Reconstruction of America’s Monetary and Banking System

A Return to Constitutional Money

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Preface

After listening to talk radio, I began to realize how little understanding most callers and even many hosts had of the gold standard. They know that the country’s monetary system is highly dysfunctional and in need of major reconstruction. Most realize that the Federal Reserve is a major part of the problem and needs to be abolished. Although few seem to want to abolish the entire banking system, most are either uncertain about the action to take on banks or have given it little thought. Few seem to know what to do with the banking system other than to abolish banking or at least abolish the Federal Reserve or just leave it alone.

When they do discuss banking, most are so absorbed with the Federal Reserve being privately owned, which is disputed, that they often overlook that the people who control the Federal Reserve also control the U.S. government. The ancestors of these people controlled the U.S. government before it established the Federal Reserve, or else the Federal Reserve would never have been established. Furthermore, they overlook that the U.S. government is the senior partner in this conspiracy to plunder the American people. The U.S. government created the Federal Reserve, and the Federal Reserve continues to exist at the pleasure of the U.S. government. Abolishing the junior partner and transferring the powers that Congress gave it to the U.S. government solves nothing, except removing some obfuscation.

When it comes to the reconstruction of the monetary system, these people fall into two groups. One group wants to retain fiat money, but they want the U.S. government to manage it directly instead of through the Federal Reserve. They propose backing the
currency with the wealth of the country, productivity, or another nebulous and difficult, if not impossible, to measure accurately economic activity or parameter—anything but precious metals. Their disagreements with the current system is not one of fundamental principles. Their primary disagreements are who should issue the money (the government or the banks) and what should the goal or target be.

The other group wants a gold-backed or gold-and-silver-backed currency. For the most part, they cannot free themselves from the heavy involvement of the government. Nearly all believe that the U.S. government needs to manage the gold standard. Most of them would have the U.S. government to issue paper money backed by gold (some also include silver). Whether this currency is redeemable or irredeemable, many are uncertain or at least unclear although a majority seems to prefer a redeemable currency. Of the few who would clearly have paper money redeemable in metal, few specify whether it would be redeemable in coins or bullion bars.

Except for Ron Paul, I have heard none argue for the classical or true gold-coin standard. Almost none seem aware that the true gold standard works best without any governmental management. (Actually, if the government manages it, it is not the true classical gold standard.)

With this book, I hope to show a way out of this quagmire. I am proposing to take the control of the monetary system from the government and banks and return it to the people. A dual or parallel classical or true gold-and- silver-coin standard with no legal exchange rate between the two is the monetary system recommended. The banking system recommended is a decentralized banking system accompanied by the real bills doctrine. The government ceases to be a participant in the monetary and banking systems and becomes solely an umpire. (Minting gold and silver coins is the only exception, but the government need not do this.)

Most people believe that under a true gold and silver standard, gold and silver backs the money. Gold and silver do not back the money. Money is not even convertible into gold and silver. The money is gold and silver!
Credit is the power to obtain goods or services by giving a promise to pay money on demand or at a specified date in the future” (Johnson, p. 9).

Mises notes, “Credit transactions are in fact nothing but the exchange of present goods against future goods” (Mises, Theory of Money and Credit, p. 35).

Money

The coinage and issuance of money are claimed to be the prerogatives of the sovereign. Under the American system of governance, the people are the sovereign. Therefore, the prerogatives of coinage and issuance of money belong to the people. They do not belong to the government or its central bank or to those who run the government and its central bank.

Money and credit are too important to entrust their creation to the government or any governmentally protected banking monopoly or oligarchy. Their creation needs to be decentralized and dispersed among the people. Money and credit need to remain directly under the control of the people. A monetary system free from governmental control and management is essential to a free society.

When left free to choose their money, the people have chosen gold and silver. Only when the government arbitrarily intervenes forcibly to remove these metals as money, do they cease to be used as money.

