

# THE U.S. DOLLAR AN OWNER'S MANUAL

The Importance of Our Dollar Currency  
Past, Present and Future

*James Alexander Webb*

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Revised 2019

*Design by Author*

*Printing by Staples*

Depictonomics Press  
P.O. Box 308  
Lake Junaluska, NC, 28745

Available on [Depictonomics.com](http://Depictonomics.com)

**DEPICTonomics**

Producer: James Alexander Webb

Monetary Economics Consult: David Ross Webb

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# Contents

Introduction.....	1
Topics 1-66.....	17
<b>Foundational Concepts.....</b>	<b>69</b>
The Price System.....	70
The Importance of Money.....	74
Methodology.....	78
Money in Price Theory.....	80
The Business Cycle.....	83
Money in Aggregate-economic Theory...85	
Use of Aggregates.....	87
Economic Projections.....	89
Equations in Economics.....	90
Competing Currencies.....	91
Protectionism and Free Trade.....	94
Riddle of Prices Solved.....	96
Taxation.....	97
Good Intentions vs. Free Markets.....	104
<b>Terms.....</b>	<b>111</b>
<b>Stylized Chronology of the</b>	
<b>Development of Money .....</b>	<b>119</b>
<b>References.....</b>	<b>121</b>
<b>Readings.....</b>	<b>127</b>

# Money Taxonomy

Standard Money  
(includes F)

Fiat Money

Includes

Certificates

Commodity, Specie Money

Greenbacks

Checking (Fiduciary) Accounts

Credit  
Money Substitutes

Savings & MMD Accts

Credit Cards

Federal Reserve Notes

F: Bank Reserves at Fed and Vault Cash

*Money: That medium of exchange or currency in which the array of prices are expressed in a market venue.*

## Introduction

The simplest, most rudimentary economy is self-sufficiency or autarchy of a cooperative group.

One step up is a market economy of simple direct barter or trade where owners exchange goods or services provided they find someone who has what they need and wants what they themselves have.

No one being forced by others to exchange (in a free market) means that both sides to the exchange benefit. Buyer and seller mutually gain, but find direct exchange to be awkward.

Gradually the barter economy begins employing intermediary goods, not traded for their own use but to allow exchanges without each having to find someone who coincidentally wants just what each person has. They can sell their goods for an intermediary good such as salt or cattle and then acquire goods they need from those who don't need what they produce by using the intermediary good to buy them.

People will choose an intermediary good that is easily divisible to overcome the inconvenience (in barter) of trying to exchange say a wagon for 2½ canoes. Now also people can account, i.e. compare different mixes or combinations of goods they own or produce once the goods are assigned a price. This simple arrangement explains the essence of money as the intermediary good. Money then is a good commonly bartered as an intermediary good.

Note that money is always in a relation of barter with other goods. It is only the other goods that become "priced" in units of this common good. Once one good is used for barter other goods lose their barter character among each other, ultimately interactions resulting in only

one commodity, or one for large transactions and another for small playing this role.

Precious metals, being easily transportable, divisible, and of known value as a commodity under barter ultimately through competitive trial emerged as the money of the civilized world.

Money then, is a common medium of exchange. Prices are generally established in units of a common commodity or substitute commodity or in certificates of such commodity.

Certificates can be money even when counterfeit.

Money can be degraded into a counterfeit of a contractual promise to pay commodity money and then into even a true certificate with no promise to convert if made legal tender and protected from massive overproduction through a monopoly of the right to print the certificate. It is then fiat money.

Fiat money is vastly preferred by a treasury or bank of issue. But this comes at the cost of the public facing higher prices from the extra spending created and at the cost of the whole economy that must live with a much weakened monetary system at once more vulnerable to mistrust and disruption.

The transition to fiat money ended the contractual linkage to gold. It follows that gold today is not money for general commerce, but a commodity. It is thus priced in dollars or some other currency before being used in a transaction.

A requirement for money is that it be that medium of exchange or currency in which the array of prices is expressed.

