

Why the Gold Industry is Being Destroyed and What to Do About It

By

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June 25, 1999

Prominent Wall Street firms, influential news columnists, central bankers and myriad others have been slamming gold as dead, a relic of the past, a stupid investment and worse. In recent weeks, long-standing expectations that the gold price would increase in times of international turmoil, such as the war in Kosovo, or when inflation picked up, have been shattered. Not only has the trading infrastructure of the gold industry been decimated, but the physical infrastructure is not being maintained. More than 100,000 mining jobs in South Africa and elsewhere have been eliminated. Mining operations are closing. Those who gain their livelihoods from gold are in shock. Some see dark conspiracies. Others blame misguided central bank policy that they hope to rectify by lobbying central bankers. But most are just totally bewildered.

The core of the problem has to do with our departure from lawful money and the primary use of gold: gold-as-money. In the last century, this was a central issue and was debated widely; major political campaigns were fought over it for almost 100 years. It was called "the money issue," and gold, the choice of the people, won decisively. In this century, that victory has been completely undermined. The result has meant unfathomable hardship to hundreds of millions. It is late in the day, but the gold fraternity can still save itself. Before dealing with the problem, the key reasons the gold industry is being destroyed must be understood.

Gold limits money creation by banks which, in turn, limits bank profits:

The 1947 edition of *The Federal Reserve System-Purpose and Functions*, an official publication, states: "Gold certificate

holdings of the Federal Reserve Banks set the limits of Federal Reserve credit expansion." Specifically, there was a statutory link between the amount of gold owned by the Treasury and the amount of credit that the Federal Reserve could create. Because of the fiction of "required reserves," this also limited commercial bank credit expansion and concomitant commercial bank profits. Today, as then, Federal Reserve and commercial bank credit creation is equivalent to money creation.

Also, in 1947, foreign central banks still had the right to redeem dollars for gold at \$35 an ounce. As a result, even though it was a felony for U.S. citizens to own gold, the public had some sense that gold limited money creation. Now that the statutory link between gold and bank credit/money creation has been broken, the amount of money--which is now all fiat, i.e., "arbitrary" without any backing--that the U.S. and foreign banking systems can create is unlimited. The crucial issue for the gold industry is that commercial banks have always understood that gold impedes their profits.

Large Banks have always controlled the Federal Reserve *de facto*:

Putatively, the Federal Reserve regulates commercial bank credit creation. But, as a practical matter, the Federal Reserve is a creature of the large commercial banks. It was created as a result of their lobbying and is *de facto* under their control. While it is true that selecting members of the Federal Reserve Board of Governors falls to the President, he looks entirely to the financial community elite for recommendations. Even the Congress, which is charged with vetting and approving candidates, looks to the financial community elite to confirm approval. For example, in a *Wall Street*

Journal article on June 4, 1999 about Federal Reserve Vice Chairman Alice Rivlin's upcoming retirement, it was reported that the "White House is leaning toward nominating Carol Parry, an executive vice president of Chase Manhattan Bank" as a replacement.

Even more telling, the original Federal Reserve legislation provided for a body called the Federal Advisory Council (FAC) whose members are selected by the boards of directors of the Federal Reserve Banks. Today, FAC members consist of the top management of banks whose assets sum to more than \$1 trillion. FAC members meet regularly with the Board of Governors to air their concerns and provide advice to the

Board. Contrary to the principles of participatory democracy and an informed electorate, these meetings are held in secret with no oversight. There is no other regulatory agency that meets in secret with those whom it is charged with regulating.

Fifty years of empirical evidence confirms that removing the gold constraint allows the banking system to greatly expand:

The amount of money in the U.S. in 1946 was about \$150 billion. As can be seen from *Figure 1* below, after the last remaining tie to gold was severed in 1971, money creation exploded to more than \$6 trillion. Of that, the Federal Reserve created roughly \$500 billion. The balance, about \$5.5 trillion, was created by commercial banks.

