A Guide to Sound Money

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SoundMoneyProject.org

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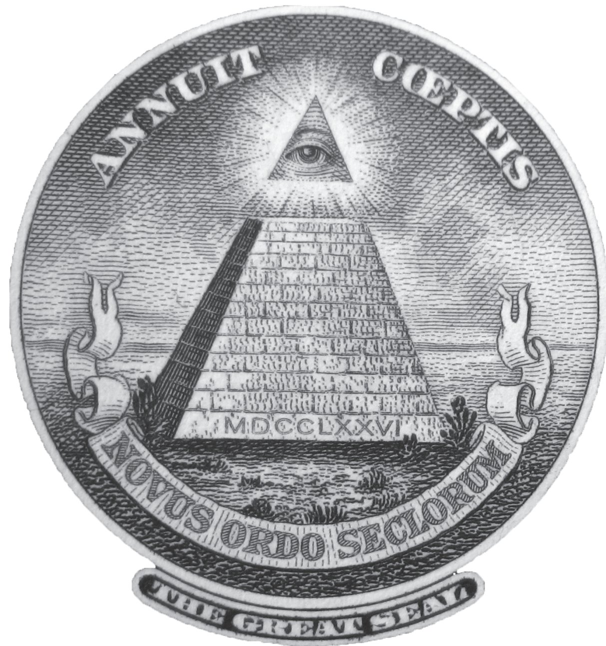

A Guide to Sound Money

We all use it every day.

Most people think about it a lot.

But when have you actually stopped to consider what money is – what it means, what it stands for?

Let's do it now. Open your wallet and take out a dollar.

What you will notice first about this green-tinged piece of paper – all U.S. banknotes measure 2.61 inches wide by 6.14 inches long – is the imagery. If you are holding a one-dollar bill, you no doubt recognize the portrait of our nation's first president, George Washington, encased in an oval frame. He seems to gaze back at you.

Turn it over now and you will see the powerful symbol of a pyramid with an "all-seeing eye" at its apex. The pyramid is meant to denote strength and duration, while the floating eye signifies divine guidance in the American cause. An inscription in Latin in printed above, *Annuit Coeptis*, which translates as "He Favors Our Undertakings." There's a banner below imprinted with another Latin phrase, *Novus Ordo Seclorum*, meaning "A New Order of the Ages."

It refers to the new era launched in 1776 by the Declaration of Independence – The American Era.

Every one-dollar bill printed by the federal government carries the Great Seal of the United States, an emblem used to authenticate official documents. It evolved from designs contributed by our nation's most prominent Founders – Benjamin Franklin, John Adams, Thomas Jefferson – who drew on symbolism to express their deepest hopes for a new nation. They wanted to convey their commitment to the experiment, and they wanted the world to recognize America's sovereignty.

The Founders were keenly aware that America's bold approach to organizing civil society under the overarching principle of personal freedom could potentially change the destiny of mankind. It was based on a radical concept: self-government. And it relied on the essential

notion of natural rights granted by our Creator – a remarkable theory that meant citizens were deserving of equal rights and equal protection under the law.

On the reverse side of the Great Seal are the Latin words, *E Pluribus Unum*, proclaiming "Out of Many, One." And indeed, it is faith in the American idea that unites us, the shared belief that individual liberty can be wholly consistent with a profoundly moral nation. The daring commitment to self-rule invoked by our Founders would prove justified by the ability of Americans to thrive and prosper when entrusted with economic freedom and personal responsibility.

Larger denominations of U.S. paper currency feature not only a selection of leaders from America's past – Washington, Jefferson, Franklin, Hamilton, Jackson, Lincoln, Grant – but also several notable institutions. The $5 bill portrays the Lincoln Memorial, the $10 bill shows the U.S. Treasury, the $20 bill has the White House, the $50 bill depicts the U.S. Capitol, and the $100 bill offers a representation of Independence Hall.

The images printed on our currency are meant to underscore our belief in the great American experiment. They are aimed at providing assurances that our nation's confidence in self-government is merited.

And on all U.S. forms of money – every banknote, every coin – you will see the declaration: "In God We Trust."

It's a sobering thought that should serve to remind us that we must *never* take our money, or our unique form of self-rule through accountable government, for granted.

Alas, the integrity of U.S. currency cannot be guaranteed by appealing to an authority beyond human control. When it comes to government-supplied money, you cannot outsource trust by invoking the Creator. Instead, it's important to realize that money is a man-made invention of sorts – a useful innovation arising from the marketplace.

It is our responsibility, as self-governing citizens of the United States, to demand *sound money* that will remain useful for future generations and ensure that the sanctity of the American idea prevails.

We Need to Define Sound Money

So what is sound money? It need not be complicated. In fact, it *should not* be complicated.

Money is sound when it embodies the same virtues we all try to nurture in our children: honesty, trustworthiness, reliability.

- Sound money is *honest* money in that it accurately conveys price signals and reliably serves as a store of value.
- Sound money is *trustworthy* and *reliable* in that it functions as a meaningful unit of account so that market participants – consumers and producers, investors and entrepreneurs – can make informed decisions and rational plans.

In defining sound money, we must go beyond the purely economic functions of money. It is also necessary to ensure that money cannot be used to expand government powers over a free society.