The people, and not the government or banks, should determine how much gold and silver coinage that they want or need. The people, and not the government or banks, should decide the quantity of

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commercial money (real bills\(^*\)) to create and the quantity of commercial money to convert to bank money (bank notes\(^*\) and checkable deposits). President Grant, in perhaps his most profound and intelligent statement, said, “The experience and judgment of the people can best decide how much currency is required for the transaction of the business of the country. It is unsafe to leave the settlement of this question to Congress, the Secretary of the Treasury or the Executive.”

When left to themselves, the people, with each person acting in his individual capacity, will arrive at and maintain an adequate supply of money. The time is long past for people to abandon the Medieval monetary philosophy that the king’s (government’s) decree gives money its value.

According to Mises, sound money has two aspects: “It is affirmative in approving the market’s choice of a commonly-used medium of exchange. It is negative in obstructing the government’s propensity to meddle with the currency system.”

\(^*\)Real bills are “self-liquidating commercial loans representing, in effect, the value of things en route to or being offered in the markets” (Gibbs, *Can Our Republic Survive*, p. 11). Thus, commercial money may be thought of as the value of items represented by the real bill expressed in gold or silver. Real bills are described in Chapter 4.

\(^*\)Bradford describes a bank note as “the formal promise of a bank to pay the bearer on demand a certain designated sum in standard money or some form of government credit money . . . The bank note is . . . a form of credit instrument” (Bradford, p. 127). Bank notes create a debtor-creditor relationship. The issuing bank is the debtor, and the note holder is the creditor. Although bank notes are distinguished from checkable deposits, they do not differ in substance. Under a gold or silver standard, both can be converted into gold or silver coins on demand. Bank notes are discussed in Chapter 4.
A gold-and-silver-coin dual or parallel monetary standard accompanied by the real bills doctrine* and decentralized banking are the monetary and banking system being proposed. It is a commodity money, real bills monetary system with decentralized banking.

This system does a better job of limiting the power of the government over the people, protecting their liberties and property, and providing for their economic welfare than any other monetary and banking system yet discovered. No system better serves the interest of the people, the money users, than does this system.

Although the focus is on gold and silver as money, no other commodity should be excluded from use as money. If the people or just two parties agree to transact business using something other than gold or silver as money, they should be free to do so. No one should be forced to accept anything as money unless he has freely agreed to do so.

The government does not need to decree what will be money. It only needs to declare what it will accept in payment of taxes, fees, and fines. Its only major involvement in monetary matters is the establishment of weights and measures, the enforcement of contracts, and proscribing fraud. Coinage is secondary and is not an exclusive duty of the government.

If properly carried out, a commodity money, real bills monetary system gives the people the power to expand and contract the money supply to suit their needs. It frees them from a money supply manipulated by the government and banks.

Money in the form of gold and silver coins developed spontaneously and naturally without governmental coercion. During the Middle Ages, real bills as money developed spontaneously and naturally to meet economic needs of the markets; governmental coercion was not necessary. Then came checks, which were orders to

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*“Real bills doctrine” is “the notion that banks should limit the creation of their monetary liabilities to the realizable exchange value (real price) of newly produced goods being marketed.” (American Institute for Economic Research, *Money, Banking and Inflation*, p. 22.)
the bank to transfer specie (precious metal coins) from one account to another. Later bank notes representing merchandise and redeemable in gold or silver began to be issued. Bank notes allowed the transfer of specie without direct involvement of banks. Again governmental coercion was not needed. The only time governmental coercion has been needed is to force people to accept fiat currency as money. Force is needed for fiat currency because fiat currency represents an obligation that is never paid.

**Monetary Theories**

F.A. Walker defines money as “that which passes freely from hand to hand throughout the community in final discharge of debts and full payment for commodities, being accepted equally without reference to the character or credit of the person who offers it and without the intention of the person who receives it to consume it or enjoy it or apply it to any other use than in turn to tender it to others in discharge of debt or payment for commodities.”

Johnson defines money as “that valuable thing or economic good which possesses in any country or community universal acceptability as a medium of exchange or means of payment.”

Ely defines money as “whatever passes freely from hand to hand as a medium of exchange and is generally received in final discharge of debt.”

Mises defines money as “the thing which serves as the generally accepted and commonly used medium of exchange.”

