.blogspot.com/2009/10/gold-is-money-part-3.html)

In this series I introduced the concept of the separation of monetary roles into different media, not fixed at parity to each other. It's like saying "fiat is for earning and spending while gold is for saving." Or you could even say "silver is for spending and gold is for saving" as Ender likes to say. It really doesn't matter what medium will win out for the spending role, but as you will see, the winner can be reliably predicted using the concepts mentioned above.

To some of my readers this revelation was like a light bulb suddenly lit. For others, this idea became a real barrier to understanding what I was writing. So in this post I'd like to take another look at the necessary separation of the monetary functions from a new angle. Hopefully this new perspective will add a few more into the "light bulb" group. But first, here are a few excerpts from Gold is Money.

From Part 1:

**Functions of Money**

"Money", as it is understood today, has three main roles. The late Dr. Willem F. Duisenberg, former President of the ECB, in his famous acceptance speech for the International Charlemagne Prize in 2002 stated it well...

What is money? Economists know that money is defined by the functions it performs, as a means of exchange, a unit of account and a store of value.

And from FOA in that same post:

***Owning wealth aside from official money units is nothing new. Building up one's storehouse of a wealth of things is the way societies have advanced their kind from the beginning. What is new is that this is the first time we have used a non wealth fiat for so long without destroying it through price inflation. Again, a process of using an unbacked fiat to function as money and building up real assets on the side. Almost as if two forms of wealth were circulating next to each other; one in the concept of money and the other in the concept of real wealth.

This trend is intact today and I doubt mankind will ever pull back from fiat use again. Fiat used solely in the function of a money concept that I will explain in a moment.

Understanding all of this money evolution, in its correct context, is vital to grasping gold's eventual place in the world. A place where it once proudly stood long ago.

All of this transition is killing off our Gold Bug dream of official governments declaring gold to be money again and reinstitution some arbitrary gold price. Most of the death, on that hand, is in the form of leveraged bets on gold's price as the evolution of gold from official money to a wealth holding bleeds away any credible currency pricing of gold's value in the short run.

To understand gold we must understand money in its purest form; apart from its manmade convoluted function of being something you save.***

In Part 1 I also introduced the Modern Money Triangle:


And I concluded with this:

The human concept of money is changing whether we like it or not. It is being torn apart. Gold, as a wealth reserve and wealth asset, will exist and trade parallel to the world of fiat, the world of credit and debt. Producers and savers will finally have the option to switch tracks so to speak. To get on a parallel track that avoids the inevitable collision with the debt-hungry collective their savings have always faced.

And as we pass through this phase transition, as gold switches from the transactional track to the wealth-reserve track, it will take on a whole new meaning... and a whole new value! The non-dollar part of the world already knows this. This is why they are buying gold now!

**A Flaw**

In Part 2 I explained how the evolution of the money concept over maybe 2,500 years led to what we think of as money today: the three functions all tied into one. And I also explained how the modern bastardization of the money concept led to a fatal flaw in today's system:

This system of lending a purely symbolic monetary CONCEPT instead of lending real wealth requires the perceived value of that CONCEPT to remain relatively stable or else the entire banking system will collapse. It is to this end that bankers, governments, politicians and economists always try to entangle (think: forced quantum entanglement) gold into the money system and control (manage) its value in order to keep their CIRCULATING DEBT CONCEPT viable and valuable.

This is the problem with the architecture of the dollar, versus how all non-reserve fiat currencies will work in a free gold environment. The dollar must cheat in order to retain any illusion of stability. There are other ways for a fiat to remain stable. Responsible currency management is one. And in a system where the value of all real things (including gold) float freely against the parallel universe of fiat currencies, this will be how they will work.

When the dollar became a mere concept in 1971, so did all fiat currencies in the world. Their only value lies in the tradable value associations we give them, based on what can be purchased in the parallel universe of real things. But because we have been encouraged to save these symbolic debt concept units in lieu of anything with real value, a mismatch has grown to epic proportions whereby not even a fraction of these debt units can be traded back into the real economy at anywhere near today's prices.

We have lent, borrowed, saved, sliced, diced, sold, resold and insured so many units of a mere CONCEPT while neglecting to pay attention to the comparative size of the real economy with which the CONCEPT must run in parallel.

I went on to explain how the value of the transactional medium of exchange will inevitably be sacrificed in a vain attempt to save the system. And that this is why it is so dangerous to hold your wealth in that same transactional medium today. This is why there are "two monies!"

You see they are now faced with a dilemma they will not discuss publicly. On one side is their product, the conceptual unit of credit account, their currency. And on the other side is their offspring, the financial system, Wall Street. What saves one will kill the other. They can save the present value of their product and kill their offspring through starvation. Or they can save their offspring by delivering what it desperately needs to survive... a constant expansion of credit (aka monetary inflation). But this will, of course, kill the value of their product, the currency.

They can save one or the other, but not both. And it was always known, but has now been proven, that the system will be saved at ANY cost. (Unfortunately for them, they did not think it through far enough to realized that the cost of saving their offspring will also kill it and a whole lot more. But that line of Thought is straying a little too far from the topic of this post.)

In order to survive, the system, the financial industry, Wall Street NEEDS a constantly increasing supply of CREDIT! If the population won't give their own blood to save this dying Frankenstein monster, then the CB's and governments WILL! It is happening now. Right under our noses. For more than a year now!

This is why it is SO important that we hold only physical gold in our own personal possession in order to escape this tangled mess. Only touchable, graspable physical gold metal under full ownership conveys ALL of the properties that have come to be attributed to this kingly wealth asset. By contrast, financial contracts denominated in gold as facilitated by bullion banks, gold derivatives, gold loans, gold depositories, gold pool accounts, gold ETF's, or known by any other name, are all at their core pure and simple... (wait for it)... CREDIT. And what feeds the monster?? All together now…………………
\*\*\*CREDIT EXPANSION\*\*\*!!

This is the very beginning of starting to understand the concept of "two monies" not tied or fixed to each other by value, but floating *against* each other in value. We understand this instinctively, but today's system fools us into doing something that is very dangerous to our wealth today:

Today's paper currencies are not just a medium of exchange, but they are still a pretty good store of value in the short term. The greater the rate of price inflation, the shorter the term that you will want to be holding the actual currency. Wealth assets, on the other hand, are the store of value for the long term. This differentiation is understood by almost everyone today. And it is so close to the concept of Freegold that it will not be "a giant leap for mankind" to get there.