That money gained its monetary status from gold and retains the custom of acceptance only possible from a commodity such as gold doesn't change the fact that we don't use gold grams or ounces as a medium of exchange, we don't and aren't likely to price all other goods in terms of gold ounces when the currencies we have carry that function.

Money, like language, is an aid to interpersonal transactions. This manual is not about making money. It is about how its use in society implies certain results discoverable by following chains of reasoning and cause and effect. Deductive logic, in the manner of proofs in geometry, allows for derivation of propositions otherwise unobtainable.

Money permeates the entire non-barter economy. Hence the subject of money is inseparable from the discipline of economics. Basic understanding of the role of money requires neither employment of complex economic models, nor a textbook approach that dedicates a majority of space to interesting but incidental aspects of the discipline. Modern economics tends to relegate money to an accounting role. This is a mistake; understanding its central influence and its historic genesis is the key to economic analysis.

Topics were selected to appeal to non-economist as well as those more familiar with economics. Topics draw most heavily from writers of the Austrian School in economics (see terms below) who developed monetary theory as a subjective-value based science. The emphasis on enhancing or reviving the dollar, as opposed to replacing it, most closely falls in line with a tract by Murray Rothbard (1997).

It is no secret that Austrian economics today is free-market in orientation. Knowledge of the economics of these writers has been expanding. There are those that may make good use of some insights of this economics whether or not interested in the workings<sup>1</sup> of a libertarian society. But it will be necessary to define some of these workings that have become increasingly distinct from society, as we find it, to clarify matters

The Austrian theory explains impacts from monetary stabilization policy. It explains how policy induced booms result in crashes.

Formal mainstream approaches have an emphasis on equations, on the use of unrealistic ideal types, and aggregation that obfuscate real world phenomenon. There has been a mistaken reliance on statistical regularities as a method of drawing inferences.

It will be shown that today's money, no longer tangibly linked to a commodity such as gold, nevertheless cannot be explained without its continued subjective tie to its past, and thus retains to a diminishing extent its commodity money character. The customary tie to the commodity predecessor of fiat money fuels the inertia that undergirds today's money. This inertia has allowed for interim periods (that can

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<sup>1</sup> Revealed in Tannehill (1970), or Rothbard (2006) who both detail how order and governance performs in the absence of the State.

last for decades) where “official” money was purported to be devoid of its inherent commodity nature. Hence the seemingly plausible contention that formally irredeemable money is as sound as commodity money is no surprise. But this contention is a fiction; at best, these interim periods were notable for relative money depreciation.

Under a fiat money regime, the monetary authority may declare tokens or scrip to be legal tender. But as a brand new money system, if not piggybacked on an established price system, these can only be introduced in a very limited setting such as a barter economy, or for small groups lacking an extensive price system. Contemporary currencies although not legally specie-based are customarily so.

For all but the most limited economies, custom carries forward money's historical linkage to a commodity base. Central bank attempts to control currencies only amount to quantity control in terms of units artificially produced. The essence of money is socially derived, not engendered by, but exploited by a government fiat money regime. Accordingly the purchasing power of the dollar has been eroded without loss of its function as the medium of exchange.

Money is peculiar in its role as a universal trading good, permeating all exchanges in the market, unlike other goods, once established it cannot be refined by competition. Recent years of dollar mismanagement under the aegis of the Federal Reserve have resulted in an increasing number of economists favoring hard money reform, with some common remedies centered on introducing competitive currencies. We shall see that in this camp too often the recipe proposed for a conversion to an official gold money system leads unnecessarily into difficulty. This camp maintains that commodity money is the better choice objectively over fiat money, and therefore a new commodity based currency could prevail in competition with fiat money. We will see however, that the dollar cannot be so easily jettisoned. The point being that the dollar is already in its essence a commodity money, only irredeemable juridically. The defense of the dollar follows from respecting its exchange economy origin as a fundamental social convention and not acceding to attempts to wrest it completely from its original social underpinnings.