The reason the Founders sought to restrain money powers granted to government is because they understood the potential for encroachment on individual rights. As explained later by Ludwig von Mises, one of the leading proponents of the Austrian school of economics:

> It is impossible to grasp the meaning of the idea of sound money if one does not realize that it was devised as an instrument for the protection of civil liberties against despotic inroads on the part of governments. Ideologically it belongs in the same class with political constitutions and bills of right.[1]

We must therefore deepen our understanding of sound money with these additional precepts:

- Sound money ensures true economic outcomes; its integrity should be upheld as a vital element of free markets rather than corrupted as an instrument of government policy.
- Sound money encourages responsible fiscal practices by restraining governments from using monetary policy to accommodate or disguise fiscal failures.

Only if government is prevented from abusing the privilege of issuing the nation's money can it be trusted with this powerful authority.

Core Principles of Sound Money

I. Honesty in Money — Money should serve as an honest measure and a reliable store of value.

The purpose of money is to serve as an honest measure, a convenient means for conducting voluntary transactions between individuals. If both parties accept its validity as a medium of exchange – if both sides deem it worthy of trust – then money can perform its primary function.

But if the value of money is somehow compromised by government control over its issuance, then it loses its reliability. If too much money has been issued, so that the value of money is subtly diluted, it can cause people to misinterpret price signals and make wrong decisions. If money garbles the message of actual demand and supply, it undermines the way free markets are supposed to work. Ultimately, the excessive issuance of money and credit results in a financial "bubble" that causes severe damage to the real economy when it finally bursts.

Instead of helping people make informed decisions – whether to buy or sell, whether to consume or save – money that is subject to government manipulation induces different behavior than would be rational. It confuses those who bring their goods and services to exchange in good faith. When money gives misleading signals, it leads to inferior economic results. Ultimately, it causes people to doubt the wisdom of free markets.

As the Founders well understood, the key to success for sustaining a self-governing people is to place limits on power. Even well-meaning officials have an innate tendency to misuse authority; the urge to impose sweeping directives rather than rely on the practical wisdom of individuals to forge their own economic way is nearly irresistible.

The best way to unleash human potential is through private enterprise – a truth the Founders also recognized – which is why they sought to limit the money powers granted to government through the Constitution. They had witnessed the devastating financial consequences of excessive monetary issuance when various state governments conferred legal tender status on their "bills of credit" after the Revolutionary War.

The lesson was clear: To comply with the principles of democracy and free market capitalism, money must be sound. Otherwise, money all-too-easily becomes an instrument of government tyranny. Instead of providing a common point of reference for a free people, instead of serving as an honest measure – money that is not sound furnishes government with a convenient means of deceit.

Today we need to reaffirm the importance of sound money as the only proper foundation for a free society. We must address the task of defining sound money in a modern world. As U.S. citizens, we have the right – the obligation – to question whether the money powers currently exercised by our government are consistent with the intentions of the Founders.

It's a profoundly important matter. Equal rights, rule of law, personal property, and individual liberty: Our most fundamental values are all involved, all at stake. And just as the American idea itself encompasses the aspirations of mankind in a much larger context, the way we take up this pressing challenge will have major ramifications beyond our shores.

II. Free Markets Need Accurate Money — Money should convey price signals with clarity so that free markets can operate efficiently.

To fully appreciate the vital role of sound money in a free market economy, we should think first about how money is used, how it comes into being. We use it to pay for what we want, of course. But one of the key attributes of money is that it makes it possible for people who are strangers to voluntarily carry out economic and financial transactions with each other.

That is really the miracle of money – the fact that people trust it at all.

Why would an intelligent person trade food or clothing, or anything valuable in terms of survival, for a mere slip of paper with writing on it? Transactions take place only if that piece of paper *means* something to both parties. The individual who receives it must be just as aware of the paper's value as the one who gives it; when the paper has been exchanged, both parties know that a deal has been struck at a specific price.

The transaction is concluded when the sum of money representing the agreed price for whatever was voluntarily traded between two individuals has been transferred. Whether the two people know each other – whether they have lived in the same community for years or have never met – makes no difference. So long as they both deem the money acceptable as

the **medium of exchange**, they can do business together. Indeed, even if the two parties involved *don't* trust each other, it makes no difference. What matters is that they trust the medium of exchange. When money can be trusted, individuals participate confidently in the marketplace.

Money's important contribution is that it simplifies not only the economic transaction itself, but the very lives of the individuals who use it. If every decision to buy something required finding someone who had what you wanted, and furthermore, that same person would have to want what you have to sell for it – clearly, life would be very much complicated. Barter is an inefficient way to conduct daily affairs.

By designating some kind of recognized common denominator of value as the appropriate means of payment for goods exchanged or services provided, society has much to gain. Necessity is the mother of invention; money is that invention. More formally, it's the social convention that emerges spontaneously to fulfill people's need to have a common means of exchange for carrying out economic and financial transactions.

Money's other important function is to provide a reference point for evaluating everything that is brought to the marketplace. By serving as the **unit of account**, money is thrust into a critical role; its reliability determines just how efficiently an economy can operate.

Money should accurately convey what something is worth. Individuals need to be able to reach agreement to exchange goods or services of prices expressed in units of the common money unit. Does that $10 bill with the prominent visage of Alexander Hamilton equate in value to the package of socks one wishes to buy? Or the taxicab ride just rendered?

The unit-of-account function is vital even when there is no difference in the *intrinsic* value of one denomination of paper money versus another. That is, no one would wish to accidently overpay with a $20 bill instead of a $10 bill simply because of inattention to the printing on the paper. Yet the only difference between the two banknotes is that one has the number 20 printed on its corner while the other has the number 10. Both of them are still just paper.

The reason a $20 banknote is considered twice as valuable as a $10 banknote is because it represents twice as many dollars. This is despite the fact that both pieces of paper contain the same amount of cotton (75%)

and linen (25%), both weigh about 1 gram, and both notes cost about four cents to produce.