The only difference is that right now, most of the public has come to believe that wealth is simply paper ownership of wealth producing industries and paper claims on real assets that can never be recovered at today's values. This is true for most all items, not just gold. And as we hold these paper documents for the long term, understanding them to be better than holding the actual currency because they provide a "yield", the recoverability of the underlying real asset is being constantly eroded away. In other words, we are unknowingly losing principle at the same time as we think we are gaining a yield!

[…]

Our ancient instincts have not gone away. We have not "advanced" as much as we think. Our use of "the pure concept of money" has not changed since the days when we engaged in direct barter trade. We still want to accumulate wealth item along side and separate from our transactional "pure concept of money" which is really just a number in our mind, or marked down on paper. We know that this "number" is not something to be saved, except perhaps for as long as it takes to arrive at the next transaction. (See: Fekete's [A ‘fairy’ tale](http://fofoa.blogspot.com/2008/11/100-year-clearing.html))

You see our modern money concept has been surreptitiously eroded into only one half of our ancient barter understanding of the money concept, and one half does not equal a whole. Most of today's money, other than the monetary base, is borrowed into existence. It represents a debt, and a debt is an incomplete transaction. It is only one half of what our instincts require as a wealth reserve, which is a fully completed transaction resulting in an accumulation of hard value. And yet we still buy these "wealth assets" denominated in only "half a concept", half of the monetary concept that our mind intuitively understands.

This is a flaw! It is a big one, especially now as "the other half" is waving the white flag of surrender and default. Some very smart analysts see this as deflationary. They truly believe that the waving of the white flag will make this "half a concept" actually rise in value against its parallel real world economic counterpart. But that is not what will happen.

**A Different Approach**

I began Part 3 by sharing with you my position as an observer of what is, not an activist for what I think should be. My position is in stark contrast to what you get from the gold standard advocates of all stripes. Sure, they have their disagreements, but they all seem to propose what they view as the perfect solution, which always requires unlikely political choices. Gary North is one that gets this distinction well.

North's position is very close to Ron Paul's. North gets the benefits of denationalizing and privatizing the gold. North, like Paul, wants to outlaw fractional reserve banking, which means his eye is on the wrong culprit. And North, like Paul, wants circulating "gold IOUs" at a fixed parity with, and redeemable in, physical gold. And he also gets the difficulty of enacting his vision, so he, like Paul, wants to amend the legal tender laws to allow a private, competing fixed gold standard.

In [this post](http://www.lewrockwell.com/north/north201.html) North describes "Two Kinds of Gold Standards," public and private, and as for a government-run gold standard he concedes, "any call by conservatives for the State to adopt a gold standard **is futile. No one will listen**." And in [this post](http://www.lewrockwell.com/north/north895.html) called "End the Fed, Get the Gold," North describes a complex idea he has for de-nationalizing the gold through a massive gold give-away. But alas, he must confess "This is why this essay is hypothetical."

I responded to the ideas presented in that second post (not directly to Gary) in [this comment](http://fofoa.blogspot.com/2010/10/one-tin-soldier.html?showComment=1287304644906#c4478715547708120433), in which I wrote:

*If you cannot see that a two-way market (between the debtors and savers) for gold (that's buy and sell - "two way") is infinitely better than a mass give-away, then I really don't know what to say. You are what FOA and Aristotle would call a "Hard Money Socialist."****Getting the gold back into circulation is done through a free market price, not through a suppressed price give-away.*** *Gary North "realizes" this, even if he doesn't realize it: "If the price of gold rises, it pays someone to own gold. So, people begin to buy gold. Gold-using producers start buying."

But debtors don't hold gold. Only savers accumulate. Producers! As he says. Gold is for saving, fiat is for spending****.*** *The debtors will immediately sell their gold claims to the savers.

In my mind, it would be infinitely better for the USG to acknowledge Freegold, declare a starting price of, say, $10,000/ounce, and then open the vaults and let the price float.* ***They buy and sell at the market price through the banks****, starting at $10K.

The price would soon stabilize, much higher than $10K of course, but* ***the two-way market would be in effect. The gold would not be gone. The currency would be stable once again.*** *You give it all away to the debtors at $42/ounce and let them sell it to the savers for their final $1,350 welfare check, where does that leave you?****Half the population wants easy money. The other half wants to save what they earn in gold. Can't you see this?*** *It is not about "the elites." They are all mostly in the easy money camp. If they give the gold away at $42/oz the elites will buy it right back from the poor and then lock down the price for a new gold standard. Buy themselves another 67 years in power perhaps. Is this what you want?

Gary wants to divvy up the gold and then inflict Freegold. If you cannot see the disaster that this is, I don't know what to say to you. All to take power away from the central banks? This is the mistake.* ***It is not their fault. As Greyfox said, “We have met the enemy and it is us.” We are at fault, for saving in promises. We give THEM power.*** *And Gary's proposal would do more harm than good to the overall modern economy. And it's not gonna happen anyway. It's a dream. A fantasy. A picket sign.

Would Gary's solution be okay with me? Sure! But it wouldn't last. And it won't happen,* ***so it's purely academic, which he acknowledges. But Freegold is not!*** *And furthermore, all the power Gary wants to take away from the bureaucrats will be taken away ANYWAY when the dollar loses its global reserve privilege,* ***and that privilege's sister, the paper gold market. Gone. Done. That's all it takes.***

Can you see the difference in approach? Well here's how I kicked off Gold is Money Part 3:

Allow me to start by beating a dead horse. There is a vital difference between what may in fact be the ideal, perfect monetary system and what are the real monetary changes we are heading straight into today. My purpose for writing this blog is to share with you, and in return to receive your feedback on my own discovery and understanding of the latter. There are plenty of other sites that discuss the former.

If we can discover together where we are heading financially, economically and monetarily, and why we are heading there, then perhaps we can know, in advance, how the understanding of the global consciousness will evolve and unfold in the coming weeks, months and years. And, with this understanding, hopefully we can gain a certain peace of mind with regard to our own financial decisions, positions and future as we head into very stormy waters.

I know from my own experience that a little peace of mind is a priceless asset. It is one worth sharing, and one worth growing. Sharing and growing this asset together with you is my goal.

Next I discussed some of the confusion that arises from our common modern understanding of the money concept, including this paragraph which hints at the problems with using the same media in two different monetary roles, even if it is a pure gold coin standard:

In fact, as a medium of exchange, money is only one half of a full barter exchange. The other half is when you change your money into that item you desire. But when physical gold is the common medium of exchange, then it is possible that the concept of a "medium" (or middleman) is incorrectly applied, because if gold was what you were after (for its store of value function), then the exchange is completed in only one step! Direct barter!

