

Questions & Answer Summary About Money, Public Policy and Informational Issues

By
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Question: What is the purpose of money?

The purpose of money is to facilitate the transfer of value over space and time. In other words, we use it to exchange wealth geographically, and to provide for future payment. Without money, which is in effect an intermediate good used for trading, it would become very difficult to have a division of labor, i.e., specialization, and everyone's standard of living would suffer.

Issue	Commodity money such as gold or silver	Fiat, irredeemable paper ticket-token or electronic-checkbook money (U.S. dollars)
Where does money come from; how does it originate?	Commodity money (a medium of exchange) is an invention of the market; it evolves. Market participants want that which is used for money to have the lowest transaction costs when transferring wealth geographically and over time. The market has determined that gold is the most efficient money, then silver. The reason the market chooses gold-as-money is because it is the commodity for which the buy/sell spread increases the least as ever-greater quantities are offered for sale. Because it takes work to create commodity money, it is said to have "intrinsic value."	An arbitrary (fiat) invention. It is created out of nothing by banks and central banks and made legal (with legal tender, a.k.a. "forced tender," laws) by politicians with whom they have colluded. Because it takes no work to create fiat money, it is said to have no "intrinsic value." With fiat money, there is no limit as to how much can be created, and it always eventually becomes worthless.
How is money defined?	With commodity money, money is defined as a quantity of a commodity. For example, in the United States, the dollar was defined by the Coinage Act of 1792 as 371.25 grains of silver.	There is no definition, i.e., there are no units of measure. This lack of a defined unit of measure, as postulated by then Warden of the Mint Sir Isaac Newton, was enough to preclude the use of fiat money in England in the year 1700 and for almost 230 years thereafter.
Is there a limit as to how much money exists?	The amount of money is limited by the costs of producing it. In the case of gold-as-money, those costs include prospecting for, mining, and refining gold.	Because fiat money is created without work, there is no limit as to how much can be created.

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Why do people accept money in exchange for their goods and services?	People recognize commodity money as something that has “intrinsic value.” The concept of money as a medium of exchange is to facilitate trading wealth for wealth; labor for labor; work for work. This has been true all over the world for all recorded time.	Because of material misrepresentation and nondisclosure about fiat money, people are tricked into accepting and saving it. In addition, legal tender laws coerce people to accept it when disputes are adjudicated in the courts. For a short while, during the American Revolution, politicians decreed that any who would not accept the fiat currency of the day (called continentals) as payment for goods and services be treated as enemies of the country and precluded from all trade or intercourse. The U.S. <i>Constitution</i> implicitly disallows the notion of fiat currency in Article I Sections 8 and 10.
Is there an historical moral issue with regard to which kind of money we have?	Commodity money is in conformity with the <i>Eighth Commandment</i> : “Thou Shall Not Steal,” and Leviticus 19:35 & 36, which says that one should not falsify weights and measures. Honesty in business dealings is considered consistent with holiness and with moral law.	Fiat money violates the <i>Eighth Commandment</i> and the admonition that one should not tamper with weights and measures. Because it is used for future payment, money is said to serve as a store of value. The generation of fiat money, which is produced without work—how much more work is involved in producing a \$100 bill as opposed to a \$1 dollar bill?—dilutes that which has been saved and that which has been promised for future payment. It is the same as stealing.
Are different types of money indicative of different societal organization?	Commodity money is generally associated with a freer more democratic society. Government needs money to pay for its programs. Commodity money is impossible to create out of nothing. It must be taxed from citizens. If they have the (theoretical) ability to resist high taxation and withhold their money from government, then politicians cannot act unilaterally.	Fiat money is generally associated with a more statist society. If politicians don’t have to consult citizens or tax them directly to fund government programs, such as wars, then politicians can, and do, implement whatever programs they wish. Thus, fiat money is a necessary ingredient for tyranny. Programs can be funded with money created by the banking system. In effect, politicians and banks embezzle the purchasing power of savings.