George defines money as “whatever in any time and place is used as the common medium of exchange . . . .”

Duesenberry defines money as “something that people are willing to accept in exchanges, even if they have no use for the thing themselves. . . . Money is something people accept in exchange for goods, in the expectation of passing it on to someone else in a further exchange.”

Roberts defines money as “anything which is widely accepted in payment for goods, or in discharge of other kinds of business obligation.”

Gnazzo defines money as “the commodity that has the most stable value, and which can be exchanged in value or kind, for any other commodity, or service in the market place.”

Thus, money is whatever a community uses to exchange for goods
When most people claim that money has “intrinsic” value, they do not mean that the atoms and molecular structure give money its value as value is subjective. (However, the physical properties of the material used for money may contribute to this subjective value.) They generally mean that the material of which the money is made has nonmonetary uses and that the

and services and to discharge debts and other monetary obligations. It is the purchasing medium.

According to Johnson, “exchangeability is the only utility possessed by money, and it is on account of this utility, and this only, that it is wanted. Money performs a specific service for men, like a hoe or a knife, and is wanted for no other purpose.” Gnazzo states, “The most important quality of money is that it can be exchanged in value for any other good or service.”

The three basic theories of money are the quantity theory, the qualitative theory, and neutrality of money theory. According to the quantity theory, “the value of money . . . is inversely proportional to the supply of goods on the market: the more money and the fewer goods, the less value (i.e., purchasing power) money has and vice versa. . . . [M]oney is a medium of exchange and, in relation to the goods and services that can be bought or sold, is subject to the law of supply and demand.” According to the qualitative theory “the value of money is the intrinsic value of the metal it contains or represents.” The metal has value as a commodity apart from its use as money. Its value as a commodity fixes its value as money. According to the neutrality of money theory, “money is merely a token of the value of things, or a means of calculating their value, without there being any reciprocal influence between money, on the one hand, and goods and services, on the other.”

Ballve concludes “that money, as a commodity that is exchanged for things, has a value of its own that is determined by market factors, and in particular by its better or poorer quality and by its abundance or scarcity.” As the neutrality of money theory claims, money is a token or medium of exchange. As the qualitative theory asserts, money has intrinsic value* by virtue of its material content and

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*When most people claim that money has “intrinsic” value, they do not mean that the atoms and molecular structure give money its value as value is subjective. (However, the physical properties of the material used for money may contribute to this subjective value.) They generally mean that the material of which the money is made has nonmonetary uses and that the
specific utility that makes hoarding possible. Finally, as the quantity theory holds, money’s purchasing power is related to the supply of and demand for goods in the markets.

The quality of money, i.e., purchasing power, is more important than the quantity of money, i.e., the number of monetary units. Fiat money people focus on quantity. With some exceptions, commodity money people focus on quality.

Money has no inherent value in and of itself. Its value lies within the goods and services for which it can be exchanged. It represents purchasing power and is a receipt for value. It represents the value of the thing for which it is exchanged. Because money is only useful for buying and selling goods and services, the more that a given amount of money can buy, the greater is its purchasing power.  

According to Ferdinando Galiani, anything used as money must have these four qualities: “1–It should have a real value in itself, and at any given time it should have the same value everywhere; 2–its real value should be easily recognizable; 3–it should be difficult to debase by fraud; 4–it should be durable.”

value of money is approximately the value of the material of which it is made. Thus, commodity money has intrinsic value, and fiat money does not.

Counterfeiting can illustrate this idea of intrinsic value. A counterfeit federal reserve note has no value once it is discovered. A counterfeit gold coin containing 20 pennyweights of pure gold alloyed nine-tenths fine has the same value as a genuine coin of the same fineness and gold content even when the counterfeit is discovered.

*“Hoarding” is simply an increase in the demand for money, and the result of this change in valuations is that people get what they desire, i.e., an increase in the real value of their cash balance and the monetary unit” (Rothbard, *Man, Economy, and State*, p. 680.) People often use hoarding as a derogatory term to describe a person’s cash holding that they believe exceeds what is normal or adequate. However, hoarding is not really idle money. It is providing a service. Hoarding insures the holder against uncertainty.