Actually, that paragraph hints at a whole slew of problems that have plagued us over and over again for centuries ever since we started using the same media for all monetary functions. But let's just continue on and maybe this will start to make some sense.

Next I ran through the problems we encountered with a couple different types of gold standard in the past; the gold exchange standard we had after 1913, and the gold coin standard we had before 1913, which is the one yearned for by the likes of Ron Paul and Gary North. That's right, there are problems that arise even in a gold coin standard. I implore you to read the [post](http://fofoa.blogspot.com/2009/10/gold-is-money-part-3.html), but especially the account (in blue) by Randy Strauss. Here's a tease just to get you to go read it:

*And recall, these comments occurred while on a gold [coin] standard AND in total absence of a government-sponsored central bank [i.e. before the Fed] -- which was authorized (against Baker's preference) a year later.

As you come to understand how Money and Credit are interrelated, the more you will understand the* ***separate*** *Wealth of gold and why you need it now more than ever.*

I went on to discuss how the money concept necessarily exists in the fourth dimension of time. How, if we only lived in a snapshot world of three dimensions, one medium would work fine for all of money's functions:

But here in the real world we must be concerned about how far we carry our money through the fourth dimension. Without this vital consideration, we stand to lose everything!

At this point in the post I discussed the separation of monetary functions through a few illustrations that I created:

**Breaking the Triangle**

In part 1 of this series I used a diagram I created called The Modern Money Triangle. The three corners of the triangle represented the three primary functions of our modern understanding of money.


But as we pass through the coming phase transition in which the parity between paper gold and physical gold will be broken, cracks will start to form in certain parts of the triangle.


The fractures you see in this diagram are time related. **On a short timeline [length of time is the key variable: "t"] fiat currencies will perform our necessary monetary functions, medium of exchange and unit of account. But at some point on the time line, 'length of time', we will switch to a different medium, gold.

On a long timeline, gold will perform our necessary monetary functions perfectly, store of value and long term unit of account.** By the way, there is no upper limit on the 'time line axis' when it comes to gold. If plotted out it runs to infinity!

The outcome will be my new Freegold Quadrangle!


The "time line axis" represents the amount of time you are willing to hang onto the fiat currency you either earn or receive in payment. If the monetary authority is printing money, "t" will be shorter and shorter. In a hyperinflationary situation "t" will slide all the way to the left with a value close to zero.


As the new Freegold system of natural, pristine balance emerges, the fiat monetary authority will find its wisest move is to keep the money supply under control. And with a "wise" CB, gradually the "t" value will shift back to the right, little by little.

**Clarify the View**

This concept that the traditional monetary functions are now separating into non-fixed (i.e. floating) media has been both an epiphany for some and a stumbling block for others. My goal here is to clarify the view for those who cannot seem to get it. When comparing any two monies, circulation velocity (or the [demand for money](http://mises.org/humanaction/chap17sec4.asp) to the Austrians) correlates to, and is a measurement of, their respective store of value properties. In other words, the currency that circulates with greater velocity is in low demand, it's the "bad money" with a short store of value timeframe, while the slower currency is in high demand, it's the "good money" with a greater ability to store value through time.

This is a clear example of how the transactional and reserve functions of money are able to separate right before our eyes into two different media. Think about Zimbabweans quickly spending Z$s while hoarding US$s. Ludwig von Mises called it a "secondary media of exchange."

The term "secondary media of exchange" obviously implies the existence of a "primary media of exchange." But why only two? Well, the answer is simple: because we are dealing with two needs, two separate functions or roles in which we use "money." The two roles are transactional and reserve (store of value). Another clear example can be found on the Eurosystem's [Consolidated Financial Statement](http://www.ecb.int/press/pr/wfs/2011/html/fs110406.en.html). The primary medium of exchange is on the right-hand side, and the secondary medium of exchange is on the left. Look at how Line #1 has grown in proportion to the whole of the reserves (secondary media of exchange) from 30% to more than 65% in a decade. Now ***that's*** how you spot a focal point!

Here's the new "FOFOA's dilemma" once again (with an added hyperlink for the adventurous!):

*FOFOA's dilemma: When a single medium is used as both store of value and medium of exchange it leads to a conflict between* [*debtors and savers*](http://fofoa.blogspot.com/2010/07/debtors-and-savers.html)*. FOFOA's dilemma holds true for both gold and fiat, the solution being Freegold, which incidentally also resolves Triffin's dilemma.*

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Another quick Sidebar:

For any real economists out there, here's how Freegold resolves Triffin's dilemma.

Triffin's dilemma highlights two flaws in the dollar and its use as the global reserve currency. Flaw #1 is the dollar being a national currency and also a supra-national global reserve currency. Flaw #2 is the dollar trying to be as good as gold in the store of value role via US Treasuries. What I mean in flaw #2 is that the dollar's credibility is hurt by a rising price of gold and, therefore, it must systemically manage that threat by backing the fractionally reserved bullion banking system which eases the natural supply constraint of gold.

The euro has eliminated both of these flaws in its fundamental architecture. It is not a national currency and it does not oppose a rising (in the present case) or a free floating (in the future case) price for non-fractional physical gold reserves. I have written extensively on this topic, and the bottom line is that gold is not yet free floating, even today, because its market is encumbered by many forms of gold IOUs that trade at par with the physical stuff through the support of the dollar system.

You can obviously resolve Triffin's dilemma by removing both flaws. But removing #1 alone is not enough, while #2 alone ***is*** enough.

Triffin's dilemma observes that when a national currency also serves as an international reserve currency (as the US dollar does today), there are fundamental conflicts of interest between short-term domestic and long-term international economic objectives. But this is only the case if that currency does not embrace a "secondary media of exchange" that is allowed to float in value in a quantity not managed by the currency manager (i.e. physical only), and can be purchased and stored in lieu of retaining debt denominated in the primary medium.

Imagine, if you will, the euro supplanting the dollar's role as the globe's super-sovereign currency unit. This is (at this point) merely a conceptual exercise for all you anti-conceptual mentalities. Let's compare the two with regard to Triffin's dilemma.

How often do we hear euro critics repeat that the euro, a currency without a country, has no political union to back it and is therefore worthless? The US dollar has a country, but in its role as the world's currency it also functions just like the euro, without a global political union.

The fundamental difference between these two units of account (the dollar and the euro) is their relationship with gold.