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Is there an implication for property rights?	Commodity money protects property and is protected by the notion of private property.	With fiat money, when money is diluted by the creation of additional money out of nothing, the property rights of savers and those who have been promised future payments, such as pensions, are violated.
Is there a connection between the type of money we have and government deficits?	It is difficult to sustain government deficits with commodity money because they would have to be funded by borrowing. Since a commodity money supply cannot arbitrarily be expanded, interest rates would increase if government increased borrowing. Manufacturers and others would then object to higher interest rates, causing government to reduce spending, and thereby causing deficits to decrease.	As long as someone, such as the Bank of Japan, the Federal Reserve, or banks, will purchase government securities by creating money out of nothing (called “monetizing debt”), deficits can be funded without greatly increasing interest rates, and deficits can grow without limit (in theory). Eventually, the debts are defaulted.
Is there a connection between taxation levels and the type of money we have?	Commodity money tends to facilitate lower tax rates and less taxation, since citizens see how much is being extracted from them.	As fiat money is created out of nothing, there tends to be inflation and ordinary working people are pushed into higher tax brackets. People pay a larger percentage of their income to taxes.
How does the type of money we have affect real wages?	With commodity money, real wages tend to increase, as does the standard of living.	With fiat money, real wages tend either to stagnate or decrease, as does the standard of living.
How does the type of money we have affect long-term interest rates?	With commodity money, interest rates have historically been about 3½ percent; just equal to the time-value of money. There is good data from Great Britain going back almost 200 years attesting to this.	With fiat money, interest rates include not only the time-value of money but also an additional increment—the so-called “inflation premium”—to compensate for the loss of purchasing power due to the actual and expected creation of additional money. Interest rates are much higher than with commodity money.
What effect does the type of money have on long-term investments?	Since people have confidence in the stability of the medium of exchange in which they expect to earn a return on investment, there is a much longer investment-time-horizon, and much more long-term investment.	With fiat money, there is a much shorter investment-time-horizon (sometimes no long-term investments at all, e.g., as in Mexico, Brazil) because few productive enterprises can earn enough profit to compensate for the loss of purchasing power resulting from money creation.

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Is there a connection between the type of money we have and economic growth?	Commodity money facilitates real growth by investing savings, thereby causing increases in physical and intellectual capital.	Fiat money results in nominal growth and less real growth. Eventually real growth and real earnings decrease. Capital is destroyed and there tends to be less replenishment of physical and intellectual capital.
How does the type of money affect price levels?	As productivity increases, prices tend to decrease, thereby resulting in more goods for more people at lower prices. This is what an increasing standard of living means.	Prices tend to increase or, at best, remain stable. In all cases, inflation eventually results because the financial sector overreaches and because politicians inevitably become avaricious for additional funds.
How does the type of money affect the propensity to save?	Commodity money is very savable because it doesn't obsolesce or deteriorate and is difficult to counterfeit. Purchasing power is not diminished.	Fiat money is less savable and can discourage long-term savings altogether, since its future value is always in doubt. Why save a depreciating asset?
How is job security affected by the type of money we have?	With commodity money, job security is impacted mostly by increases in productivity, which tends to destroy some jobs and create others. Decreasing prices help offset the negative effects associated with the destruction of jobs resulting from productivity (labor saving) improvements.	With fiat money, job security is impacted by rapidly changing interest and foreign exchange rates, and less of a propensity to save and invest for the long term.
Number of manufacturing jobs.	Since there is more investment in productive ventures with commodity money, there are more and higher-paying jobs than otherwise. Because manufacturing is investment intensive, there are also more manufacturing jobs.	Since there is less investment in long-term productive enterprise, there are fewer and lower-paying jobs in countries with fiat currencies. This is because fiat currencies cause higher interest rates and a shorter investment-time-horizon, causing a decrease in manufacturing activity. Generally, there is an increase in the so-called service sector because it has a much shorter investment-time-horizon.

