

ARE MONETARY AND BANKING CRISES INEVITABLE IN THE NEAR FUTURE?

By

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Contrary to a widespread belief, socialism in the Soviet Union and Eastern Europe did not collapse because of the clever geostrategic maneuvers of the Reagan Administration. Neither did the East Bloc break up because its leaders were incompetents who put into practice the wrong plans. Particular politicians and policies--East or West--had next to nothing to do with it.

The East Bloc fell apart--and had to fall apart, no matter what anyone did--because of an obscure principle of economics known as "the impossibility of rational economic calculation under bureaucratic central planning". Socialism failed--and must always fail--because, without prices for goods and services generated by a free market, central planners cannot allocate resources and manpower intelligently. But central planners cannot allow a free market to set prices (otherwise there could be no central planning). In the long run, this self-imposed bureaucratic blindness to the real values of people and things results in monumental waste, the failure of central plans to deliver sound capital investments and advancing standards of living, and finally the collapse of those societies that allow politicians and bureaucrats, rather than free entrepreneurs and workers, to direct the course of economic affairs.

Although this principle had been recognized by other economists for almost a century theretofore, it received systematic exposition in Ludwig von Mises's seminal treatise, *Socialism*, first published in the 1920s. So, during the heyday of central planning from the 1920s to the 1980s, no one should have been unaware of the problem. Nonetheless, the political elite and the *intelligentsia* ignored it, just about everywhere. In the Soviet Union and Eastern Europe, where Stalin and his successors imposed industrial-strength central planning through police-state terrorism and slave labor in the Gulag, the price was higher than in (say) the United States, to which Franklin D. Roosevelt was able to administer only a diluted dose of the same poison. But a price there was, paid as usual by common people.

Economic theory also teaches that any scheme of fiat currency and fractional-reserve central banking is just as inherently flawed, incapable of permanent existence, and inevitably doomed to disaster as all-around, full-blown socialism, because fractional-reserve central banking systematically subverts the free market's structure of prices through expansion of currency and credit--which results in redistribution of wealth, misallocation of scarce capital, and collapse in either depression or hyperinflation followed by depression. This is no new insight. The problems fractional-reserve banking causes were widely discussed in the 1800s; and the whole subject of political versus free-market money was exhaustively examined by Ludwig von Mises, in his treatise *The Theory of Money and Credit*, first published in the 1920s. (Probably the best book on this subject now available for the average reader is Murray Rothbard's *The Mystery of Banking*.) But, throughout the Western world during the 1900s and even unto the present moment, the political elite, high finance and big business, and their hired *intelligentsia* have generally ignored these problems--doubtlessly because irredeemable currency and fractional-reserve central banking have served their short-term interests, and the costs of the system have always been paid by picking the pockets of the common man.

For this country's system of fractional-reserve central banking, though, Americans cannot blame some foreign dictator such as Stalin, but instead need to indict their own home-grown usurpers and tyrants: primarily, Presidents Woodrow Wilson (who signed the Federal Reserve Act in 1913), Franklin Roosevelt (who outlawed private possession of gold for use as currency in 1933-1934), and Lyndon Johnson (who repudiated the government's promise to redeem its paper

currency in silver coin in 1967-1968). Some people also assign a large share of responsibility to Richard Nixon, who terminated redemption of Federal Reserve Notes in gold for foreign banks in 1971. This, however, is unfair. By "closing the gold window", Nixon extricated this country from an especially expensive variety of parasitism by the Federal Reserve System: its ability to prop up the value of Federal Reserve Notes by looting America's gold reserves. Indeed, such was Nixon's legal duty. Because the Federal Reserve System as a whole is unconstitutional, paying out this nation's gold in redemption of Federal Reserve Notes is unconstitutional, too. (Nixon, of course, was far from being a constitutionalist. But, as folk wisdom teaches, "God writes straight with crooked lines".)

In the case of the Federal Reserve, economic history all too strongly confirms economic theory. In 1913, the Federal Reserve's touts predicted that it would allow bankers and politicians to "manage" currency "scientifically", and thereby to end business cycles, eliminate inflation, and forefend depressions. Yet, the country soon suffered a sharp, albeit short depression in 1920-1921, followed by the horrendous collapses of the stock market and the banks in 1929-1933, and the Great Depression that festered for the remainder of the 1930s. And since World War II, Federal Reserve Notes have lost more than 90% of their purchasing power--which is a serious consequence of inflation by any reasonable standard.