If you have followed my blog at all, you know that the euro has Freegold, the wealth consolidator and "real money" with no country, no links and no political union to back it. So which unit of account (€ or $) is closest to gold? Which currency, of these two, is most likely to be preferred as the global reserve currency next to Freegold in the wealth reserve role?

The point is, once "Freegold" (nature's wrath) inflicts itself upon us all, it won't really matter what is chosen/used as the super-sovereign or supra-national currency to lubricate international trade. It could be the euro, the yuan, the SDR, Facebook Credits or even the dollar! Triffin's dilemma will be gone. And you shouldn't worry so much over the transactional currency question, because that will be chosen through

* the market forces of regression,
* the network effect and
* game theory's focal point discovery at the international level.

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**A Practical and Probabilistic Comparison**

Now that I'm almost done with the intro, and before we move on to the main body of this post which is the Austrian forefather's deconstruction of the money concept and how it fits perfectly with Freegold, let's take a moment to compare the gold standard concept to Freegold in terms of practicality and probability. We'll save 'honesty' until after we discuss the money concept.

What the hard money/gold standard crowd ultimately wants is a single unit to faithfully serve as both the monetary medium of exchange *and* long term store of value. A single unit is, in fact, what we have now as the dollar is the currency in widest use (network effect) and the US Treasury bond is the focal point global store of value. Both are denominated in dollars and are therefore a single unit through fixed parity. If the medium of exchange was to collapse, so would the store of value.

So the hard money camp would like to harden (make more difficult to obtain) that single unit by backing it with gold, making every single unit redeemable in gold, or at least allowing the free market to do away with any entity that fails to meet every redemption request. From a practical perspective this would obviously require major political and legal changes which is why this camp is full of activists with colorful picket signs. And this is why they have lowered their initial target to simply changing legal tender laws to allow their single hard unit to compete with the existing easy unit and, hopefully, theirs will win the popularity contest.

But in order to achieve such monumental changes, they really need a ground-swell of support from the people. You, dear reader, are probably much closer to their view than 95% of the rest of the population. So, from a probabilistic perspective, I'd like you to think about your own paycheck. How much of it goes right out the door to pay for food, utilities and your mortgage? 90%? And how much do you really care that the 90% of the money you earn and only hold for a couple of weeks sustains its purchasing power for the next 100 years (for the benefit of those people you gave it to)? I only ask this to get you to think about what is important to the majority of the people.

The hard money/gold standard crowd wants to make every one of those dollars you earn hard (difficult to get) so that they retain their long-term purchasing power. They want the banks to hold gold on reserve for every single dollar you receive, even if it goes right out the door. There won't be many pay raises in your future if these guys get their way.

Or would you simply be happy as long as the 10% of your paycheck that you decide to save stores its purchasing power for 10, 20 or 100 years? Yes, see, this is what really matters… to everyone! And this is why the medium of savings must be separate from (and float in value against) the transactional currency. I'm certainly not arguing the benefits of inflation, because there is a better way to control inflation than simply making every single unit hard (difficult to obtain).

The economy needs the lubrication provided by transactional currency for it to run smoothly. Obviously not all of it is saved and stored as wealth. Only a small portion of the ***flow*** of transactional currency is saved. And those that would hope to print in order to buy are only stealing from that small portion that is saved. If you "do the math" you'll find that, in the long run, this is true. And if you separate that saved portion by using a secondary medium that floats in value, then inflationary policy becomes self-defeating to the currency manager. **This is how you have a true competing currency. Not two currencies competing for the medium of exchange crown. But a separate medium of savings competing against the medium of exchange for "pole position" on the 'Time=t' axis:**


This is Freegold, and it is unfolding today. It requires no activism or political/legal changes at this point. It is, how do you say, baked into the cake already? And once again, [these](http://fofoa.blogspot.com/2011/02/how-is-that-different-from-freegold.html) [posts](http://fofoa.blogspot.com/2010/12/freegold-in-proper-perspective.html) [briefly](http://fofoa.blogspot.com/2011/01/freegold-foundations.html) [explain](http://fofoa.blogspot.com/2011/01/reference-point-gold-update-1.html) how we aren't quite there yet, how Freegold is different from what he have today, even though it is "already in the pipeline."

**The Money Concept**

[FOFOA](http://fofoa.blogspot.com/2011/04/big-gap-in-understanding-weakens.html): The measure of any money's store of value is a continuum of time. It is directly linked to demand and velocity. Even the worst money (say, Zimbabwe dollars during the hyperinflation) works as a very temporary store of value. Perhaps you read stories about workers in Zimbabwe getting paid twice a day and then running out to spend it before coming back to finish the shift. This is an example of the briefest time period in which currency stores value.

[FOA](http://www.usagold.com/goldtrail/): Was gold a medium of exchange? Yes, but to their own degree, so were the bowls. Was gold a store of value? Yes, but to a degree, so were dinner plates. Was gold divisible into equal lesser parts to define lesser barter units? Yes, but to a degree one could make and trade smaller drinking cups and lesser vessels of oil.

Here's the thing, 'store of value' and 'medium of exchange' are relative terms. Anything real stores value (a painting, a computer, a jewel), and lots of things are media of exchange in various settings (dollars, other currency, cigarettes in jail, etc). And for stores of value, there is a continuum as to how long things store value. What we are talking about is **degree**. And this gets to the heart of a semantic issue about money being media of exchange *and* a store of value.

[Menger](http://mises.org/etexts/menger/eight.asp): [I]t appears to me to be just as certain that the functions of being a "measure of value" and a "store of value" must not be attributed to money as such, since these functions are of a merely accidental nature and are not an essential part of the concept of money.

[Mises](http://mises.org/humanaction/chap17sec3.asp): Money is a medium of exchange. It is the most marketable good which people acquire because they want to offer it in later acts of interpersonal exchange. Money is the thing which serves as the generally accepted and commonly used medium of exchange. This is its only function. All the other functions which people ascribe to money are merely particular aspects of its primary and sole function, that of a medium of exchange.

Both of the above quotes get at the idea that, because money is a medium of exchange, it is also, to some degree, a store of value. Even Zimbabwe dollars were a brief store of value, but being a store of value isn't what money is all about. Being a store of value is not its central function—it is derivative of its being a medium of exchange. Being a medium of exchange is money’s essence—what makes money money. This means that, by definition, money’s ability to serve as a measure of value and store of value is secondary.