Paper money is merely a stand-in for actual value. It provides a unit of measurement that allows us to compare the cost of goods, services, or assets. When all marketplace participants can evaluate potential exchanges in terms of the same monetary unit, free markets bring about optimum outcomes. But if that same unit of account distorts value over time, the whole calculation goes wrong. If the money is an unreliable **store of value**, free markets are confounded.

This is because many transactions involve the passage of time. By providing a common point of reference for all parties concerned, money reduces uncertainty in economic and financial markets. But it is imperative that money be deemed reliable both now and into the future. People are willing to invest funds today in anticipation of rewards tomorrow because they believe they will not be defrauded by a change in the unit of account. If the value of the money received in the future is decreased – if each unit, say, each dollar, is worth less than at the time the deal was agreed – then the investor has been cheated.

It's this moral dimension that underscores the importance of trustworthy money. The willingness to work and sacrifice for the sake of future prosperity is a universal human quality – the hallmark of entrepreneurial faith – but people must believe there is a link between effort and reward. Money forges that link by providing a dependable store of value.

Free market capitalism depends on people's willingness to forego consumption today to provide the resources that will enable a greater standard of living in future years. By investing their saved financial resources – the "seed corn" – in projects that have the potential to yield *productive gains*, these everyday "capitalists" raise their own economic prospects. At the same time, they perform a vital social function by helping to bring about future economic prosperity for society as a whole.

Faith in the future is a necessary component of democratic capitalism. The individuals who seek a positive return on their savings make it possible for an entire nation to benefit from economic growth. Together with the inherent optimism that is an indispensable trait of entrepreneurship, it is this belief in a better future that leads to economic success. Economic success, in return, reinforces belief in free enterprise.

But the readiness to make one's savings available for investment can be severely undermined by suspicions that the money denominating the terms of the agreement cannot be trusted. If the value of money is not consistent through time, if the unit of account slowly deteriorates over the life of a contract, an honest deal is turned into a scam. If money does not provide a store of value by maintaining its purchasing power – it fails the test as a monetary standard.

Money must tell the truth by holding its worth. It's imperative for the proper functioning of free markets. Money must be honest not only at the moment an economic transaction is conducted; it must also maintain the validity of financial contracts through time. Money is meant to serve as a stable benchmark.

III. Clear Price Signals Are Key to Economic Stability — When price signals are distorted through loose monetary policy, economic resources are misallocated and financial capital is misdirected.

Free markets operate at maximum efficiency when money fulfills its primary functions by serving as a broadly recognized medium of exchange, an accurate unit of account, and a dependable store of value. Producers and consumers in the marketplace can make meaningful judgments about the relative value of goods and services by comparing prices. Depending on levels of supply and demand, transactions will tend to occur at the point where one obtains the highest quality for the lowest price. At this optimal value, markets are said to "clear"; in other words, people wishing to purchase a particular item will proceed to do business with people wishing to sell when the price is right.

For some goods or services, it may not be quality so much as quantity that is important to the buyer. In such cases, demand and supply are mostly driven by price. For the consumer it means: The cheaper I can get it, the more I will buy. For the supplier it means: The cheaper I can produce it, the more I will sell.

When goods and services are price sensitive, it is particularly important that price signals are clear. Otherwise, mistakes are made that cause economic inefficiencies. If buyers suffer an unexpected loss of purchasing power, they cannot maintain earlier consumption levels. If suppliers have to raise prices to stay even with inflation, they could end up with excess

goods or unsold services.

The key is to bring supply and demand into balance – to reach equilibrium. Free market pricing makes it possible; it's the mechanism through which the interests of buyers and sellers are reconciled at optimum levels. Even if buyers might wish to pay a lower price, and sellers might wish to receive a higher price, the interplay of demand and supply determines the actual price at which transactions occur. Free market pricing – where markets are genuinely competitive, with different choices available – enables this process to occur to the benefit of all participants.

That free market pricing actually works is a testament to the power of clear price signals. The economic aspirations of millions of individuals work themselves out in the marketplace as sellers and buyers resolve their needs and desires. Prices convey the relative values of goods and services by sending clear messages about demand and supply at various levels of quality. All those messages are transmitted through one vital instrument: money.

Money is the sole means of communication for price signals, and moreover, it's a two-way channel: Prices not only broadcast information to potential buyers, they also provide feedback to sellers about whether to increase quantities through higher production, improve quality through innovation, or both.

So it is very important that money speaks in a clear language. It must describe the current state of demand and supply with clarity and conciseness. The market for any good or service requires accurate price signals to reach optimal equilibrium among buyers and sellers. This is true as well for financial markets; clear price signals make it possible to synchronize the independent financial choices of millions of people at maximum levels of economic efficiency.

Most wondrous of all: No conscious coordination or central plan is needed to make it work.

IV. Integrity in Money — Sound money forges the link between effort and reward by providing a dependable store of value over time.

But the entire process depends crucially on the integrity of the money.

Price signals must be conveyed with honesty and accuracy. At any given moment, of course, prices may change in response to shifting factors; flexible prices reflect the dynamism of evolving consumer tastes, or the impact of technological innovations. But what must *not* change is the reliability of the unit of account to send precise messages regarding those price movements. The unit of account must be an honest messenger as it informs producers and consumers about the current state of play between demand and supply.

If money does not communicate the truth – if it distorts, mangles, or otherwise obfuscates the message – money performs a disservice to market participants. Instead of aiding them to make rational decisions, it throws them off course. What seemed to make economic or financial sense at one point in time can be turned into a bad decision.