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Research & Development and Science Education.	Because commodity money has a lower interest rate structure and a longer investment-time-horizon, there tends to be more long-term investment. Research and development tend to be a long-term activities. Thus, commodity money results in more scientific activity and the need for more science education.	Because fiat currency results in a higher interest rate structure and a shorter investment-time-horizon, there tends to be less long-term investment. If interest rates are high enough, as in Mexico or Brazil, there may be no long-term investment at all and little research and development, and less demand for science education.
Interest rate volatility and foreign exchange volatility.	Virtually none.	With fiat money, there is inherent high volatility, which tends to be hedged by derivatives, and which adds additional cost to financing. People in the financial sector benefit. Workers, manufacturers, entrepreneurs and consumers pay the cost.
Levels of debt.	Because with commodity money prices tend to decrease, it becomes harder to service and pay down debt, and debt is discouraged.	Because debt gets serviced and repaid with cheaper money, increases in debt are encouraged. This also works to decrease the purchasing power of savings and future payments, the majority of which constitute pension funds. Today, worldwide government debt is in excess of \$13 trillion.
Boom & bust in the economy.	Without fractional reserve lending (leverage), a.k.a. the creation of “bank money” by banks, economic activity expands without busts. With increasing amounts fractional reserve lending, there are periodic booms and busts. A bust results when marginal credit that cannot be serviced is liquidated.	Fiat money tends to create huge bubbles, which, when they collapse—and they always collapse—lead to extended depressions and severe hardship, especially for ordinary working people and seniors.

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Effect on the banking system.	The role of bankers is limited to: (1) storing money for safekeeping; (2) acting as intermediaries between savers and credit-worthy borrowers; and (3) facilitating the payments transfer system.	Bankers have a greatly expanded role: they sell instruments to hedge interest rate and foreign exchange volatility; and they create fiat money (in the form of credit) for which they get the interest and fees. In effect, banks' traditional role as intermediaries between savers and borrowers decrease, and the banks become the equivalent of hedge funds whose downside is guaranteed and subsidized by ordinary working people. The euphemisms for these guarantees are called the "lender of last resort" bailout facility at the Federal Reserve, and so-called Federal Deposit Insurance, which is not insurance.
Likelihood, duration, and size of wars.	Wars cost money. Since the only sources of revenues with commodity money are taxes—which people tend to resist—or borrowing—which drives up interest rates—there tend to be fewer and smaller wars. For example, it is less likely that the U.S. would have fought in Vietnam if President Johnson had to finance the war with taxes.	Fiat currency enables politicians to generate revenues with less accountability. They are then able to act without the consent of the citizenry, which, if consulted, would probably allocate their savings differently. Thus, politicians have a freer hand to engage in military adventurism, and they do.
Effect on military preparedness and the ability to wage war if need be.	A stronger industrial base makes for a stronger military. Also, lower interest rates, which are a by-product of commodity money, make for a greater capacity to finance a war.	A weaker military due to a weaker industrial base. Since interest rates are higher, there is less of a capacity to finance a war.
Social mobility: the ability to improve one's lot in society.	High.	Less to none. Because improving one's lot requires the accumulation of wealth, and because it is not economic to save fiat currency, the poor tend to stay poor.

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Social engineering (the redistribution of wealth).	Hard to do because it must be done with taxation and people tend to oppose higher taxes. They take a greater interest in where money is spent when it is their own.	Easier to do by creating money out of nothing and “spending” it, lending it, or guaranteeing loans (where it is known in advance that such guarantees can be met by creating additional money). Contrary to popular opinion, most of wealth redistribution is from the poor to the rich.
Who gets the wealth of society?	The people who earn it: workers, entrepreneurs, and the producers of goods and services sold in the market in voluntary transactions.	An inordinate amount of wealth is transferred from those who produce it to banks and financial intermediaries. Large credit-worthy borrowers benefit. Also, politicians tend to profit along with people who are direct beneficiaries of government largesse.
Special privileges for banks and other financial players.	None.	Because of the instability of fiat-based monetary regimes, to “protect” the efficacy of the payment transfer systems, there is a need for a “safety net” for the financial sector. This “safety net,” as Chairman Greenspan has pointed out, is a subsidy to the financial sector. It constitutes wealth transfer from ordinary taxpayers to the financial sector. While regulators are charged with monitoring the financial sector to reduce or make less likely massive wealth transfer, the financial sector has a history of compromising politicians who are nominally in charge of the regulators. At the end of the day, in all cases, regulation fails and the system collapses.

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