the Henry George News

PUBLISHED BY HENRY GEORGE SCHOOL OF SOCIAL SCIENCE • MARCH 1968

# From Gold to Token Money

by MITCHELL S. LURIO

THE question of the desirability of an adequate gold reserve to back up our currency and demand bank deposits has always been debatable among students of Henry George. Because opinions differ widely, a variety of courses by individual exponents has been offered at Henry George extensions, all designed to eliminate what their originators considered to be the weaknesses of the present money system. The subject is of special interest in view of recent events, and I have just completed a course on "Gold, Money and Devaluation" at the HGS in Boston.

It is natural to compare values in terms of familiar commodities that are scarce, desirable and susceptible of measurement in homogeneous units. Many forms of wealth have served as a measure of value in the past, and gold was used in this capacity more than sixty centuries ago. The natural development was the entrusting of gold to goldsmiths of repute who had the facilities to determine its quality and weight and to guard it against marauders. Depositors received receipts, later issued in various denominations, thus facilitating trade and eliminating the need to withdraw and redeposit the metal.

Checking accounts gradually evolved to avoid the necessity and danger of holding a quantity of bankers' receipts, and later clearing houses to offset debits and credits, further reducing the physical handling of gold.

At various times gold and silver coins were used, but these had to be checked for weight and quality and were shaved by the dishonest so that token coins of cheap metal, representing a given amount of gold and silver, were issued by responsible goldsmiths or bankers or by kings. The temptation for rulers to take over this function was irresistible for, when in need, they could issue such tokens in unsupported quantities. This is nothing but counterfeiting and constitutes a hidden tax.

There are always borrowers who will pay a price for a loan, and since there was little call for the gold itself, bankers saw they could make such loans to responsible borrowers, in the form of paper receipts or bank deposits way in excess of the gold backing up such obligations. Since only a fraction of claims against bankers were covered by gold, economists refer to this development as fractional-reserve banking. Within limits, one may take the position that there is nothing reprehensible about this as long as depositors know that the bankers are making short term loans on crops or goods going to market, from the proceeds of which the loans will be repaid.

*(Continued on Page 15)*

(*Continued from Page 1*)

Bankers, particularly after the Federal Reserve System was started, increased their loans on land, real estate, equipment, franchises and on the future earnings of consumers. Such loans are not collectible in a matter of a few months. The Federal Reserve System acquired increasing, and now holds enormous amounts of, government paper because of national deficits. As will be shown later, such loans and investments create inflationary token money in the form of demand deposits and currency. Something like 90 percent of all existing demand deposits have come into existence by reason of the loans and investments of the banking system. As confidence falls in the soundness of the dollar, gold is being withdrawn by foreign central banks so that the whole purpose of adequate gold backing has been defeated.

There is a small school of libertarian economists who have long decried fractional-reserve banking. One of their spokesmen, Dr. Murray N. Rothbard, says "the bank creates new money out of thin air . . . in short, the bank is *already* and at all times bankrupt" under fractional-reserve banking. He insists that a bank should be a warehouse whose receipts are backed up 100 percent by gold. Depositors would then have to pay charges sufficient to cover the operating costs of such warehouses.

The early view of the money system was that it was similar to a tool or machine, facilitating production and exchange—a technological device and not an initiatory factor. The new view is that government can regulate the token money supply so as to bring about desired changes in price levels, employment, commercial interest rates and recently, the so-called balance of payments.

Economists of the predominant Keynesian or neo-Keynesian persuasion maintain that they can "fine-tune" the economy by monetary and fiscal manipulation. Their willingness to accept a continuous deterioration of the purchasing power of the dollar such as 3 or 5 percent a year, reveals a fatal weakness. This means chronic default by degrees and the annual mulcting by government of about ten billion dollars a year from savings, pensions and life insurance values.

Recalling the diminution of effective resistance to the obliteration of the German mark before Hitler or the speeding up of inflation in France, with ten devaluations since 1914,* and the accompanying chaos, corruption and anguish until de Gaulle put gold behind a new franc, it is amazing that the "fine-tuners" believe they can prevent engulfment by a sea of token money. We now have a situation where, in addition to the baleful influence of the private collection of so large a part of economic interest, a new set of crippling distortions and maldistributions not foreseen by Henry George, have arisen from deliberate government interference with the money mechanism.

Even those who think they have little or nothing to lose when the dollar deteriorates so long as wage levels rise correspondingly will be hurt under their pensions, insurance values and social security benefits. The middle class can take a terrible beating. But the shrewd and unscrupulous are betting on inflation, building up debts to repay in cheap dollars and acquiring equities as a hedge. Politicians yield to growing inflation to defer the day of reckoning. It is an extraordinary fact that in foreign inflations, the leaders in all fields paid no heed to the protesters and resisted any efforts to halt the ultimate breakdown of their monetary systems.

When the money system goes there must be corruption, bitterness and the

* *Lessson in French-Inflation,* by Melchior Palyi, Economists National Committee on Monetary Policy.

substitution of fear for self-reliance. The mental and moral power that is the unique attribute of man under proper conditions is drained away as chaotic situations and demagoguery force his dissent to the depths of despair and depravity.

Human actions are creative and productive in a wholesome economic climate—they are abortive in darkness and disease. Nothing transcends in importance the economic decisions that this generation is now in the process of making among the choices still open. If we choose the wrong road, the decline may be far more precipitous than anyone but an Orwell would have thought possible.

**Mitchell S. Lurio recently retired as president of Walter E. Heller & Company of New England, Inc. He is spending part of his time as a financial consultant and the rest is devoted to the Henry George School in Boston of which he is president and director. He is also a member of the Board of Trustees of the HGS in New York and trustee of the American Institute for Economic Research at Great Barrington, Massachusetts. This article will be followed by one on the pros and cons of the remedy proposed.**

•

## Play With Big Stakes — Win Big

**In California and that vast West Coast area, they play games, big games, called "land hunting" or "land research." This report was in the Los Angeles Times Supplement West of January 2nd. In 1956 a man with a so-so job in an aerospace firm, having concluded that the tax laws were designed to discourage work and reward speculation, took a big chance. He invested his entire net worth, $5,000, in underdeveloped land which is worth today $200,000. And income taxes don't bother him because he doesn't have to pay them.**

**According to the rules of this game Uncle Sam would be making part of the down payment where the buyer is in the 50 percent tax bracket. The interest on the margin account would be fully deductible and only half as costly as it would appear. Since the investment would rate as a growth stock, with no dividends but a chance for share appreciation, the profits would carry the lowest tax rate. The maximum tax on long term capital gain is 25 percent. Should anyone lose, Uncle Sam will share the loss. The interest expense is softened 50 percent by tax savings while the profit from a sale will cost only 25 percent.**

**The Federal Reserve Board has regulations which call this plan unlawful as regards other investments but raw, predeveloped land is wide open and a juicy package of high leverage tax savings.**