When the value of money is not consistent through time, prices no longer communicate useful information. Prices are expressed as numerical quantities of money; if the money itself is losing value through time, prices must increase to compensate for the deteriorating unit of account – even though no additional real value has been added. For the producer, this could mean unsold inventories at the new higher price, or it could mean lower real profits at the original price. Potential consumers might opt out of buying goods or services at higher prices unless they also can be compensated for reduced purchasing power caused by the decline in the value of money.

Money is the medium, in short, and the medium is the message.

Free market outcomes are compromised when money is not an honest messenger. The miraculous efficiency of supply and demand forces is stymied; instead of reconciling buyers and sellers through competitive bids conveyed through accurate price signals, imbalances start to occur on one side or the other. Investment opportunities aimed at raising future production may seem too risky when future prices are uncertain; as a result, potential economic growth is forfeited.

Whether the distortions to price signals caused by unsound money lead to shortages or excesses, market efficiency is grossly impaired. Worse, unsound money undermines the basic tenets of a free market system, prompting questions about whether such a disorganized process delivers superior results to central planning.

V. Ability to Plan Ahead — When money can be trusted, individuals are able to plan ahead with confidence.

What makes the difference between an economy that operates to deliver optimal levels of prosperity – and an economy plagued by debilitating uncertainty? The answer centers on the ability of individuals to plan ahead with confidence.

The confidence relates directly to economic freedom in a stable business environment. When entrepreneurs can make rational plans based on clear price signals, they can confidently expect to generate profits through productive activities. When potential buyers can anticipate future expenses based on foreseeable prices, they can confidently work out prudent budgets that include new purchases.

Economic performance is based on planning – and planning is vitally dependent on meaningful price signals. The clarity of the price signal is directly related to the quality of the money. Sound money is the ultimate planning tool for entrepreneurs; it is the ultimate accounting tool for responsible individuals.

When money does not transmit meaningful price signals over time, it marks the beginning of disenchantment with individual planning, and hence, belief in the power of free enterprise to deliver prosperity through innovation.

When money does not function as a consistent unit of account, it conveys deceptive messages to the very people willing to forego consumption for the sake of providing the necessary capital to generate higher future production. Instead of raising future consumption levels, their precious financial resources are misdirected, even wasted. When money loses its value over time, they are deceived; instead of enjoying increased purchasing power in the future, they end up with less.

False money causes false choices. When money does not serve as a reliable store of value, it plays investors for patsies and transforms savers into suckers.

Dishonest money is an insult to free market capitalism.

We know the fundamental cause of monetary distortion: inflation.

Excessive issuance of money dilutes the unit of account so that market participants are induced to make economic and financial decisions based on artificial price signals. Inflation not only distorts relative prices so that buyers are confused about real value – consider the housing sector – it also artificially stimulates new production in response to false demand.

When individuals are spurred by what seems to be a perpetual rise in home prices, they seek to become homebuyers. Construction increases disproportionately in comparison to other economic activities. Plentiful financing becomes available for housing, with loans allocated beyond justifiable levels. As price signals convey false messages, labor and construction materials, as well as credit resources, are diverted into increasingly unproductive uses. Both consumers and producers are seduced by the perception that home prices will continue to move upwards. They are drawn into an unwarranted tidal wave of credit... and when the wave crashes onto the shore of economic reality it wreaks financial devastation and disillusionment.

It is monetary illusion that does the most egregious harm to our free enterprise system. Distorted price signals threaten the validity of individual economic liberty – which is why those who are not ready to concede the battle must concentrate their efforts on ensuring that money can be trusted.

VI. Consistency in the Worth of Money Over Time — The virtue of saving goes unrewarded when purchasing power is undermined by inflation.

Americans have become so accustomed to money manipulation, we hardly dare to believe we should be able to demand a dollar with consistent worth over time. It seems almost quaint to expect our money to provide a meaningful point of reference for evaluating economic and financial decisions, past and present.

We know all too well that one cannot simply observe the current price of an asset, compare it to the amount paid years earlier, and be able to straightforwardly recognize the real increase or decrease. Instead, its value must be calculated in dollars that have been "inflation-adjusted" to reflect the impact of our deteriorating unit of account.

This is true whether you are trying to assess the value of your home, your business, your savings or your investments. So much for the notion that money should be an accurate unit of account, a reliable store of value; it is always necessary to do the tricky math to get the real story.

We should be used to it, but somehow – it is always jarring. Even though we've internalized the fact that a dollar isn't worth what it used to be, it's still a shock. Though we have become sufficiently sophisticated in financial matters to distinguish between "nominal" changes as compared to "real" changes in the value of an asset, it is nevertheless surprising – and inevitably disappointing – to be confronted with the decline in the worth of our money over time.

For most people, the depressing reality sets in when assessing the value of a house purchased many years earlier. Say you bought a house in 1990 for $200,000, and you estimate you could sell it today for $300,000; it might seem reasonable to assume you had achieved a gain over two decades or so; after all, the current price is 50% higher than the amount paid to acquire it.

Yet no one who has resided in our nation for the last twenty years would be so naïve as to think this was factual. No one would expect today's price in dollars to convey the real value of such a major investment – the actual truth.

Instead, you would have to compute the home's real value by using inflation-adjusted dollars. To do so, you might consult the official Consumer Price Index calculator provided by the U.S. Bureau of Labor Statistics; a few swift computations later, you would be confronted with the distressing truth. What might have appeared as a healthy profit is actually a pathetic loss. The house went from being priced at $200,000 in 1990 to being priced at $300,000 in 2010 – but that doesn't mean it increased in value.