†See Chapter 5 for a more detailed discussion of fiat money and the quantity theory of money and the quality theory of money.
Money should not be confused with wealth. It is not wealth; it is a tool to acquire wealth. Things like cars, houses, factories, and food are wealth. Money can reduce wealth to a single number, price.

Moreover, the wealth of a country has no relationship to the value of its money. The value of a country’s money is independent of the country’s wealth, prestige, and military might. As Mises observes, “. . . the valuation of the monetary unit does not depend upon the wealth of the country, but upon the ratio between the quantity of money and demand for it, so that even the richest country may have a bad currency and the poorest country a good one.” An example of this observation today is that the United States are the mightiest country in the world, but they have a poor currency.

Nevertheless, because gold and silver are desirable in themselves, they are part of wealth even when in the form of coins. Gold and silver coins can be thought of as wealth in circulation. Being merely legal claims, paper money, whether redeemable or irredeemable, is not a part of wealth.

Fiat money adherents mistakenly believe that money creates wealth. They believe that inflating the money supply increases wealth. The opposite is true. Inflation destroys wealth. Wealth causes an increase in the value of money. With commodity money, as wealth increases, general prices decline, and the value of money rises. This increase in money’s value gives the incentive to search for more of the monetary commodity.

According to Alchian and Allen, “Money is a device that lowers costs of exchange and enlarges productivity via specialization.” Rothbard states, “[Money enables] goods and services to travel more expeditiously from one person to another.” George writes, “. . . [money] may be passed from hand to hand in canceling obligations or transferring ownership. . . .” George adds, “. . . the use of money, no matter of what it be composed, is not directly to satisfy desire, but indirectly to satisfy desire through exchange for other things.” Duesenberry remarks, “Unlike most things, money isn’t used up when it is used.” People acquire money not to consume it or to employ it
in their own productive activity, but to exchange it in the future for goods and services.

Monetary Systems

Monetary systems can be divided into two major categories: (1) fiat money, managed money, debt money, forced paper money, or irredeemable paper money and (2) commodity money, full-bodied money, metallic money, specie, hard money, or precious metal money. The fiat monetary system subdivides into two major systems: (1) The government issues the money directly, or (2) banks, usually under the supervision of a central bank, issue the money for the government. The commodity money system subdivides into two major groups: (1) a pure commodity money system where all paper currency is backed 100 percent by precious metal and (2) commodity money accompanied with bank notes backed by commercial money (real bills). A variant of the latter leads to unsound banking; it occurs when bank notes are backed or by bills of acceptance,1 tax anticipation bills,

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1 According to the American Institute of Banking, a bill of acceptance or bank acceptance “is a bill of exchange drawn on and accepted by a bank or banker. Its real purpose is to use the bank’s credit to obtain funds” (American Institute of Banking, p. 149). Bank acceptance occurs when “the bank, acting on the behalf of a customer, accepts a draft or drafts drawn against it by some third party and payable at some future date. The bank issues a letter of credit to the customer authorizing the draft to be drawn against it, and thereby becomes liable for the acceptance of such drafts when drawn and presented to it” (Bradford, p. 113).
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bills of accommodation,* or other similar bills or by government bonds in addition to or in place of real bills.

Commodity money is “that sort of money that is at the same time a commercial commodity.” Gold and silver are the premier commodities used as money.

Webster defines fiat money as “paper currency of government issue which is made legal tender by fiat or law, does not represent, or is not based upon, specie, and contains no promise of redemption.” The government or its central bank issues fiat money, and the government declares it to be legal tender. Under a fiat monetary system, debt, promise, or obligation is used as money and as final payment. In the United States money occurs in the form of federal reserve notes. In

*Webster defines a bill of accommodation as “a bill, draft, or note made, drawn, accepted, or endorsed by one person for another without consideration, to enable that other to raise money or obtain credit thereby, the acceptance, endorsement, etc., being called an accommodation acceptance, enforcement, etc.” A bill of accommodation is essentially a promissory note where the borrower secures accommodation from a bank on his own note, single name paper, or on an endorsed note of his customer, double name paper (Dunbar and Sprague, p 296). According to Henry Macleod, “The essential distinction between real and accommodation bills is that one represents past and the other future transactions. In a real bill goods have been purchased which are to meet the bill; in an accommodation bill goods are to be purchased which are to meet the bill” (H. White, p. 431).