This manual revisits some of the seldom-discussed aspects of money—aspects essential for making investments, hedging against inflation, buying gold, understanding moves in the bond market, or details of monetary policy.

Fundamental analysis yields more reliable results than technical in considering financial trends. For instance, inflation favors debtors over creditors due to a lag in the interest rate price premium. When inflationary expectations increase, stock market prices for certain corporations can rise to reflect the projected relative gains, specifically gains by corporations that are net debtors. Depositors and bondholders, and corporations that are net creditors may face losses. And there are profit gains when inputs purchased before price increases are compared to product prices that have risen during the production period.

Such attention to causality obviously precedes technical treatment of data because the relevant variables must first be identified. The conventional habit of data driven investigation has led to too many lost trails of inquiry. Hence insights deductively formulated may have been given too little attention to assist the analyst.

This includes insights of Austrian School economist Ludwig von Mises, (*The Theory of Money and Credit*, 1912) who outlined the monetary theory of boom and bust resulting from credit expansion, the ABCT (Austrian Business Cycle Theory). His protégé in business cycle theory and later Nobel Prize winner F. A. Hayek, in 1925 challenged the misdirection of U.S. stabilization policy in the mid 1920's. Their warnings in the 1920's that current policies would lead to economic imbalances and a financial crash went unheeded. While Mises personally declined to hold accounts in banks in the 1920's that he knew to be unsound, Irving Fisher, architect of Federal Reserve policy in the 1920's was clueless up through the crash of '29 and personally lost a fortune in the stock market (deSoto-2006, 487-493)

Murray Rothbard's *Americas Great Depression* (1963) restated the theory. Rothbard documented the unprecedented new tax and regulatory burdens that lengthened the bank crises into a great depression. In the (1971) introduction to the 2nd edition (1972) Rothbard's early recognition of the inflationary recession or

stagflation phenomenon emerging in the 1970's was instrumental in exposing contradictions in the Keynesian economic paradigm.

The dollar evolved as a social institution. That is, from its social or public custom of use as opposed to official sanction. Too often the positive side of human nature and our daily exhibited propensity for social cooperation have been underplayed. Mises points out in *Human Action*, that peaceable habits engendered by trade arise even when parties have no liking for each other. Markets and free trade are thereby of immense importance in keeping the peace locally and globally.

Money, (the dollar in particular), is the people's heritage. Confirmed each day in transactions, it is a tool or technology that ranks in importance with the development of language or cultivation of crops.

The story of our dollar has been under reported, especially the events of the Twentieth Century which led up to loss of the free use of money in exchange—specifically, the measured, progressive loss of separation between money and politics and the resultant effective piracy of our monetary heritage. Whether perceived entirely along the way or not by those responsible for this loss, the consequences go far beyond visible marginal gains and losses we might attribute to influence by various interest groups or sectors in the economy.

The important differences between commodity money and fiat money should be restated. The former (as gold or silver) were initially underpinned by non-monetary uses; the latter (our current fiat dollar) is now underpinned only by custom and government mandate.

The money supply may be defined as the sum of each individual's holdings of currency and checkable deposit accounts plus CD's, savings and money market accounts.

Conventional use of measures of the velocity of money lack a scientific basis. The average turnover rate or velocity is equated (inversely) to the demand for money, a relationship largely misunderstood. The subjective human character of economics is based on individuals acting with a purpose either in isolation or as identifiable members of a group. Relative valuations of money holdings and other assets need not be linked at all to the velocity turnover of money holdings. Exchange volume is no reliable indicator

of asset pricing. For example, one party can be involved in bidding up the price of a painting at an auction without any money transaction on his part.

**Money is that medium of exchange or currency in which the array of prices is expressed in a geographic region or market venue.** Historically the most marketable good, money emerged as a social or economic rather than a political phenomenon. Underlying transactions by peaceful trade, money facilitated the demise of socially destructive predatory means of wealth transfer.

