Money: It's Not What You Think

[The author's favorite chapter, but it was cut out by the editors. Informative and entertaining reading with some surprises. Unedited.]

Money, for better or for worse, is what is used on this planet to keep score. When you have it, you feel like you are winning the game. When you don't have it, you feel like you are losing the game.

THE HISTORY OF MONEY

Money is a medium of exchange. Everyone uses some form of money. We think about it, we want it, and we're willing to work for it.

BARTER

Money has been part of human history for over 3,000 years. Before the medium of money, wealth was measured by the number of ox or acres one owned. Two individuals, each possessing a commodity the other wanted, would enter into an agreement to trade their goods.

In Mesopotamia circa 3,000 B.C., barley was used in trade; although it was an inconvenient standard or medium of exchange that was difficult to both transport and store. The early American colonialists used beaver pelts, tobacco and dried corn as currency to pay for goods and services. This direct trade of goods and services was called barter.

Early mediums of exchange were animal skins, weapons or salt. Around 1000 BC the Chinese replaced using actual weapons as a medium of exchange with using miniature replicas of the same items cast in bronze. These became the first likeness to coinage.

COINAGE

Although the Chinese were the first to use coins, the first sovereign minted coins were created in Lydia which is now Turkey. In 600 BC Lydia's King Alyattes minted the first official currency. The silver and gold coins were stamped with images to indicate their denominations.

PAPER CURRENCY AND BANK NOTES

In the 600 BC, the Chinese move from coins to paper money and they inscribed it with "All counterfeiters will be decapitated."

Eventually, private "banks" held coins, commodities and other money deposits, and issued banknotes for the depositors to carry around. When a merchant traveled a long distance to a far way market, he no longer needed to carry gold or silver out of fear of being robbed during his journey. Instead, he carried a bank note or receipt for the gold or silver being held in storage. This facilitated the movement of wealth and greatly expanded trade beyond the immediate community.

Banks later began issuing their own currency. Interest payments arose out of banks, while holding cattle as security, would keep any calves that were born while the cow was being held as collateral. The term "payments in kind" derived from the German word "kinder" meaning child, and this came to be known as "interest."

COMMODITY MONEY

Commodity money is money whose value is derived from the intrinsic value of the commodity itself. It does not represent, nor does it need to be exchanged for, anything else having the actual value.
Commodity coinage represents a value equal to the coins intrinsic value and retains its value even if it is melted and physically altered. From 1,300 B.C., non-sovereign, crudely made, copper silver and gold coinage had intrinsic value based on its weight. This freed people from their dependency on their local community and allowed to travel with the ability to exchange a form of payment for food and shelter, resulting in a dramatic increase in the interaction between communities.

SOVEREIGN MONEY

Sovereign Money is currency issued by the sovereign government, with the issuing government retaining a variety of powers not available to institutions or individuals. If an entity other than the government tried to issue a domestic currency it would be prosecuted as a counterfeiter and subject to severe penalties.

It has been a universal practice for nations to adopt their own unique domestic currencies. Throughout history the trend has been one nation one currency, such as the U.S. dollar, British Pound, Japanese yen and Chinese Yuan.

The main exception is the Euro currency used by the 18 members of the European Monetary Union where each member nation uses the euro as a currency that is technically "foreign" to the individual nation. Having a commonly used currency with stringent rules, shared among countries with dissimilar economies, cultures, language and fiscal policies; is proving to be problematic.

The state monopoly on currency began in the sixth century B.C. when the rulers began to appreciate the advantages of a state issued and controlled currency. "Money" now advanced from being just a convenient commodity of copper, silver and gold to being a sovereign issued and controlled medium of exchange; but still based on intrinsic value.

CURRENCY DEBASEMENT – ANCIENT TIMES

It was the Roman emperors beginning with Nero (reigned 54 – 68 A.D), who conducted the first known, systematic experiments in currency debasement.

Each successive ruler systematically and incrementally mixed ever increasing amounts of base (low value) metals into the sovereign coins to both generate revenues and reduce their debts. They then felt the need to create a mystique or premium on their minted coins, so they typically adopted religious symbols on their coins. Less gold but more God.