Quite the contrary. Due to the decreasing worth of the dollar over the same duration of time, the seeming gain was more than offset by the shrinking unit of account. Your house today would have to sell for $333,605 – just to break even.

Keep in mind that demand and supply for housing are not the issue here, but rather we are examining the impact of money illusion due to the loss of purchasing power in the dollar. The dollar today has only 60% of the

purchasing power it had in 1990 because of inflation; that is the stark reality of monetary manipulation.

Whose fault is that? Does it really matter?

We can answer the second question by asking ourselves whether it matters that our currency no longer fulfils its primary functions as money. The dollar is the world's leading monetary unit of account, we are aware of this fact, and we also know that the dollar is supposed to provide a store of value. So is it unreasonable to expect the dollar to perform these basic tasks by serving as a meaningful measure of value through the years?

If money is a fundamental tool for individuals who voluntarily engage in financial and economic transactions with each other – if money provides the point of reference that allows price signals to be conveyed with clarity so free markets can deliver growth and prosperity – shouldn't it work?

We should be able to make straightforward calculations of value – to measure profit or loss on our investments, or know the worth of our retirement savings – without having to adjust for the decline in the dollar year after year.

We should be able to plan ahead.

For a nation of citizens dedicated to entrepreneurship and free enterprise, we have shown surprising passivity with regard to the damaging effects of monetary distortion on American economic performance. There is no such thing as "benign" inflation; there is only deception by means of a declining monetary standard.

We can blame our own government – and its agency, the Federal Reserve – for the damaging consequences of loose money. But we should also upbraid ourselves as citizens for having so long neglected to address our government's lack of monetary accountability. The deteriorating dollar has inflicted serious economic, financial, and even psychological and moral harm on our country.

Yet we have acquiesced to government the right to corrupt this most vital component of free markets, the medium through which price signals are conveyed to people who would transact their business in good faith. We have been denied the fruits of honest endeavor because we have not

decried monetary distortion. We have fumbled the opportunity to benefit from an economy performing at its full potential for prosperity.

VII. Asserting the Right to a Reliable Dollar — Money's most important function is to provide a useful tool for private enterprise – not to serve as an instrument of government policy.

Money should rightly serve the purposes originally planned by our Founders. They required that the dollar be defined in precise weights of precious metals – gold or silver – so that citizens could rely on its intrinsic worth and plan their economic futures accordingly.

But we have assigned to the government the task of ensuring the value of the dollar without imposing restrictions in keeping with prior constitutional constraints. Instead of preserving the fundamental role of money as honest messenger in a free market economy, we have allowed it to become an instrument of government planning. Instead of insisting on a sound dollar to serve as the basis of sound government finances, we have let it become the shock absorber for federal deficit spending.

It has taken a long period of time for the transition to take place. Our current fiat monetary regime – in which banknotes issued by the Federal Reserve as legal tender are neither convertible nor fixed in terms of any objective standard of value – is a significant departure from the original definition of an American dollar as a specific weight of gold or silver. Given this slow evolution away from sound money, it is perhaps understandable that Americans became less vigilant about its integrity.

But as citizens are waking up today to the dangers of overreaching government and turning once more to the Constitution to guarantee states' rights and individual rights, the essential role of sound money in a free society is gaining renewed focus. While it is true that America moved incrementally from granting restrained money powers to Congress to allowing dollars to be issued by the Federal Reserve based on the economic priorities of government, we should not be excused for lapsed diligence.

Not paying attention to government encroachment does not absolve citizens of responsibility to safeguard the future of economic freedom. We are fortunate to live in a representative democracy; our elected officials are

obliged to reflect our will.

So if the value of the U.S. dollar has been severely degraded from its original virtue, if our money has been stripped of the capacity to function as an honest messenger relaying free market prices, we must acknowledge our own fault in allowing it to happen.

At the same time, we should take heart. We still believe in government of the people, by the people, for the people – so all is not lost. We have the power to fix it, to reclaim the dollar as a true monetary standard. The redeeming grace of democracy is that we can get back on track.

Clearly, America lost sight of the fundamental necessity for sound money to guarantee economic and political rights. But now we have come to see that the low fever of steady inflation is malignant to free markets. Misallocations of resources and misdirected capital flows distort future outcomes. Economic performance suffers as a result – and this is true even when the Consumer Price Index registers only mild price increases for a specified basket of goods and services.

What we have learned is that, despite Federal Reserve denials of policy mistakes, huge monetary bubbles can develop in markets for real estate, commodities, financial derivatives – or even money itself, with currencies traded daily by the trillions.

When the bubble bursts, the financial blowback imposes its heaviest burden on the real economy. People who had no personal involvement in runaway financial markets end up suffering real economic consequences as global meltdown takes its toll at the local level. And it's little comfort to be informed that inflation is "subdued" – not when you are trying to salvage your small business in an economy that has succumbed to fear, not when your neighborhood bank refuses to make loans.

Yet nothing will change in this boom-and-bust cycle until Americans decide that monetary policy is important. We must put an end to dollar distortion; we must demand money we can believe in, money we can trust. Constraints on monetary issuance must be imposed once more so that our government cannot debase the dollar for its own purposes.

Money and credit should serve the real economy, not function as cheap tokens in a speculative game; it's a lesson we have learned the hard way.

But honest money won't happen unless we take action to bring it about. If we are to restore value to the dollar, we must specify the constraints under which dollars can be created. And we must lay out the sound money principles that will guide our efforts.