Yet hegemonic, hierarchical systems of organization based on compulsion and dominance (kingdoms, governments etc.) gradually won stewardship over money, and in keeping with their exploitative practice undermined its stability.

In the U.S. this state of affairs devolved by default. The public relinquished complex money and finance decisions to firms and institutions closest to centers of finance and most adept in taking control of these matters.<sup>2</sup>

An unbiased accounting of the government role in monetary management and macroprudential policy has been lacking. Such an accounting would reveal the subsidy to the banking industry resulting from the seigniorage (money creating) process. It is predatory in its wealth transfer effects. Open market operations (Fed purchases of bonds, or any assets) provide new reserves for banks. These gains (seigniorage) to the banking system are a separate matter from Fed profits. Newly produced reserves support a multiple of new demand deposits used by banks for interest earning loans for which the banking system need only maintain reserves at a small fraction of new loans.

Even a money supply increase of only 3 to 5% per year that seemingly just accommodates an expanding economy can be

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<sup>2</sup>One often hears the reference to the role of government as analogous to that of a referee. This allows for attributing government wrongs to failings of character, not insulated power. Yet referees and governments are stark examples of two concepts entirely at odds. Referees, are an example of participatory or commercially based order totally outside of any need to be established by government. They provide needed regulatory services under the free market model, not the political or legislative model.

problematic macro-economically. With such a rate, purportedly to maintain overall price stability (rather than a slower increase as under the gold standard with beneficial dollar appreciation), malinvestments and distortions ensue as interest rates are made lower than normal. Under normal circumstances with increasing savings and increasing productivity “To keep the price level steady would mean, in similar circumstances, that the loan rate of interest would have to be lowered below the equilibrium rate.” F.A. Hayek, (1967 [1935], 27).

Under market disciplined free banking, the tendency for banks to keep ever smaller fractional reserves (or low capital) would be checked. Markets would be forced to develop their own prudent behavior absent the government imprimatur, the FDIC, and the implicit backing by involuntary taxation.

Treatment of deposits as legal titles would support a policy of 100% reserve requirements. Just as a storage facility simply charges fees for storage, not considering deposits of items as liabilities on their balance sheet to be loaned out, so too banks could be constituted. A free market would determine the financial landscape and the degree of bank leverage.

Under the present system when banks run into trouble the FDIC and the Fed stand by, not as legitimate insurance--which could never apply to such economy-wide operations—but as guarantors for a taxpayer bailout. This encourages unnecessary and inappropriate risk taking by banks (moral hazard). Thus the government seemingly rescues private excesses. But those excesses result from the antithesis of free market banking policy.

Given these concerns some advocate replacing Federal Reserve System credit money production with Treasury money printing and credit. But the Fed is only one aspect of the problem. Replacing it with Treasury inflating fails to address dollar depreciation. Although limiting the ability of the private banking system to earn more windfall interest through expanding loans when more reserves are pumped into the system, both Treasury money such as greenbacks and bank loans (demand deposits) would remain fiat based. Such money is functionally the same as counterfeit money, the key being who gets to print it. With treasury fiat money the incentive to inflate remains intact. The Treasury already sells treasury bills and bonds that take on

some of the qualities of money as liquid repositories of wealth. We see also little inhibition in over-issuing these securities, even to the point where we now have the potential of a future global flight from these assets.

Naturally, increases in government deficits impact the loan market with borrowing demands backed by the security of the taxing power of government. This is known as crowding out. It diminishes funds available for business needs.

These unsatisfactory outcomes give rise to innovative corrective proposals by various free market proponents. They propose retrieval of the dollar from the present regime of fiat money, or replacement of the dollar in favor of soundly based free market money. Beside questions surrounding the Fed, there are other aspects of the problem not well understood. Some of these aspects have to do with the laudable suggestion that a commodity dollar is superior to a fiat dollar.