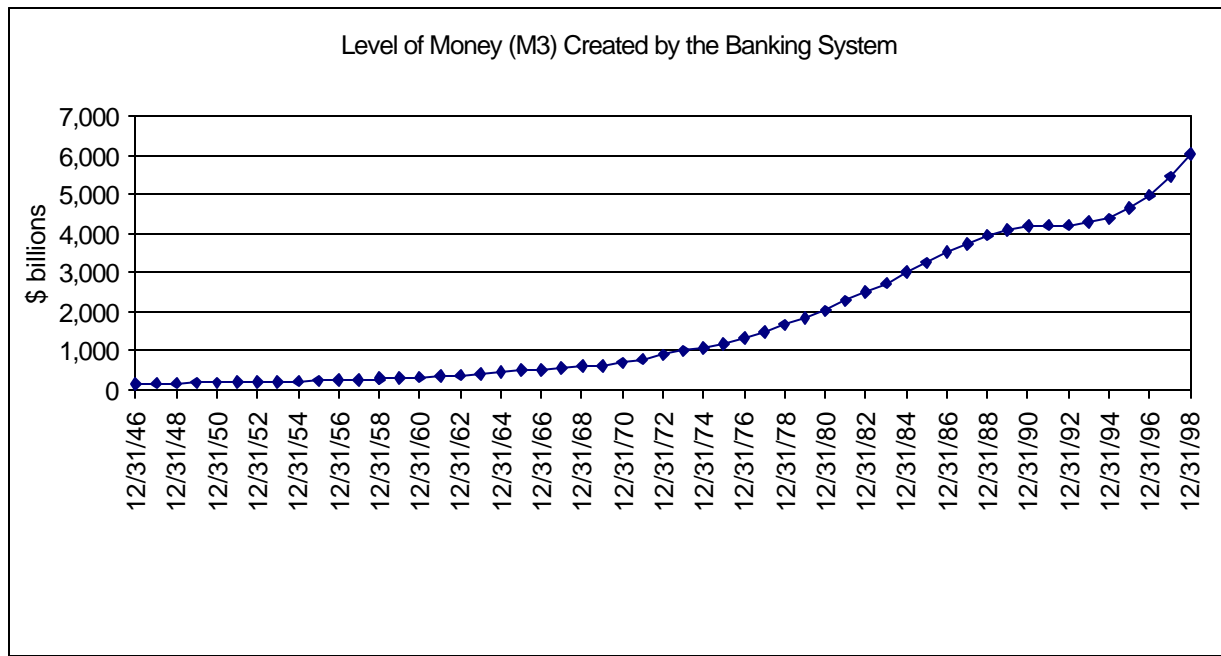


Figure 1: Level of Money (M3) Created by the banking system (Source: Federal Reserve H.6 Series for the period 1959 to present; and the *Historical Statistics of the United States: Colonial Times to 1970*; Series X-415, X-418, X-419; U.S. Department of Commerce for the period 1946-1958.)

Money creation is extraordinarily profitable:

As *Figure 2* shows, the ability to create money has been extraordinarily profitable for commercial banks. In 1997, they reported after-tax profits of nearly \$60 billion!

To put this into perspective, the profits of the automobile industry for the same period were less than \$10 billion. Wall Street firms and commercial banks' large credit-worthy borrowers reap enormous profits from fiat money as well.