VIII. Constitutional Imperative in Money — The Constitution gives authority to Congress to "coin" money, not print it, in keeping with the Founders' intention to prevent abuse of money powers.

Sound money can be defined in different ways, depending on how stringently one wishes to constrain its issuance. For some, it must have its own intrinsic value, usually derived from precious metals; those who have a general distrust toward overly powerful government are more comfortable when the value of money is safely removed from discretionary authority.

This is the path taken by the Founders, who restricted the right of coinage to gold and silver. Congress was granted authority to "regulate" the value of money in the Constitution (Article I, Section 8), but this was conveyed in the same sense as the power to fix the standard of weights and measures for the new nation; both of these duties are authorized in the same sentence. The power to coin money and regulate its value was strictly disciplined by defining the U.S. dollar in terms of a specific weight of gold or silver.

In an updated approach, the soundness of the dollar might be pursued by ensuring the convertibility of paper money on demand, or by linking it to precious metals through government-issued bonds. Or some might argue that it would be sufficient to allow gold and silver to circulate alongside dollars; this would allow currency competition, but economists point out that "Gresham's Law" would likely take effect. That is, if the dollar had to be accepted as legal tender at the same value as gold or silver, the "bad" money would drive out the "good" money from circulation.

Another way to restrict the issuance of dollars would be to impose a commodity price rule that would govern actions taken by the Federal Reserve to contract or expand the money supply. Some would suggest that merely targeting inflation provides a sufficient rein on monetary creation; however, we have seen that dangerous monetary bubbles can arise even when inflation appears under control. Others insist that the government balance the federal budget, at the very least, so that future

deficits cannot be financed through misuse of the monetary privilege. One thing is clear: A growing number of Americans recognize that sound money, and sound government finances, must be part of the solution to runaway spending and the debilitating lack of certainty in our nation's economic future.

The relationship between fiscal and monetary measures taken by government is dangerously interlinked – such that a grave conflict of interest exists. While it may seem ironic now, Alan Greenspan, former chairman of the Federal Reserve, expressed concern over this very situation decades ago. In an essay entitled "Gold and Economic Freedom," published in 1966, he noted the ambitions of statists to promote expansionist government through unlimited credit creation and concluded:

> Deficit spending is simply a scheme for the "hidden" confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights. If one grasps this, one has no difficulty in understanding the statists' antagonism toward the gold standard.[2]

Greenspan's appreciation for the fiscal discipline imposed by gold convertibility can also be discerned in his 1981 op-ed piece for *The Wall Street Journal* wherein he recommends the issuance of gold-backed Treasury notes to curb government profligacy. "The redemption of dollars for gold in response to excess federal government-induced credit creation would be a strong political signal," Greenspan explains. "Gold notes could be a case of reversing Gresham's Law. Good money would drive out bad."[3]

It's interesting to speculate how things might have turned out differently. Had the U.S. adopted such a proposal at the time, during the tenure of President Ronald Reagan, our monetary compass might well have been locked onto a more stable course.

IX. Limiting Government Intervention — The more power we grant to government to determine the value of money, the more helpless we become as masters of our own economic fate.

Once you realize that the collective intelligence of free people operating in free markets brings about superior economic results than those obtained through government central planning, the need for sound money is clear. When money tells the truth about demand-and-supply conditions, individuals are fully capable of making rational economic decisions that

improve their daily lives and future prospects. Moreover, when money provides a store of value, capital is drawn toward its most productive use; the innovations spawned by entrepreneurial opportunity increase future levels of prosperity.

We just need money that does what it's supposed to do: Give clear price signals so that individuals in the private sector can draw their own conclusions about what is in their best economic interest and take actions accordingly.

Free enterprise trumps government-engineered results because it unleashes the creative potential of individuals. But it requires valid price signals to make it all work; this is what makes the case for sound money intertwined with the case for democratic capitalism itself.

Government officials have an innate predilection to seek greater power over the lives and decisions of citizens – even over the value of the money they use to make choices. If government has the right to manipulate the monetary standard itself, it can distort price signals as needed to accomplish its own political objectives. And if government takes advantage of its authority to spend the peoples' purse and impose future debt burdens on citizens yet unborn, then the potential for corruption knows no limits.

Determination to limit government powers is what impelled the Founders to prevent such adventurism through constitutional restraint. Yet faith in the people is validated only to the extent that citizens accept the challenge of self-government. Responsibility cannot be blithely entrusted to elected officials; nor can it be entrusted to appointees heading obscure yet powerful federal agencies.

So now we face a government-controlled monetary regime so expansive and powerful that Americans hardly dare question its influence over financial markets or its authority to alter economic outcomes. The Federal Reserve takes the position that its policies are paramount, whether it redirects the flow of capital by manipulating interest rates, or distorts fundamental parameters of risk and return in the financial marketplace. The Federal Reserve justifies its intervention by claiming a higher economic or social objective.

Meanwhile, this agency of government exerts inordinate control over

the behavior of individuals who would prefer to exercise free market choices. And as the Founders rightly feared, when government becomes too powerful a force in people's daily lives, it saps not only the creative energies that might have yielded greater results for society as a whole – it also undermines individual confidence. The more dependent we become on government to tell us what our money is worth, the more power we concede to government to determine our economic destiny.

Through monetary expansion, the Federal Reserve creates asset price inflation – affecting stocks and bonds – and encourages short-term speculation. It also misleads business owners into thinking they have become more profitable; this encourages overexpansion and unwarranted hiring, leading to future unemployment when the inevitable bust occurs. Violent contractions of credit are wasteful and destabilizing, causing dissension among citizens who blame fellow victims of misleading price signals when the real culprit is the force behind monetary illusion.