Freeing precious metals from capital gains taxation, or legalizing any kind of private coinage, would be an advance toward financial freedom. As mentioned, some writers propose a gold or commodity based money to compete with the dollar, as a return to sound money. As paradoxical as it may seem, the release of the dollar to its market-liberal economic role would not be accomplished by a purported legal abandonment of the government fiat dollar money system. Achieving a free market end also requires measures enhancing the dollar's underlying support. The dollar can be seen as a free-market institution usurped by the state. Abrupt abandonment of the present fiat dollar would be pulling the rug, albeit now counterfeit, out from under the economy.

We may follow this reasoning more easily if we see money, and so the dollar, not as a creature of government, but rather an outcome of commerce among the general public, as the essence of trade and the market, presently under custody of the government and as having been weakened by political replacement of the option of redemption with legal tender fiat. With this in mind, an informed goal of reform should be to rescue, not destroy the dollar.

As a matter of correct terminology, governments don't strictly create money. Markets and people can create a money regime; governments only then take custody of its management. Governments

certainly produce units of a currency and produce money substitutes, usually in concert with commercial banks. Devaluation of dollar units has not removed its currency functionality.

A recent introduction of **Liberty Dollars** that had partial specie backing by a private interest was enough of a competitive threat to the dollar as a store of value that authorities moved to prevent this option by prosecution on the basis that it constituted the act of counterfeiting. One key element was that this currency carried the trademark designation of dollars. What the displacement of use of dollars with the use of these alternative Liberty Dollars amounted to was a move to capture some degree of the seigniorage that results from printing dollars (although these did not resemble dollars, only made use of the designation of the dollar). In this case the margin of gain to the provider, instead of the whole face value of the bill, amounted to its face value, less the promised backing in specie (a fraction of the face value). This was somewhat similar to using another company's trademark to sell products, here it was the word 'dollar'.

It should be seen that, if allowed, the printing and selling of these partially backed notes would have had an impact similar to adding to the money supply. As this caught on, more providers would emerge with higher ratios of backing to out-bid the Liberty Dollar, and so on with more providers to out-bid those, until eventually all of the seigniorage advantage was gone as the backing approached 100%.

That authorities moved to disrupt this process points to the vulnerability of fiat dollars over commodity backed dollars. The activity could have been a means to move towards edging out at least some of the demand for unbacked paper currency. Yet more likely this whole process would fail to supplant the fiat dollar that would never have been deposed, and by using the dollar imprimatur competing notes would have begun trading at a premium over the official dollar. When the Greenbacks were introduced under Lincoln as unbacked Treasury Notes, they were discounted in value. One can find an economic parallel to this type of partially backed currency in periods when the copper penny was available as an alternative to fiat paper dollars, or currently the nickel. These coins had a melt value at a substantial fraction of the currency (market) value, but never dominated as a hedge against inflation.

To the extent the specie backed notes such as Liberty Dollars would replace other money balances held by the public, the effect would have an inflationary bias in reducing the demand for liquid dollar balances. This could draw attention to the weaknesses of Federal Reserve money. The risk, of course, is the possibility of setting off an inflationary flight from fiat money that would be disruptive for the money economy itself—that would perhaps bring down ATM's etc. in an irreversible collapse of the intricate and extensive crucial nexus of division of labor and coordinating functioning of the market economy.

To some this risk could be seen as acceptable given the negative economic long-run outlook under a continued fiat regime that perpetuates boom and bust, secular inflation, and gradually creates a critical state that portends a probable but unpredictable future financial collapse.

One could predict, that if allowed, the newly introduced 'money' would gradually pre-empt earlier issues of these partially backed 'dollars' by incrementally including more gold backing. In fact, a new concept of money in this genre has been forwarded privately. These are notes containing gold leaf presumably with the amount of gold represented by the note (at some specified market value of gold measured by dollars). Incidentally this would assist in accommodating the need to have contractual guarantees for redeemability for small denomination notes under a gold standard. But in the last analysis, such an introduction of title to gold ownership in the form of currency would hardly amount to a new currency.