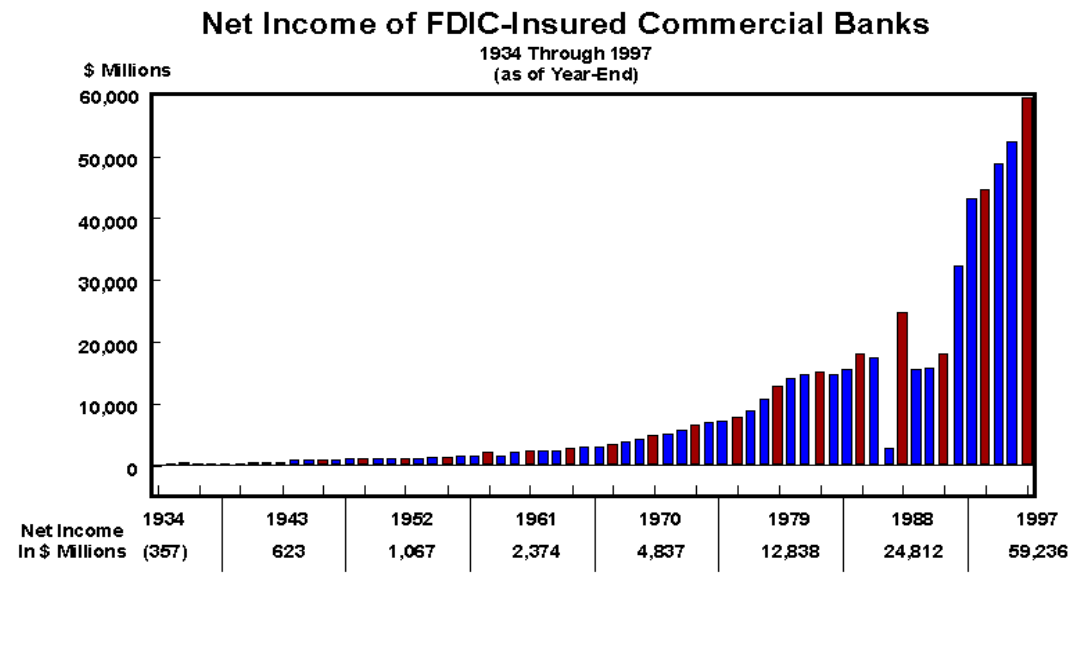


Figure 2: Net Income of FDIC-Insured Commercial Banks 1934 Through 1997 (Source: Federal Deposit Insurance Corporation)

Almost all bank profits are unearned and result from fiat money:

What services do commercial banks in the U.S. provide that add value to people's lives? For the most part, they provide check clearing and act as intermediaries between savers and borrowers. But certainly these primarily paper-pushing functions would not yield such colossal profits in a competitive market. More to the point, banks are able to reap this \$60 billion windfall because of their ability to create fiat money and the financial "products" that derive from it.

About half of bank profits result from gambling, euphemistically called "trading," as in "currency trading" and derivative issuance, both of which are subsidized by the public. Because of what are in fact subsidies enacted by law, ordinary taxpayers guarantee the banking system's entire balance sheet. Its assets are guaranteed by the so-called "lender of last resort" bailout facility at the Federal Reserve, and its liabilities are guaranteed by the Federal Deposit Insurance Corporation. No other segment of society has these guarantees or enjoys these special privileges.

In addition to these direct subsidies, there are substantial indirect subsidies. For example, in the last two years, the International Monetary Fund (IMF) has transferred about \$185 billion of taxpayer money to foreigners so they may make good on debts owed to mostly U.S. banks. Representative Ron Paul, a member of the House Banking Committee, referring to the so-called "Mexican bailout" three years ago, suggested that, if the \$40 billion sent to Mexico had purple ink, the fingers of some major U.S. bankers would be purple. Key information has been kept from public scrutiny: all of the agreements that the IMF has entered into with foreign nations are secret. Since the IMF is transferring public money, why shouldn't the documentation be public? With the exception of the intelligence agencies, there is no other entity that gets public funding that does not have public disclosure and public oversight.

Parenthetically, these subsidies are not consistent with the "free market" rhetoric that bankers use. The subsidies would not be possible if we had gold-as-money, which was part of the motivation for President Roosevelt outlawing gold in 1933.

What's more, after-tax profits tell only a small part of the story. There are, in addition, the multi-million dollar salaries, perks, pensions and stock options that commercial bank executives pay themselves.

The relevant calculation is bank revenues less interest expense, i.e., the

amount of interest commercial banks pay "depositors" on money that commercial banks themselves create. Last year, that amount was nearly \$277 billion. To put *this* into perspective, consider that the Federal Reserve spends roughly \$3 billion to clear all the checks in the nation. What conceivable benefit is there to the public that the banking system should take in an additional \$274 billion?

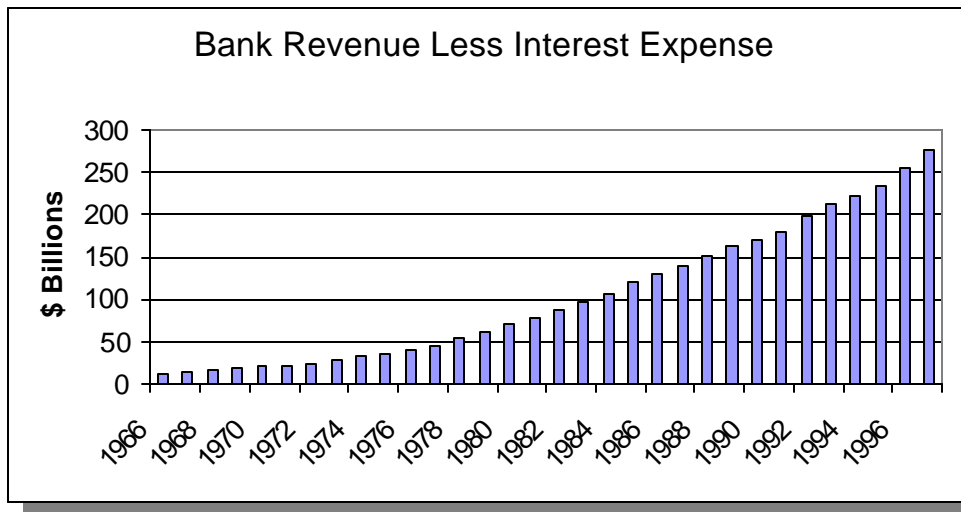


Figure 3: Bank Revenue less Interest Expense (Source: Federal Deposit Insurance Corporation)