It was not only the rulers but also the citizens who were debasing the coins' intrinsic value. People would shave the coin's edges to produce metal filings to be later melted down and sold. This led to the expression "shaving coins." This activity was countered by adding the ridges to the coins edges that we still sometimes see today.

CURRENCY DEBASEMENT – MODERN TIMES

In 1965 the US Treasury Department instructed the US minted to dramatically increase the amount of base (low value) metal to substitute for the precious metal in U.S. coins (Figure 9-1). Of course, the US Treasury Department will never use the word "debase" in the same sentence, paragraph or report as the words "US currency." The government's own literature euphemistically calls the debased and devalued coins "less than full bodied" and claim it was necessary do to inflation. Debasing a coin, like creating inflation, is to steal from the creditor.

Figure 9-1

Pre – 1964 coins	Face Value	Intrinsic Value
1946-1964 Roosevelt dime	$0.10	$1.63
1932-1964 Washington quarter	$0.25	$4.09
1964 Kennedy half dollar	$0.50	$8.18
Post – 1964 coins		
1965-2013 dime	$0.10	$0.017
1965-2013 quarter	$0.25	$0.045
1946-2013 nickel	$.05	$0.045

As of 10/23/2013 Coinflation.com

FIDUCIARY MONEY

Fiduciary money is money that has a stated value not related to, and usually substantially greater than, the intrinsic commodity value of the coin or bank note. It is based on the premise that the issuer (bank or government) will redeem the money for gold or silver on demand at a future time. The prospect of future redemption provides the faith and willingness for each successive recipient to accept the represented value implied by the fiduciary money.

Fiduciary money has been around for over 2,500 years. Issued by sovereign powers or governments, it has had no intrinsic value itself, but was imprinted with the stated value of the commodity it represented and for which it could be readily exchanged. It is a promise to pay in the form of a commodity, such as silver or gold, when backed by that commodity.

While on the gold standard (see Gold Standard section this chapter) U.S. currency was backed by gold and it could be exchanged for a set amount of gold. In 1933 when Pres. Franklin D Roosevelt outlawed the private ownership of gold by individuals and ordered gold coins, bullion and the U.S. issued gold backed certificates and bank notes to be turned into the Federal Reserve.

FIAT MONEY

Fiat money (from Latin meaning "it shall be",) is a state issued money which lacks intrinsic value, is not redeemable in any commodity such as gold or silver, can only be converted into other denominations of itself and is declared by governments to be legal tender. Legal tender simply means there is a law requiring citizens to accept the currency in domestic commerce and to use it to settle domestic debts.

Fiat money is not new. It originated back in 11th century China and its use became widespread in during the Yuan Dynasty.

The U.S. dollar became a fiat currency when Pres. Nixon suddenly took the U.S. off of the gold standard in 1971 when he closed the gold "window" by no longer allowing foreign Central Banks convert U. S. currency into gold. U.S. citizens actually had their ability to convert their currency to gold when the currency was taken off of the gold standard (for the second time) with the Emergency Banking Act of 1933 act under FDR.

When the U.S. dollar was first taken off of the gold standard during the Civil War, the US government felt compelled it to add "In God We Trust" to the currency out of fear that citizens would not have trust in just the US government alone.

With a fiat currency, the floating value can easily be modified to suit an agenda. Steve Forbes has often uses the metaphor: "If we change the size of a foot from 12 to 14 inches, everyone will have a bigger house."

The stark reality of the fiat U.S. dollar was publicly pronounced by Iranian Pres. Mohammad Ahmadinejad, at the 2007 OPEC summit when he stated "They get our oil and give us worthless pieces of paper." [1] Almost all fiat money has eventually self-destructed in hyperinflation resulting in default on the currency.

Writing about fiat currency in "The Fate of Paper Money," Author Mike Hewitt reports [2] that it there is no historical precedent for a fiat currency having succeeded in holding its value. Their review of 775 fiat currencies revealed that 20% failed through hyperinflation, 21% were destroyed by war, 12% were destroyed by independence, 24% were monetarily reformed and 23% remained in circulation.

Although the average life expectancy for a fiat currency is less than 30 years, the British pound Sterling has fared quite well. The Sterling is the oldest fiat currency in existence, having been around for over 320 years. The British pound, defined as 12 ounces of silver, is worth less than 0.5% of its original value. This means the most successful, long-standing currency in existence has lost 99.5% of its value.