Further consideration of this episode of specie (partially) backed notes such as the Liberty Dollar brings up an interesting point. It is easy to see that a private provider of these new dollars would be able to exchange older ones for newer at a higher face value as the fiat dollar price of gold rose, as did occur with Liberty Dollars. Providers would see their gold holdings appreciate to allow issuing new 'dollars' with less physical gold. In time holders of earlier issues would see potential for appreciation and begin a speculative rush into these instruments that would put further pressure to bid up the fiat dollar price of gold in the market.

Hence under the supposition that these partially backed 'dollars' were not prohibited, it would be quite possible that depreciation of

the fiat dollar could accelerate if large financial institutions saw an opening to provide 'dollars' backed by gold. Since there is no floor for the exchange value of the dollar as constituted, the value of the dollar could collapse. But fiat dollar denominated financial assets would be at risk, they could henceforth collapse in value as well. The speculative adjustment mechanism in financial markets could overwhelm any attempt to return to a convertible dollar without any real confidence in the Treasury's ability to acquire gold reserves, or to stem a runaway gold price.

Historically, hyperinflations have been halted by credible policies that return a currency to a sound commodity link or to another currency, but usually after the ability to sell financial assets has been eliminated by their loss in value.

With this said, the astute reader may argue, along with the establishment neoclassical economist, that with intelligent monetary policy, and protection of the dollar from such replication challenges we have been considering, there is no good reason to worry. It could be maintained that, granted that inflation of prices may well continue long run, this beneficially allows the government to be financed by monetizing its debt and so reduces the tax burden.

But even assuming that the fiat dollar could last indefinitely, the loss to the public has been recognized by numerous writers defending free-markets. It is three-fold:

First, the loss of purchasing power. It is not as if everyone's money balances were magically enhanced with new money, or fixed incomes were easily adjustable. Losses amount to precisely the same as if a select few were allowed to print money in their basement and then spend it pushing up prices faced by the rest of us. While we in fact have seen prices fall in the electronics sector, in real terms by even more than in nominal terms, how many more sectors could have been lowering prices had we not had a general inflation rate that depreciated the dollar by more than 90% since fiat money was extant? Is it any surprise that of the top 18 largest MSA (Metropolitan Statistical Areas) for 2008-9 as reported in the 2012 Statistical Abstract of the United States (p. 448) the Washington Metropolitan Area had the highest consumer unit annual expenditure and with more than half of the top ten counties (in median income) for the entire



country? Your position in the spending chain determines your ability to exploit prices not yet adjusted to the money supply increase.

Second, the loss of fiscal discipline: The present regime fails the public in the areas of fiscal responsibility and accountability because of the ease of financing government expenditures. Would there have been the means to fund a bloated bureaucracy, no-bid contractors, fund the preposterous drug war that has eviscerated whole ethnic communities, or engage in pre-emptive strikes, or intervene in foreign conflicts that now look imprudent with hindsight? Can governments be trusted with such an easy source of financing? The suspension of the gold standard by the European belligerents in WWI allowed for deficit financing enabling unprecedented carnage and prolonged that war to such a destabilizing outcome that it produced WWII and then kept the world at the brink of calamity throughout the 20th Century.

Third, the loss of stability: business cycles have been shown to be exacerbated, or even caused by errant monetary policy that created asset bubbles, skewed investments, and misappropriate capital expenditures. Real estate booms are underlain with subsidies and tax exemptions only possible with deficit financing and credit conditions spurred by easy monetary policy that lowers interest rates artificially.

Writers have emphasized an important difference in approaches to reform that should be made clear: actors in place are not as important as institutions and procedures such as legislation; individual conduct by those in government, or even those close to government largess will always exploit opportunities to gain outside of the mutual exchange nexus of markets and are behind some of the legislation cranked out by Congress or rule making by agencies. The fix must be at the level of institutions and checks and balances. The fix will need to address the proliferation of positive law over remedies already in place under common law—remedies long established as an avenue to adjudicate identifiable damages produced by violent or fraudulent acts.