Increasing gold prices threaten the financial sector's unearned profits:

What does this have to do with gold? First, as noted above, if there were a link between gold and our monetary unit, the central bank and the FDIC would not be able to implement the subsidies and the unearned profits/revenues described above would not be possible. Those who profit from the creation of fiat money understand this and share a commonality of interests in suppressing gold.

Second, gold is a dagger pointing at the banking system's heart because virtually all Wall Street professionals, the establishment news media, and academia use the price of gold as a leading indicator of inflation. Money creation (a.k.a. bank credit expansion) and the profits that flow from it depend on interest rates staying low.

An increase in the gold price would signal imminent inflation initiating a chain of events that would be very detrimental to the banking system:

- Interest rates would be bid up;
- Business relationships that were entered into based on lower interest rates, e.g., almost the entire U.S. home mortgage market is now linked to variable interest rates, would begin to unravel;
- Bank assets would become impaired;
- Derivative leveraging and the mismatching of assets and liabilities, which is the essence of commercial bank credit creation, called "fractional reserve lending," would unwind;
- And, the profit bonanza would come to a screeching halt.

Simply put, if the gold price goes up, the fiat-money-induced bonanza for commercial banks and for Wall Street firms, who garner transaction fees on the fiat-money creation and who also engage in subsidized gambling, will go away. In my view, this is what Federal Reserve Chairman Alan Greenspan was alluding to when, before the Committee on Agriculture, Nutrition, and Forestry, U.S. Senate on July 30, 1998, he testified: “. . . central banks stand ready to lease gold in increasing quantities should the price rise.”

Either honest monetary weights and measures prevail or fiat money prevails. There is no possible compromise:

Given the amounts at stake not only for commercial banks, but also for Wall Street firms and for those who profit from fiat money, it should be no surprise that they have acted to hammer gold. Gold industry participants are in mortal combat with the banking system over the money issue. Their product is being denigrated, its market is being manipulated, and they are increasingly being driven out of business. At the end of the day, either gold wins or fiat money wins. For the sake of ordinary people all over the world who depend on stable monetary weights and measures for their pensions, their savings and their jobs, fair-minded people must ensure that gold wins.

Fiat money is succeeding because of coercion, misrepresentation and nondisclosure. Because fiat money has proved a failure in so many countries, wiping out the savings, pensions and jobs of hundreds of millions, it is exceptionally vulnerable and absolutely can be defeated. If the gold industry wants to remain in business and prosper, then fiat money must be attacked. There is simply nothing else that is being done or can be done that will substitute for this.

The right thing to do:

There is a closing window of opportunity for the gold industry to endorse and encourage the burgeoning movement to restore honest monetary weights and measures (Honest Money). The benefits to the gold industry--and particularly to the mining companies--will be beyond imagination.

More importantly, there is a moral obligation to help mitigate the damage being perpetrated by fiat money upon ordinary people. By supporting the Fight for Honest Monetary Weights and Measures, the gold industry will not only help to reduce the suffering, it will be bringing into public view an appalling injustice. For myriad reasons, this is the right thing to do.

Lawrence Parks is the Executive Director of the Foundation for the Advancement of Monetary Education (FAME). He has broad experience in academia, in business, and in finance. He holds a Ph.D. in Operations Research from the Polytechnic University. Dr. Parks has studied the money issue for more than thirty years. His writings have appeared in *Pensions & Investments*, *The Economist*, *The Washington Times*, *The Freeman*, *The Free Market*, *The United States Congressional Record*, *National Review*, and others. He is a columnist for *The Money Review*.

He is an active member of many civic and social organizations, a member of The Workers Education Local 189, CWA AFL-CIO, The National Writer's Union, UAW 1981, AFL-CIO, and he is a frequent speaker on the Fight for Honest Monetary Weights and Measures. His focus is on how our present fiat monetary system operates to destroy savings, pensions and jobs and what to do about it.

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