The following are examples of what has happened to sovereign nation currencies that are not based on a precious metal, gold or silver, standard:

Country   Largest Currency denomination

Yugoslavia – 10 billion dinar, 1993
Germany – 1 billion mark, 1923
Zaire – 5 million zaires, 1992
Venezuela – 10,000 bolivares, 2002
Turkey – 5 million lira, 1997
Russia – 10,000 rubles, 1992
Greece – 25,000 drachmas, 1943
Chile – 10,000 pesos, 1975
Argentina – 10,000 pesos argentinos, 1985.

Because there is no government in the world that is willing to surrender control over its domestic monetary policy, currency is not likely to ever again be either commodity (made of gold or silver) or fiduciary (backed by gold or silver) but will remain only a currency backed by "In God We Trust".

COMMENT BOX

The "MONOPOLY" game rulebook states
"The bank never 'goes broke.' If the bank runs out of money, it [like our Federal Reserve] may issue as much as may be needed by merely writing on an ordinary piece of paper."

THE MONEY "PRINTING" MYTH

Yes, the Federal Reserve does create money out of thin air, but it does so with key strokes on a computer keyboard and through the Federal Reserve's balance sheet, not by actually physically putting ink on paper to "print" money.

When the Federal Reserve Bank feels it needs to increase the monetary base, that is, to increase the currency in circulation, it does not fire up the printing press. Instead, since banks have "bank accounts" at the Federal Reserve's central bank, the Fed simply credits the bank's account with an electronic deposit to purchase the bank assets, such as bonds or mortgages. This deposit can then be used by the commercial banks to make loans and increase the "monetary base" or money in circulation and presumably boost the economy.

The US Treasury's Bureau of Engraving and Printing does printer paper currency to replace old currency it has taken back plus a 10% overrun for the replacement of currency presumed to be lost, hoarded or otherwise out of circulation. In 2013 the Bureau of Engraving and Printing printed 26 million Federal Reserve Notes, with bills of various denominations totaling a face a value of $1.3 billion at an average cost of seven cents per note (bill).

U.S. CURRENCY: PAPER

In 1690 the Massachusetts Bay Colony, one of the 13 original colonies, was the first issuer of paper currency in the U. S. In 1764 Great Britain ordered a ban on the issuance of paper currency by the colonies.

In 1775 the Continental Congress issued paper currency based on and denominated in Spanish dollars to finance the Revolutionary War. Their face value rapidly decreased until 1781 at which time they became virtually worthless and were exchanged for treasury bonds that 1% of their face value. This was to be the first, but certainly not the last, default of the US government on its currency (Chapter 6).

In 1792, at the urging of treasury secretary Alexander Hamilton, Congress passed the Coinage Act of 1792 which established the U.S. dollar as the basic unit of currency. The dollar coin (the U.S. had no paper currency at that time) took its name from, and was physically a very close copy of, the then well-established Spanish a dollar. Spanish dollars were in fact accepted in the US as legal tender up until 1857.

In 1861 the federal government, through the U.S. Treasury Department, issued the first national paper currency called United States Notes (U.S. paper currency is called "notes") to finance the Civil War. The color green was chosen because it was thought to be a symbol of stability. These "greenbacks" were printed from 1862 to 1971 with a major redesign occurring in 1929 to decrease the large size called "horse blankets" to the size of present-day U.S. paper currency. These United States Notes were created as fiat currency, authorized by the First of Legal Tender Act and with no guarantee they could be redeemed in gold or silver.

In 1863 Congress established the National Banking system and authorized in the U.S. Treasury to oversee the national currency.

From 1878 to 1964 United States "silver certificates" were issued and used alongside the existing United States Notes in circulation. Up until 1968 they were redeemable for their face value of silver dollar coins or raw silver bullion.

During World War II the government issued at the currency with a unique brown seal for distribution in Hawaii and a unique yellow seal for distribution in North Africa. This was done to allow any of the US currency falling into enemy hands to be identified and canceled to protect the country's silver deposits.