Specifically, there is a case made by free-market advocates for reforming the monetary landscape that would imply revisiting the 1913 decision to create a central bank and the 1933 decision to demonetize gold. As with other areas of life when we look at systems of compulsion we find that they can appear to be a solution to discord

but can fail to produce intended results. It is sometimes more difficult to work within tried and true social norms that are based on the public's propensity to cooperate through peaceful trade and commerce.

Order can best emerge from the harmony of mutual gain through specialization, division of labor and from freedom to control and benefit from the product of one's labors, based on equal respect for property rights (equality in property as defined by John Locke's Law of Equal Freedom). A consensus that achieves or acquiesces in debasing an honestly derived currency for expediency by a political or financial elite not surprisingly diminishes economic choices.

In brief, economic reasoning from sound premises can lend to early recognition of major swings in markets and policies. These premises also point the way to the reclamation of our monetary heritage of sound money.

An ultimate solution will necessarily reflect natural law and 1) help stabilize the economy, 2) prevent chronic inflation and 3) eliminate the risk of a global monetary melt-down.

This implies addressing the proper regulation of banking through removing obstacles to market discipline caused by Federal insurance and central banking legislation.

It implies revamping of the dollar and recognizing the failure of its fiat legal status. The first task is clear—to undo the constructivist-legislated destruction of the commercially derived essence of our money as an institution of emergent order. Upending the dollar holder's title to precious metals reduced the dollar to an artifice. Included in this text are brief sketches of an innovative dollar peg to gold that may exclude ultimate gold convertibility. After grounding the dollar on what was the public's heritage from the competitive process arising out of time-tested commercial custom, perhaps another form of money will emerge through choice in currency. Producing a blueprint for such needed reforms may be quite different from this approach, only limited by the imagination of contributors who, having learned the basics, will no doubt, with increasing acumen, preserve the integrity of money in its future forms.





## Topics

1. Money established by past use
2. Dollars are not government made
3. Origin of the dollar
4. Legal Tender status not backing
5. An idea unacknowledged
6. The Dollar—its commodity past
7. The nature of a dollar collapse
8. More money is not necessary
9. Prices rise when money increased
10. But now overvalued
11. Money not priced like goods
12. Gold lacks supply problems
13. U.S. in currency default
14. Dollar now degenerate fiat money
15. Why gold is now legal
16. Monetarism not free market
17. Is silver money?
18. What are Federal Reserve notes?
19. The Fed
20. Money inflation subsidizes banks
21. Treasury money vs. Fed money
22. Fiat money extra-constitutional
23. History of fractional reserves
24. Money surges undesirable
25. Slow inflation undesirable
26. Does greed cause price inflation?
27. Do costs push up prices?
28. Government money origin, a false narrative
29. Inflation no cure for credit crises
30. Crises by money management
31. Risks from reflation policy
32. Fiat money drives out sound
33. No need to undercut dollar
34. Competing currency reform

35. Why not a parallel currency?
36. Fiat money precarious
37. Need to shore up Dollar
38. Resistance to reform
39. Markets speed currency demise
40. Government-country conflated
41. Currency recall risky, unworkable
42. Gold not a quick fix
43. Dollar price of gold not known
44. Can't set a price for gold
45. Nor a maximum price
46. Pegging the Dollar to gold
47. Converting to gold
48. Dollar more unstable than gold
49. No need for a parallel gold money
50. Let people decide
51. Fiat money inflation is wasteful
52. Freedom to choose
53. Gold standard undermined
54. Gold has financial flexibility
55. Fairness of private property
56. Failure of money management
57. Fiat money has inflation bias
58. More money is no help
59. Monopoly
60. The cost of losing price system
61. Fiat money system too risky
62. Money inflation...non-neutrality
63. Money inflation unfair
64. Money-inflation malinvestment
65. Sound money to reduces waste
66. Banking: Impaired markets
67. The future

End of Sample text