The Federal Reserve, by its existence, thwarts a free-market approach to setting the cost of capital. It serves the needs of government by standing ready to purchase federal debt securities. It can reduce the cost to government of financing its debt; keeping interest rates inordinately low makes it cheaper to borrow from domestic and foreign lenders. To the extent low interest rates overly expand the monetary supply and cause inflation, the government effectively repudiates a portion of its debt through reduced dollar purchasing power. Loose money also cheapens the value of the dollar relative to foreign currencies – artificially boosting exports and undermining the principles of free trade.

All of these misuses of monetary powers granted to government argue against continuing with our status quo approach to managing money through an unrestrained Federal Reserve. If we are to fight back against such unhealthy practices, we must address the need for fundamental reform of monetary policy.

X. Sound Money Would Restore America's Strength — A sound dollar would be a testament to our national values and founding principles.

Americans rely on free markets to make rational decisions. We must have a reasonable sense of certitude about the future; we must be able to assume that today's prudent financial decisions will bring forth fruit. This

includes being able to devote a portion of our money to savings with the expectation that it will yield a positive return. Free market capitalism recognizes that the act of saving is not only the enabling factor for future economic prosperity – it's a moral virtue.

But without the ability to make accurate judgments about the dollar's worth going forward – without confidence in our money as a store of value – it's impossible to have any real faith in our capacity to plan ahead.

Americans have become far too accustomed to the hidden plague of inflation, far too submissive in accepting monetary expansionism even when the economy is performing at levels far below its capacity. We need to let prices find their natural level; it's the only way industrious people can respond logically to genuine conditions of demand and supply.

When demand is temporarily reduced, as individuals reassess their prospects in the wake of a recession, and when unemployment is stubbornly high – these are not reasons to apply more monetary "stimulus" to trick people into making choices on the basis of misleading price signals. We should hardly observe any rise in consumer prices, let alone commodity prices, when demand is low. And if we wish to raise demand, what better way than to restore normal rates of interest so that savers are compensated for providing funds for productive capital investment?

Instead, we are left to interpret the nuanced statements of Federal Reserve officials who hint of perversely low interest rates for the indefinite future. Meanwhile, we observe worrisome trends in currency and commodity markets indicating that some future monetary bubble may be forming even now. Once again, our retirement plans are at the mercy of the next money meltdown.

Friedrich A. Hayek, who received the 1974 Nobel Prize in Economics, warned about the dangerous tendency to acquiesce individual liberty to government oversight under the spell of an eroding monetary standard:

> The increased dependence of the individual upon government which inflation produces and the demand for more government action to which this leads may for the socialist be an argument in its favor. Those who wish to preserve freedom should recognize, however, that inflation is probably the most important single factor in that vicious circle wherein one kind of government action makes more and more government control necessary. For this reason, all those who wish to stop the drift toward increasing

> government control should concentrate their efforts on monetary policy. There is perhaps nothing more disheartening than the fact that there are still so many intelligent and informed people who in most other respects will defend freedom and yet are induced by the immediate benefits of an expansionist policy to support what, in the long run, must destroy the foundations of a free society.[4]

If we are to retain the freedoms our Founders believed we were capable of holding, if we are to preserve a free society, we must reassert our constitutional right to sound money. We must demand the restoration of an honest dollar.

For too long, we have ignored the powerful images and inspirational creeds that we carry on our dollar bills. The symbols etched on U.S. money represent our heritage, our destiny; they pay homage to America's daring experiment in self-government and self-determination. But instead of reminding us to stay vigilant to our original principles and values, they now silently upbraid us for our passive submission to the oldest exercise of tyranny against citizens: Debasing the currency.

Thomas Jefferson wrote in 1784: "If we determine that a Dollar shall be our Unit, we must then say with precision what a Dollar is."[5]

For the Founders, the dollar could only be defined in terms of precious metals; the Coinage Act of 1792 fixed the value of the dollar at 371.25 grains of pure silver or 24.75 grains of pure gold. Recognizing the potential for excessive monetary issuance through paper currency or credit, the government was not empowered to issue "bills of credit" that had to be accepted as legal tender. For Mr. Jefferson, the establishment of a national bank with vast money powers to raise funds for government would be a violation of the Tenth Amendment, going far beyond the enumerated powers described by the Constitution.

Today our nation's money is issued by an agency so aligned with the fiscal interests of the U.S. government – the Federal Reserve stands ready to make unlimited purchases of Treasury securities – that any attempt to suggest it operates independently is simply not credible.

Now is the time to reclaim our monetary heritage as we take back our government. We need to examine new proposals to restore soundness to the dollar. Various approaches have been put forward – from linking the

dollar to gold, to constraining the Federal Reserve through specific rules, to putting an end to deficit spending – and all deserve serious consideration. The American people have suffered enough from fiscal and monetary policies that distort economic outcomes; we are ready to take our money straight. Given the damage inflicted as a result of loose money and excessive government involvement in private markets, it's hard to argue that we cannot do better.

Certainly, we cannot afford to go through yet another boom-and-bust cycle with its demoralizing consequences for our nation and the world. The dollar's primary role in world financial affairs is the most vital nonmilitary instrument of our national power. Pledging to maintain the fixed rate of convertibility between gold and the dollar under the Bretton Woods international monetary system in 1963, President John F. Kennedy affirmed: "The security of the dollar involves the security of us all."[6]

If we are to return to a secure world based on sound economic and financial practices – if the American Era is to continue to inspire people everywhere – we must take action to secure the value of the dollar. Our nation began as a new idea that would liberate individuals to pursue their dreams. What a travesty if that vision should succumb to the age-old practice of currency devaluation that has destroyed empires throughout history. What a tragedy if the United States should neglect the opportunity to restore its economic strength and fundamental ideals by reasserting its belief in sound money.