Moreover, since 1933 the Federal Reserve System has been anything but strengthened, because every link between Federal Reserve Notes and gold or silver coin has been severed. Today, (in the words of former high-level banker John Exter) Federal Reserve Notes are an "I owe you nothing" currency. True, the Treasury and the banks will redeem Federal Reserve Notes for "lawful money"; and the Treasury must receive Federal Reserve Notes in payment of taxes. See Title 12, United States Code, Section 411. But the "lawful money" paid out consists only of base-metallic coins. See Title 31, United States Code, Section 5118(b, c). So redemption amounts to exchanging intrinsically valueless rag currency for almost valueless slugs. And a right to use Federal Reserve Notes to pay taxes is of dubious economic benefit to the taxpayer whose wealth is expropriated through that very payment.

Because Federal Reserve Notes are irredeemable in silver or gold, or any commodity other than the Treasury's base-metallic slugs (and even then at no permanently fixed ratio of exchange), their purchasing power in the free market ultimately depends upon public confidence--or, more realistically, public gullibility. That is, the Federal Reserve System is a *confidence game*, in both senses of that term. What should give every American pause is that the powers that be--who are most intimately acquainted with the problem because they are its cause and the reason it is not being solved--lack confidence themselves.

For the most pertinent example, a statute recognizes and provides for the possibility, if not the likelihood, of a recurrence of what happened in 1929-1933:

[D]uring such [financial] emergency period as the President * * * by proclamation may prescribe, no member bank of the Federal reserve system shall transact any banking business except to such extent and subject to such regulations, limitations and restrictions as may be prescribed by the Secretary of the Treasury, with the approval of the President.

Title 12, United States Code, Section 95(a). As this statute proves, the political and economic Establishment is prepared for banking and currency crises so severe that a national financial dictatorship will be necessary to deal with them.

The Federal Reserve System is a confidence game, not only domestically, but on a global scale as well, because of the status of Federal Reserve Notes as the premier world reserve currency and preferred medium of exchange in international trade. This status, however, is becoming increasingly tenuous--as even a cursory study of today's financial media will disclose.

If unsophisticated Americans allow themselves to be misled by rosy propaganda flowering from the Federal Reserve and the Treasury, the rest of the world does not. The instability of Federal Reserve Notes and the Federal Reserve System as a whole is becoming increasingly apparent to foreigners. And knowledge of this increasing instability is itself further increasing instability in the vicious circle characteristic of the break-up of all Ponzi schemes. This auto-catalytic process threatens to generate an accelerating downward spiral of crises, until America's monetary and banking systems are either reformed or self-destruct. If economic history is any guide, as this process works itself out gold and silver will appreciate step-by-step with the depreciation of Federal Reserve Notes.

More ominously, powerful forces are even now working for major reduction of the role of Federal Reserve Notes as a world reserve currency and medium of international exchange. In Europe, politicians in the European Union desire as much as possible to replace Federal Reserve Notes with the Euro. To the extent the Euro is successful in this competition, the purchasing power of Federal Reserve Notes, at least in international markets, will drop significantly--because, as demand for that currency declines, its supply remaining the same, its value must also decline. And in Asia, Red China--for geostrategic as well as economic reasons--is likely to adopt policies that will diminish the role of Federal Reserve Notes, and therefore decrease their purchasing power, in that huge market, too. Although these actions will threaten Federal Reserve Notes and the Federal Reserve System in particular, they will not necessarily undermine *fiat* currency and fractional-reserve central banking in principle. Europe, Asia, or both will simply substitute some other *fiat* currency for Federal Reserve Notes, and rely on some fractional-reserve central banks of issue other than the Federal Reserve. However, the displacement of Federal Reserve Notes and the Federal Reserve System from their leading positions in world finance cannot but throw into serious question the stability of other *fiat* currencies and the fractional-reserve banks that emit them. Very likely, this will lead to a general increase in the values of gold and silver as against all fiat currencies.

Far more dangerous than these possibilities is the call by radical intellectuals in the Islamic world for more than a billion Muslims to reject all forms of Western fiat currency, and adopt instead the Islamic gold *dinar* and silver *dirhem* coins as their exclusive media of exchange, both perforce of their religious duties under Islam and as a means to strike at the Great Satan's greatest vulnerability. Were this movement to take hold, it would drive the values of gold and silver to unprecedented heights, and the values of Federal Reserve Notes (and all other *fiat* currencies as well) to unheard-of lows. One need be no expert trader of precious metals to imagine what would happen if (say) 500,000,000 Muslims suddenly entered the markets, each seeking just an ounce of gold, an ounce of silver, or both! And a month later, did the same thing...and so on. Such an eventuality could presage the beginning of the end, not only for irredeemable Federal Reserve Notes, but also for all *fiat* currencies, and even for fractional-reserve central banking (which is prohibited under Islamic law).

So, the question is not, "Will there be monetary and banking crises in the foreseeable future?" but, "What can common Americans do about them--preferably, before they break out?"

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