Now before I continue, I want to remind you of *my* definition of "Honest Money" from the second paragraph of this post. In that paragraph I wrote that my definition would eventually start to make sense, and right about now it should be starting:

*"My definition is that honest money is simply money that does not purport to be something it is not."*

Compare my definition to what the hard money/gold standard crowd says is "Honest Money":

*"And modern practitioners will tell you that gold and silver are honest money."*

Since we're dealing with the semantics of "money" here, we should keep in mind that the original Austrian definition of money was that it is primarily a medium of exchange. So in this light, are gold and silver the best monies? Let's check back with Carl Menger who is widely regarded at the founder of the Austrian School of economics:

[Menger](http://mises.org/etexts/menger/eight.asp): [M]oney is the most appropriate medium for accumulating that portion of a person’s wealth by means of which he intends to acquire other goods (consumption goods or means of production).

[…]

But the notion that attributes to money as such the function of also transferring “values” from the present into the future must be designated as erroneous. Although metallic money, because of its durability and low cost of preservation, is doubtless suitable for this purpose also, it is nevertheless clear that other commodities are still better suited for it.

And while we're at it, how about a little Hayek?

[Hayek](http://mises.org/daily/3204): If I were responsible for the policy of any one of the great banks in this country, I would begin to offer to the public both loans and current accounts in a unit which I undertook to keep stable in value in terms of a defined index number. I have no doubt, and I believe that most economists agree with me on that particular point, that it is technically possible so to control the value of any token money which is used in competition with other token monies as to fulfill the promise to keep its value stable.

Obviously I am including the link before each quote for those of you that think I am taking these out of context. But hopefully you'll start to see a pattern emerging from the quotes.

As I mentioned above, in the same way that a medium of exchange is to one extent or another also a store of value, stores of value are also to one extent or another media of exchange. The question is one of degree, and this is how, through market forces, we end up with "two monies." Being the focal store of value does not make something the best medium of exchange, and vice versa.

This might be a good time to take another look at the ECB quarterly [statement](http://www.ecb.int/press/pr/wfs/2011/html/fs110406.en.html). There it is, two monies. One on the left, one on the right. Separate roles. And for you euro-critics, have another read of [this](http://www.irpp.org/po/archive/may01/friedman.pdf) because you might want to brush up on your currency theory. Having a hard fixed rate currency is just like sharing a standardized meter, liter or gram.

And speaking of the left side of the ECB statement, here's some more Mises:

[Mises](http://mises.org/humanaction/chap17sec19.asp): Gold is the money of international trade and of the supernational economic community of mankind.

Schwa! **Supernational economic community of mankind?** That almost sounds like gold is the money of the [Superorganism](http://fofoa.blogspot.com/2010/04/life-in-ant-farm.html)!

**A Second Money?**

But what use could we have with a second money?

[Mises](http://mises.org/humanaction/chap17sec17.asp): For some of them it is easier to find without delay a buyer ready to pay the highest price which, under the state of the market, can possibly be attained. With others it is more difficult. A first-class bond is more marketable than a house in a city's main street, and an old fur coat is more marketable than an autograph of an eighteenth-century statesman. One no longer compares the marketability of the various vendible goods with the perfect marketability of money. One merely compares the degree of marketability of the various commodities. One may speak of the secondary marketability of the vendible goods.

He who owns a stock of goods of a high degree of secondary marketability is in a position to restrict his cash holding. He can expect that when one day it is necessary for him to increase his cash holding [p. 463] he will be in a position to sell these goods of a high degree of secondary marketability without delay at the highest price attainable at the market.

[…]

Consequently **there emerges a specific demand for such goods** on the part of people eager to keep them in order to reduce the costs of cash holding. The prices of these goods are partly determined by this specific demand; they would be lower in its absence. **These goods are secondary media of exchange, as it were, and their exchange value is the resultant of two kinds of demand: the demand related to their services as secondary media of exchange**, and the demand related to the other services they render.

What Mises is talking about here is the focal point effect. As more people focus on a single secondary "money" for the purpose of storing value outside of the primary medium of exchange, it starts to develop a separate kind of demand, apart from its other uses. And just so we're clear that he's not talking about money substitutes like bank credit:

[Mises](http://mises.org/humanaction/chap17sec17.asp): One must not confuse secondary media of exchange with money-substitutes. Money-substitutes are in the settlement of payments given away and received like money. But the **secondary media of exchange must first be exchanged against money or money-substitutes if one wants to use them--in a roundabout way--for paying or for increasing cash holdings**.

Claims employed as secondary media of exchange have, because of this employment, a broader market and a higher price. The outcome of this is that they yield lower interest than claims of the same kind which are not fit to serve as secondary media of exchange. Government bonds and treasury bills which can be used as secondary media of exchange can be floated on conditions more favorable to the debtor than loans not suitable for this purpose. The debtors concerned are therefore eager to organize the market for their certificates of indebtedness in such a way as to make them attractive for those in search of secondary media of exchange. They are intent upon making it possible for every holder of such securities to sell them or to use them as collateral in borrowing under the most reasonable terms. In advertising their bond issues to the public they stress these opportunities as a special boon.

Here's an exercise only for the conceptual mentalities. Try applying that last paragraph to the concept of Freegold. I did, and it makes a whole lotta sense in the context of this blog!

Okay, so if we pay attention to the [network effect](http://fofoa.blogspot.com/2010/11/dilemma.html) of those that actually have intergenerational-sized wealth to preserve, and we look for the [focal point](http://fofoa.blogspot.com/2010/12/focal-point-gold.html) that game theory predicts will be the winner within the Eurosystem's [ConFinStat](http://www.ecb.int/press/pr/wfs/2011/html/fs110406.en.html), we can pretty much know without a doubt what the new "secondary medium of exchange" winner will be. But what about the primary? Shouldn't it be silver or something? Or isn't there some big NWO power that's going to inflict upon us a sinister new SDR? Or perhaps, should we all buy Bitcoins and Facebook Credits to prepare for barter exchange during TEOTWAWKI?

In Austrian economics there are basically two halves to the explanation of money. One half is Carl Menger's explanation of the marginal utility of money that emerged long ago from a system of direct barter, and the other half is Ludwig von Mises' regression theorem that connects modern money to Menger's emergent money through our time-value memory and expectations of a money's ability to store value. And what I hope to show you is that the natural progression toward Freegold (true honest money in my book) is consistent with both Menger's marginal utility argument and Mises' regression theorem, while the difficult regression back to a fixed gold standard is not.