We must dare to be bold, even radical, in putting our nation back on the right track. While there are different approaches to achieving sound money, they all embody the same core principles. They all seek to restore America's monetary integrity. In the words of Jack Kemp, an American statesman and economic conservative:

> I am a radical believer in the idea that the dollar should be so honest, so sound, so trustworthy, so good, so predictable, so lasting in value, that it's as good as gold.[7]

The task of restoring sound money is worthy of our finest efforts. It's a cause we should proudly champion, a promise to future generations, in keeping with our highest principles. We cannot permit America to go the way of spendthrift nations and failed ideologies. The dollar should be as honorable and steadfast as the American idea itself.

Notes

1. Ludwig von Mises, *The Theory of Money and Credit* (Indianapolis: Liberty Fund Press, 1912), p. 455.

2. Alan Greenspan, "Gold and Economic Freedom," reprinted from *The Objectivist*, July 1966, in Ayn Rand, *Capitalism: The Unknown Ideal* (New York: New American Library, 1966), p. 95.

3. Alan Greenspan, "Can the U.S. Return to a Gold Standard?" *The Wall Street Journal*, September 1, 1981.

4. Friedrich A. Hayek, *The Constitution of Liberty* (Chicago: The University of Chicago Press, 1960), pp. 338-39.

5. Thomas Jefferson, "Notes on the Establishment of a Money Mint, and of a Coinage for the United States," April, 1784, from *The Works of Thomas Jefferson*, Federal Edition (New York and London: G.P. Putnam's Sons, 1904-5). Vol. 4.

6. John F. Kennedy, Address at the Meeting of the International Monetary Fund, September 30, 1963. Available at www.presidency.ucsb.edu/ws/?pid=9444.

7. "The Speech: Jack F. Kemp; 'The Dollar Should Be So Trustworthy, So Good, That It's as Good as Gold'", *New York Times*, January 12, 1988.

Core Principles of Sound Money

I. **Honesty in Money** - Money should serve as an honest measure and a reliable store of value.

II. **Free Markets Need Accurate Money** - Money should convey price signals with clarity so that free markets can operate efficiently.

III. **Clear Price Signals are Key to Economic Stability** - When price signals are distorted through loose monetary policy, economic resources are misallocated and financial capital is misdirected.

IV. **Integrity in Money** - Sound money forges the link between effort and reward by providing a dependable store of value over time.

V. **Ability to Plan Ahead** - When money can be trusted, individuals are able to plan ahead with confidence.

VI. **Consistency in the Worth of Money Over Time** - The virtue of saving goes unrewarded when purchasing power is undermined by inflation.

VII. **Asserting the Right to a Reliable Dollar** - Money's most important function is to provide a useful tool for private enterprise – not to serve as an instrument of government policy.

VIII. **Constitutional Imperative in Money** - The Constitution gives authority to Congress to "coin" money, not print it, in keeping with the Founders' intention to prevent abuse of money powers.

IX. **Limiting Government Intervention** - The more power we grant to government to determine the value of money, the more helpless we become as masters of our own economic fate.

X. **Sound Money Would Restore America's Strength** - A sound dollar would be a testament to our national values and founding principles.

About the Author

Judy Shelton is an economist with expertise in global finance and monetary issues. She is Co-Director of the Sound Money Project at the Atlas Economic Research Foundation. Author of *The Coming Soviet Crash* (1989) and *Money Meltdown* (1994), her international economics articles have been published by *The Wall Street Journal, New York Times, Washington Post, Financial Times, Nihon Keizai Shimbun* and *El Economista*. She has given expert testimony before the Joint Economic Committee, Senate Banking, Senate Foreign Relations, House Banking, and House Foreign Affairs committees. She is a former senior research fellow at the Hoover Institution (Stanford University) and was professor of international finance at DUXX Graduate School of Business in Monterrey, Mexico. She was a staff economist for the National Commission on Economic Growth and Tax Reform chaired by Jack Kemp (1995-96) and has served on the boards of Hilton Hotels and Atlantic Coast Airlines. In January 2010 she was named Vice Chairman of the Board of Directors of the National Endowment for Democracy; she is the Board's regional expert on Russia, Ukraine and Belarus and also serves on the Budget and Audit Committee. Dr. Shelton holds a Ph.D. in business administration from the University of Utah.

About *A Guide to Sound Money*

A Guide to Sound Money is a joint project between the Atlas Economic Research Foundation and the FreedomWorks Foundation.

About Atlas Economic Research Foundation

Since 1981, Atlas has helped develop independent think tanks, in the U.S. and around the world, that can move public policy debate in the direction of greater liberty. The Atlas network now involves more than 400 think tanks in 80+ countries. Atlas programs and services connect these organizations to the tools, training, and resources they need to succeed.

Atlas launched its Sound Money Project to encourage more institutes to develop and promote constructive solutions to current monetary problems. Atlas does not accept government funding, and depends entirely on voluntary contributions. To learn more about Atlas, and how you can help, visit *AtlasNetwork.org*.

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"All those who wish to stop the drift toward increasing government control should concentrate their efforts on monetary policy."

F. A. Hayek, *The Constitution of Liberty*