†Unless otherwise noted, all definitions from Webster are from Webster’s New International Dictionary, second edition, unabridged.

‡The federal reserve dollar bill should not be confused with the “dollar.” As used in the Constitution, the dollar is a specific weight of silver. The federal reserve dollar bill is a promise to pay in lawful money, whatever that has become.

In “To Regulate the Value of Money,” Vieira argues that federal reserve notes are not really money. (1) The law describes them as “advances” to the Federal Reserve and “obligations of the United States”; therefore, they are instruments of debt and not assets. (2) Because a statute is required to make
federal reserve notes to be receivable for all taxes, customs, and public dues, they cannot be considered constitutional money. (3) Because they are “redeemable in lawful money” (this statement used to appear on federal reserve notes, but was later removed), federal reserve notes cannot logically be lawful money. Thus, federal reserve notes cannot be considered true money. Nevertheless, federal reserve notes are functionally money as people use them as a medium of exchange and to discharge debts. They do so primarily because the U.S. government forces them on people with legal tender laws.

*Money does not circulate like blood in veins. It is not in constant motion. It moves more like instantaneous discrete hops as it moves from one person’s cash holding or hoard to another person’s. Someone always owns it, and it is always part of someone’s cash balance. Never does money exist outside someone’s cash holdings or someone’s ownership.
securities, consumer purchases, investments, speculation, and other types of debt and commercial paper in addition to or in place of real bills. Although these bank notes are redeemable in gold or silver on demand, they lead to inflation because they do not represent new items offered to the markets or short-term (no more than 90 days), self-liquidating instruments. Under this system, redemption has to be suspended through either large-scale bankruptcy or governmental intervention, when speculative excesses are reached.

Hoppe compares fiat money with commodity money as follows,*

“Fiat money is the term for a medium of exchange which is neither a commercial commodity, a consumer, or a producer good, nor title to any such commodity: i.e., irredeemable paper money. In contrast, commodity money refers to a medium of exchange which is either a commercial commodity or a title thereto.”

Johnson makes the following comparison between commodity money and fiat money: “(1) commodity money, or money made out of material of which the free use is permitted as money, so that its value is the product of two sets of utilities, namely its utility as money and its utilities as an ordinary commodity; (2) fiat money, or money the value of which has no relation to the value of the material out of which it is made, being the product solely of its utility as money.”

To manufacture commodity money requires extensive labor and capital. Fiat money is manufactured essentially from nothing.

Rist explains the difference between commodity money and fiat money as follows:

[I]t must be recognised that the belief in gold arises not from age old superstitions of a more or less magical character, but from

*Hoppe’s description overlooks an important feature of fiat money, and, that is, the issuance of fiat money is arbitrary. Under Hoppe’s description, silver dollars issued in the 1880s and 1890s were commodity money as they were made of a commercial commodity. However, as Congress and the Secretary of the Treasury arbitrarily fixed the amount issued, they more closely resemble fiat money, especially since the coin’s face value was greater than the value of its metal content.
age old experience. A claim on gold—a cheque or a banknote—is something clear and precise that everybody understands, just as everybody understands a mortgage on a piece of land or a house that he knows. Paper [fiat] money is a claim on something unknown, on a country or a government, whose political, social or financial escapades and arbitrary decisions nobody can be sure of beforehand.  