[Robert P. Murphy on Menger](http://mises.org/daily/1333): ...Because of this, owners of relatively less saleable goods will exchange their products not only for those goods that they directly wish to consume, but also for goods that they do not directly value, so long as the goods received are more saleable than the goods given up. In short, astute traders will begin to engage in indirect exchange. For example, the owner of a telescope who desires fish does not need to wait until he finds a fisherman who wants to look at the stars. Instead, the owner of the telescope can sell it to any person who wants to stargaze, so long as the goods offered for it would be more likely to tempt fishermen than the telescope.

Over time, Menger argued, the most saleable goods were desired by more and more traders because of this advantage. But as more people accepted these goods in exchange, the more saleable they became. Eventually, certain goods outstripped all others in this respect, and became universally accepted in exchange by the sellers of all other goods. At this point, money had emerged on the market...

Taking the above in the context of the ongoing monetary evolution to Freegold, gold is more "saleable" as a store of wealth or in Mises' words, a "secondary media of exchange" in part because of its historical monetary function, which raises its salience:

[FOFOA](http://fofoa.blogspot.com/2010/12/focal-point-gold.html): There is nothing that makes "Grand Central Station" a location with a higher payoff (you could just as easily meet someone at a bar, or the public library reading room), but its tradition as a meeting place raises its salience, and therefore makes it a natural "focal point."

And also because it has the highest marginal utility at storing wealth (the gold tank can absorb an unlimited inflow), gold wins the "market process" as the store of value as Freegold evolves and the "money functions" separate into transactional medium and store of value:

[FOFOA](http://fofoa.blogspot.com/2010/12/value-of-gold.html): Will that 26th gold coin purchase provide the same utility or diminished (less) utility than the first? Remember, the only utility of gold coins is that they retain their value for thousands of years. That's all they do. And hoarding them doesn't interfere with any other economic activity, at least not when they are not "official money."

The answer is "the same utility," because unlike ANYTHING else, (yes, even silver), gold has INFINITE marginal utility in this particular role.

[Moldbug](http://unqualified-reservations.blogspot.com/2011/04/on-monetary-restandardization.html): However, because silver was fully demonetized in the 20th century and gold was not, the market capitalization of the gold stockpile is 60 times the capitalization of the silver stockpile. Thus, comparable volumes of gas are pressing in to the gold tank and the silver tank, but the silver tank is 60 times smaller. It is actually surprising that silver has not risen faster and harder.

But this present advantage is also silver's long-term Achilles heel. The silver tank, being so much smaller, cannot take this kind of pressure. It will almost certainly explode. I have personal advice for those playing the silver market: bring your steel balls.

**Regression**

And speaking of historical function and its salience as a focal point - as to the other half of the Austrian money theory, the Mises Regression theorem:

[Robert P. Murphy on Mises](http://mises.org/daily/1333): People value units of money because of their expected purchasing power; money will allow people to receive real goods and services in the future, and hence people are willing to give up real goods and services now in order to attain cash balances. Thus the expected future purchasing power of money explains its current purchasing power.

But haven't we just run into the same problem of an alleged circularity? Aren't we merely explaining the purchasing power of money by reference to the purchasing power of money?

No, Mises pointed out, because of the time element. People today expect money to have a certain purchasing power tomorrow, because of their memory of its purchasing power yesterday. We then push the problem back one step. People yesterday anticipated today's purchasing power, because they remembered that money could be exchanged for other goods and services two days ago. And so on.

So far, Mises's explanation still seems dubious; it appears to involve an infinite regress. But this is not the case, because of Menger's explanation of the origin of money. We can trace the purchasing power of money back through time, until we reach the point at which people first emerged from a state of barter.

So, basically, marginal utility explains the original emergence of money while Mises' Regression theorem explains the long-running connection of modern money to its ancient origins. Regression kinda gets a "bad" money "in the door" and then human memory and expectations provide inertia. But part of the beauty of Freegold is the embrace of marked-to-market physical gold reserves, which will, if you understand the concept, provide a well-developed and stable price discovery for currency priced in physical gold which will allow ready exchange by anyone, anywhere, any time. Two monies, floating in stasis, freely exchangeable on demand.

So in this way, Freegold does not violate Mises' Regression theorem because the regression needed to maintain the transactional currency doesn't go back far at all. In fact, it's almost instantaneous. You will always accept the primary medium of exchange for your goods and services because the market for the secondary has been stabilized and made infinitely sustainable through a floating price in conjunction with the elimination of paper IOU encumbrances.

Regression tells us that we accept a currency because we think in terms of it, we remember in terms of it. Can you see some overlap between the above: "People value units of money because of their expected purchasing power;" and this from FOA?

[FOA](http://www.usagold.com/goldtrail/): Naturally, for gold to advance as the leading tradable good it had to have a numerical unit for us to associate tradable value with. We needed a unit function to store our mental money value in. In much the same way we use a simple paper dollar today to represent a remembered value only. Dollars have no value at all except for our associating remembered trading value with them. A barrel of oil is worth $22.00, not because the twenty two bills have value equal to that barrel of oil: rather we remember that a barrel of oil will trade for the same amount of natural gas that also relates to those same 22 units. Money is an associated value in our heads. It's not a physical item.

The first numerical money was not paper. Nor was it gold or silver; it was a relation of tradable value to weight. A one ounce unit that we could associate the trading value to. It was in the middle ages that bankers first started thinking that gold itself was a "fixed" money unit. Just because its weight was fixed.

In reality, a one ounce weight of gold was remembered as tradable for thousands of different value items at the market place. The barter value of gold nor the gold itself was our money, it was the tradable value of a weight unit of gold that we could associate with that barter value. We do the very same thing today with our paper money; how many dollar prices can you remember when you think a minute?

It is because we think in dollars, or pesos, or rubles that we continue using those units as the primary media of exchange. It is human inertia that keeps them working. You can no more easily switch to a different unit, like a Bitcoin for example, than you could switch America to the metric system (like they tried in the 70s) or get an entire people to switch languages. Even Murray Rothbard was hip to this:

[Rothbard](https://mises.org/freemarket_detail.aspx?control=492): Money, however, is desired not for its own sake, but precisely because it already functions as money, so that everyone is confident that the money commodity will be readily accepted by any and all in exchange. People eagerly accept paper tickets marked "dollars" not for their aesthetic value, but because they are sure that they will be able to sell those tickets for the goods and services they desire. They can only be sure in that way when the particular name, "dollar," is already in use as money.

Can you see how this might be problematic for a "competing currency" in the Ron Paul sense? A currency that will be competing against "the dollar" for the transactional or "primary medium" role?