Vieira compares commodity money with fiat money as follows: With commodity money, the actual commodity, the silver or the gold, is both the medium of exchange and the standard of value. The supply of commodity money is self-limited because of the costs of minting, refining, and coining the silver and gold. New supplies of commodity money will be coined only to the extent that coinage is economically profitable. The market will simply not produce more gold and silver coin than is necessary compared to all the other uses of that capital. . . . [F]iat money is composed of some intrinsically valueless substance which the issuer does not promise to redeem in a commodity or in a fiduciary money. Because fiat money has no legal connection to a commodity money, and, therefore, has no real economic cost in terms of production, the supply of fiat money is never self-limiting and is always largely a matter of public confidence in the economic or political stability of the issuer.  

Mises describes the difference between commodity money and fiat money as follows:  

. . . it is the commodity in question that constitutes the money, and that the money is merely this commodity. The case of fiat money is quite different. Here the deciding factor is the stamp, and it is not the material bearing the stamp that constitutes the money, but the stamp itself. The nature of the material that bears the stamp is a matter of quite minor importance.  

With commodity money, the commodity makes the money. “The value of a coin has always been determined, not by the image and superscription it bears nor by the proclamation of the mint and market authorities, but by its metal content.” With fiat money, the stamp and force of government makes the money. Fiat money derives its power to make purchases and to pay debt solely from words
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printed on the currency, i.e., it derives its power from governmental fiat.

Fekete notes that commodity money is “tied to a positive value: the value of a well-defined quantity of a good of well-defined quality.”32 Fiat money is “tied not to positive but to negative value—the value of debt instruments.”33

Commodity money is the only form of money that is a present good. All paper money, including fiat money and certificates, is a promise to pay; it is a future obligation. With fiat money the payment is never made; it is only discharged. Payment with commodity money completes the transactions; payment with fiat money is an extension of credit. (In this respect a gold certificate is like fiat currency. The gold certificate is credit, a promise to pay in gold and the transaction is not completed until the certificate is redeemed in gold.) With irredeemable fiat currency, the transaction can never be completed because the currency is irredeemable. The transaction is discharged by a transfer of credit.

Commodity money does not have to be in the form of coins minted by the government’s mint to function as money. Gold and silver bullion can be used, and frequently are, to make large purchases and to pay large debts. Under the gold-exchange standard, bars of gold, not gold coins, were used to pay debts.

In fiat monetary systems, the monetary unit is a nebulous abstraction, a legal fiction. Fiat money is not tangible and lacks definition.

In commodity money systems, the monetary unit is tangible and measurable. It is a specific and definable weight of a particular commodity, usually gold or silver. Unlike fiat money, commodity money has value in and of itself independent of its monetary use.

Commodity money differs from fiat money in two important ways. First, under a commodity monetary system, the money supply adjusts automatically to monetary needs. “[T]he demand for, and supply of, money react simultaneously, through market prices for all goods and services and the monetary metal, to determine a given quantity of money.”34 The markets decide how much money to create
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and issue. Under a fiat monetary system, the money supply is regulated artificially. The government or its central bank regulates the money supply. The government decides how much money to create and issue. Second, the value of commodity money is directly related to the material of which it is made. For fiat money, value is independent of its material and depends solely on the demand for and supply of money. Of these two differences, the most important lies in the method used to regulate the supply of money.

Under the gold or silver standard, the quantity of money is not subject to governmental manipulation. With fiat money, the government maintains control of the money and can change the money supply to suit domestic (political) considerations.

Commodity money is an economic currency. Needs of the economy determine its quantity. It is directly connected with the production of real goods and services.

Fiat money is a political currency. Needs of politics determine its quantity. It is directly connected with government debt even if the government issues the currency directly and interest free. (When the government issues currency like U.S. notes, it is issuing interest free government debt that is used as money. Often such debt is never paid.)

Under a commodity monetary system, the value of the monetary commodity comes from its production. Under a fiat monetary system, the value of money comes from its legal obligation.

With fiat money, people trust politicians, bureaucrats, and bankers. They trust paper and promises. With commodity money, people trust gold and silver. They trust that which is no one’s obligation or promise.

Functions of Money

Money is a purchasing medium, a medium of exchange. It is immediately available in its existing form to the buyer and immediately acceptable by the seller. Not only is money a means of payment; it is also the thing used as final payment for purchases and debts. After a purchase has been made, money involves no continuing or further