[Rothbard](https://mises.org/freemarket_detail.aspx?control=492): Hayek should be free to issue Hayeks or ducats, and I to issue Rothbards or whatever. But issuance and acceptance are two very different matters. **No one will accept new currency tickets, as they well might new postal organizations or new computers. These names will not be chosen as currencies precisely because they have not been used as money, or for any other purpose, before**.

One crucial problem with the Hayekian ducat, then, is that no one will take it. **New names on tickets cannot hope to compete with dollars or pounds which originated as units of weight of gold or silver and have now been used for centuries on the market as the currency unit, the medium of exchange, and the instrument of monetary calculation and reckoning.**

And with that, here is some more from FOA. Bear in mind, here, that FOA used the term "Mises" to represent the modern "hard money/gold standard crowd" or as I called them, modern practitioners:

[FOA](http://www.usagold.com/goldtrail/): My typical hard money shared long held belief, back then, was always:

----"Gold is the only official money of the world and will return to these roots one day"-------- and -----" some worldwide financial dislocation will drive all governments back to this position"-----!!!!

It wasn't going to happen, no matter what, short of nuclear war. All we had to do was look around and see how people the world over were attached to using fiat currencies. The economic system itself was morphing into new ground as world trade learned to function very efficiently with fiat digital settlement. And that's something the 70s crowd said could never happen. That was how many years ago?

A lot of the Mises crowd tried to point out that ---- "hey, this is all very good but if you were on a gold system this economic game would be all the more better" ----! Ha Ha, no one cared,,,,,, why risk what was already in process. Even the third world didn't want to hear it. They figured that any return to a hard money system would harken back to a time they remembered well. These guys suffered during the early century and no one was going to tell them that the gold standard wasn't the fault. The US is today, and was then, robbing them blind, but the situation seemed, to them, that this new dollar standard was building them up. Looking at it all,,,,, we robbed the Japan lifestyle standards the most. All to buy us an almost free standard [of living], and they loved it.

When it came to using fiat money in our modern era, it made little difference what various inflation rates were in countries around the world; 50%, 100% 1,000%,,,,,, they went right on playing with the same pesos. There have been countless third world examples of this dynamic, if only we look around. Mike, look at what happened in Russia after they fell,,,, the Ruble stayed in use and function with 6,000% inflation. My god they still use it now.

No,,,,,,, my guys are dead on the money with respect to the political dynamic that's playing out. The world is heading towards a huge financial / currency crack up, but it won't work out with gold coming back into the money game. This very long term transition is playing on a move away from dollar domination with Europe preparing to suffer less than us by pulling in as many other political trading blocks as they can.

When you look at who they are reaching for; every one of these blocks wants gold moving higher to shelter their dollar trading losses. None of them expect to unload dollar reserves because our end time trade deficit won't permit it. They can't just send the dollars to each other, buying their own goods; that would never exhaust the external dollar float. Hell, they now have their own money to do trade with, the Euro.

If you're still with me, I hope you are starting to see some of the problems with all of the various "hard money" propositions. Even competing currency ideas like e-gold or GoldGrams are unlikely to be adopted according to Mises' Regression theorem:

[Timothy D. Terrell on Regression and new currency viability](http://mises.org/daily/629): ...If the digital currency plan requires people to trade and quote prices in terms of **something other than the widely used dollar, yen, mark, euro, or other established currency, Mises’s regression theorem would imply that the plan is doomed**. Well before e-money became possible, Rothbard addressed this problem:

*Even the variant on Hayek whereby private citizens or firms issue gold coins denominated in grams or ounces would not work, and this is true even though the dollar and other fiat currencies originated centuries ago as names of units of weight of gold or silver. Americans have been used to using and reckoning in "dollars" for two centuries, and they will cling to the dollar for the foreseeable future. They will simply not shift away from the dollar to the gold ounce or gram as a currency unit.*[*[4]*](http://mises.org/daily/629#_ftn4)

What *will* work is a plan that simply facilitates the exchange of already-recognized currencies...

**Thinking it Through**

This kinda throws a wrench in the whole competing currencies idea to which the hard money crowd has somewhat retreated. Just like Mexico still uses the peso and Russia the ruble, we'll likely be thinking in terms of dollars long after it collapses. Which brings us back to their only other idea, which is to somehow make the dollar redeemable in physical gold at a fixed weight and in any quantity the dollar-holders demand.

If this sounds a little bit familiar, it should. Yes, we've tried that before. Of course the hard money crowd would like to change it up a bit this time, although they can't quite agree on the right combination of changes. Here are a few of their suggestions:

1.) Denationalize both the dollar and the gold so it can be fixed by the free market.
2.) Outlaw fractional reserve banking.
3.) Renationalize the dollar (end the Fed) and redefine it as a fixed weight of US gold.

Obviously there are major hurdles to each of these, as well as serious impracticalities and contradictions. Monetary systems tend to evolve naturally, in their own version of [punctuated equilibrium](http://fofoa.blogspot.com/2009/09/evolution.html). And the rare changes that actually take hold throughout history, whether judged morally good or bad in hindsight, whether ultimately credited to politicians or the free market, have always been aligned with this evolutionary process.

And today, the dollar's past relationship to gold is problematic for all of their ideas, yet not for Freegold. Here is Murray Rothbard again:

[Rothbard](http://mises.org/rothbard/genuine.asp): Before proceeding to investigate what the new definition or weight of the dollar should be, let us consider some objections to the very idea of the government setting a new definition. One criticism holds it to be fundamentally statist and a violation of the free market for the government, rather than the market, to be responsible for fixing a new definition of the dollar in terms of gold. The problem, however, is that we are now tackling the problem in midstream, after the government has taken the dollar off gold, virtually nationalized the stock of gold, and issued dollars for decades as arbitrary and fiat money.

I also wrote about some of the "midstream" problems for the dollar in Confiscation Anatomy:

[FOFOA](http://fofoa.blogspot.com/2009/08/confiscation-anatomy-different-view.html): The US gold hoard is now off the table. Think of a poker cheat who pockets his winnings yet still wants to play. When he loses he writes paper IOU's to the other players. Can he ever pull his money back out of his pocket without having it taken away? Think of an individual who declares his own insolvency and defaults on his obligations to pay, only to resurface later with a windfall inheritance. What problems will he face?

[…]

The US government will never take this risk! It will never expose itself to this legal nightmare! The US is already a golden outlaw!

To skirt the obvious problems in dealing with these issues head-on, some of the hard money camp has subtly retreated even further, now asking for a mere "commodity standard." Here is [Ron Paul](http://www.ronpaul.com/2009-11-14/end-the-fed-consider-outlawing-fractional-reserve-banking/) again:

***News Anchor:*** *And just one more thing which is that when you talk about the right course, if I am not mistaken, you want to go back to the gold standard? Is that the right way to run monetary policy, in your opinion?****Ron Paul:*** *No, but I’d like to go forward to a* ***commodity standard****. There were a lot of flaws in the old gold standard because there was bimetallism and a fixed price between gold and silver.

[…]

I really like the idea of* ***allowing the market to determine what backs the currency****, make sure there are no-fraud laws, and really look into the matter whether or not we should have fractional reserve banking.*

Reminds me of the old saying, "what a tangled web we weave…" You see, it's kind of like playing Whack-a-Mole when you resist the nature of the beast. Unfortunately for the US, it's gold, not "commodities" that is the money of the Superorganism. Mises again:

[Mises](http://mises.org/humanaction/chap17sec19.asp): No government is, however, powerful enough to abolish the gold standard. Gold is the money of international trade and of the supernational economic community of mankind. It cannot be affected by measures of governments whose sovereignty is limited to definite countries. As long as a country is not economically self-sufficient in the strict sense of the term, as long as there are still some loopholes left in the walls by which national governments try to isolate their countries from the rest of the world, gold is still used as money. It does not matter that governments confiscate the gold coins and bullion they can seize and punish those holding gold as felons. The language of bilateral clearing agreements by means of which governments are intent upon eliminating gold from international trade, avoids any reference to gold. But the turnovers performed on the ground of those agreements are **calculated on gold prices. He who buys or sells on a foreign market calculates the advantages and disadvantages of such transactions in gold. In spite of the fact that a country has severed its local currency from any link with gold, its domestic structure of prices remains closely connected with gold and the gold prices of the world market.**

Did you catch that? In his magnum opus, published in 1949, Ludwig von Mises described **Reference Point: Gold**, which is the underlying nature of a global marketplace that reveals where our monetary evolution is actually heading! Here are a few of my posts on the subject:

[Reference Point Revolution!](http://fofoa.blogspot.com/2011/03/reference-point-revolution.html)
[Reference Point: Gold - Update #1](http://fofoa.blogspot.com/2011/01/reference-point-gold-update-1.html)
[Reference Point: Gold - Update #2](http://fofoa.blogspot.com/2011/04/reference-point-gold-update-2.html)

Ron Paul is absolutely correct about at least one thing. Fractional reserve banking is the problem, and it will soon be history. But I'm not talking about fiat fractional banking, I'm referring to fractional reserve **Bullion Banking**. This is the root of all our monetary problems! It is even the root of the problems that arise in the fiat currency banking system. I realize what a bold statement this is, but I have gone into great depth on this blog exploring it from many different angles. Here are a few recent posts on this subject for those that are interested:

[The View: A Classic Bank Run](http://fofoa.blogspot.com/2011/02/view-classic-bank-run.html)
[Who is Draining GLD?](http://fofoa.blogspot.com/2011/01/who-is-draining-gld.html)
[Reply to Bron](http://fofoa.blogspot.com/2011/02/reply-to-bron.html)

So what *is* honest money? And what does it mean "to return to honest money?"

Honest money is simply money that does not pretend to be something it is not. And the only way you get there is with "two monies." One that is a primary medium of exchange but does not pretend to also be the primary store of value. In doing so, it will actually become a pretty good short term store of value as it finds stability through stasis with a floating counterweight.

And a second one that *is* the focal point primary store of value, but does not pretend it can also be a primary medium of exchange at the same time. (There is no need to lend or borrow the secondary medium of exchange!) In doing so, it will become the greatest "secondary media of exchange" that ever existed! It will be a sight to behold!

And yes, we *are* returning to honest money today! The signs are everywhere, the most prominent being the rising price of gold against a falling dollar. Those who are buying gold, like China, Russia, Europe, India, Asia and the Middle East, are preparing for the return to honest money. They are preparing because they realize there is a huge advantage in preparing for something that is coming versus just watching it arrive from the sidelines. Yet, for some reason, we don't hear them demanding a new fixed dollar-gold standard from the US. Hmm. Fool me once, shame on you. Fool me twice, shame on me!

As you browse the web you will find dozens or even hundreds of interpretations of what the rising price of gold means. You now have mine to add to the pile. It means we are in the process of returning to honest money. But there are those that would like to take advantage of this to fix (read: manage) the price of gold to the US dollar *once again*. Does this sound honest to you?

There is a good reason why my future gold price projections are roughly one order of magnitude greater than those who want the US to manage the price of gold and to fix that price to the dollar… once again. It's also why those giants that exist outside of the dollar-centric world of the hard money activists are buying gold, and only gold, in preparation for the transition. Here are a few of my posts that will give you a clue to the "order of magnitude" difference:

1. [It's the Debt, Stupid](http://fofoa.blogspot.com/2010/06/its-debt-stupid.html)
2. [How Can We Possibly Calculate the Future Value of Gold?](http://fofoa.blogspot.com/2010/06/how-can-we-possibly-calculate-future.html)
3. [Gold: The Ultimate Wealth Consolidator](http://fofoa.blogspot.com/2010/07/gold-ultimate-wealth-consolidator.html)
4. [Relativity: What is Physical Gold REALLY Worth?](http://fofoa.blogspot.com/2010/08/relativity-what-is-physical-gold-really.html)
5. [The Value of Gold](http://fofoa.blogspot.com/2010/12/value-of-gold.html)

I would recommend reading them in that order.

So let's see. I think we have a winner. Let me check my scorecard:


And the best part is the probability, because there's no activism required. All you can do is prepare your own savings to be safely shuttled through the transition. So put down that picket sign, take off the t-shirt, undo the CAPSLOCK and go buy yourself some physical gold. Then, just like the Giants, you will be prepared for the return to honest money.

And finally, a big, dramatic tip of the hat to JR for his invaluable contribution to this post!

Sincerely,
FOFOA

Posted by FOFOA at [5:38 PM](http://fofoa.blogspot.com/2011/05/return-to-honest-money.html) [179 comments](https://www.blogger.com/comment.g?blogID=4490468598422095060&postID=8618081914219076213&isPopup=true) [Links to this post](http://fofoa.blogspot.com/2011/05/return-to-honest-money.html#links)

[Older Posts](http://fofoa.blogspot.com/search?updated-max=2011-05-25T17%3A38%3A00-07%3A00&max-results=5)