The Federal Reserve Act of 1913 authorized federal banks to issue Federal Reserve Notes, the legal tender currently in use in the U. S. These are manufactured by the U.S. Bureau of Engraving and Printing at a cost of seven cents each, issued and put into circulation by the Federal Reserve Bank. They are backed by assets of the Federal Reserve which generally consist of treasury securities purchased by the Fed based on face value of the currency. If that sounds like smoke and mirrors to you, it's because the ambiguity, convolution and opaqueness of the monetary system is not unintentional.

The words "In God We Trust" were first added to the currency ($.02 coin) in 1864. In 1956 President Dwight D. Eisenhower signed legislation making the phrase the official motto of the U.S. and it has been required on U.S. currency since 1957. In 1963 the words "payable to the bearer on demand" were removed from all newly issued U.S. currency. Basically, they replaced the gold with God.

US CURRENCY: COINS

The coinage act of 1792 created the US Mint and established the federal monetary systems denominations of coins and the value of each coin in gold, silver or copper. The first U.S. dollar was both named after and based on the Spanish dollar, being produced in the same size and with the same silver content as the then widely used the Spanish dollar.

As with all prior civilizations, the US government wasted no time debasing its coinage. The coinage act of 1834 reduced the weight of the nation's gold coinage by 6% but retained its same face value. This was a continuing trend which climaxed with the coinage act of 1965 which removed all silver from quarters and dimes.

U. S. AND THE GOLD STANDARD

The gold standard is a monetary system where the sovereign nation's paper currency has a value directly linked to gold or silver and the currency can be exchanged or redeemed for gold or silver coins or bullion held in reserve by the currency's issuer.

The collapse of the Civil War era Continental currency resulted in the 1787 Constitutional Convention in Philadelphia including the gold and silver causes into the U.S. Constitution to prevent individual states from issuing their own banknotes or currency. Thus began the bi-metal (gold and silver) based currency.
From 1792 to 1834 the US silver dollar, based on the Spanish dollar, was in use.
From 1834 to 1861 the US had a bi-metal system where both silver and gold coins were in use. The government decreased the gold content of the coins in 1834 and again in 1837 but maintained the same face values.

From 1862 to 1879 the US went off the gold and silver standard due to the Civil War and issued United States Notes known as "greenbacks", not backed by gold. After the war, Congress decided to go back on to the gold standard and steadily decreased the "greenbacks" in circulation until only $347 million, the amount that could be backed by the existing U.S. gold reserves, existed. That amount remained in circulation until 1971.

The current U.S. Federal Reserve Notes are no longer valued in, backed by, or redeemable in gold or silver. Instead it is backed by the full faith and credit of the federal government. "In God We Trust."

COMMENT BOX
Note how the Federal Reserve acted in the late 1800s to preserve the value of US currency by taking currency it could not back with gold out of circulation. Compared that with 2008 - 2014 during which time the Federal Reserve was pumping $85 billion a month of fiat money into the economy.

From 1879 to 1933 the US was on a true gold standard with currency backed by and convertible into gold.

In 1933 the election of Franklin D Roosevelt ushered in a series of executive orders followed by legislative actions resulting in the U.S. being taken off the gold standard. The convertibility of currency into gold was suspended and the private holdings of gold coins, bullion and U.S. issued gold certificates were outlawed. The private ownership of gold was deemed unlawful, punishable by a $10,000 fine and/or 10 years in prison. Privately held gold was nationalized (confiscated) at $20.67/ounce then revalued by the government at $35/ounce resulting in a 68% monetary gain by the federal government. This suspension of the gold standard was promoted as being only temporary, but was actually proven to be permanent.

In 1944 at the New Hampshire Bretton Woods Resort, 44 nations gathered to establish the post-World War II international monetary system that would come to be known as the Bretton Woods Accords. World currencies became convertible only into US dollars and US dollars were to be convertible into gold with an exchange-rate fixed at $32/ounce. The US was required to maintain a 25% gold reserves behind is currency (a fractional reserve) and the US dollar became the world's reserve currency.

From 1934 to 1972 there was a U.S. gold standard in name only. Although the Gold Reserve Act of 1934 continued to define the dollar value in terms of gold, it lacked the convertibility to gold by American citizens. The convertibility of U.S. currency into gold by foreign central banks lasted until the 1971

The 1965 Coinage Act instructed the U. S. Mint to replace the silver in dimes and quarters with lower base metals.

In 1964 the U. S. Treasury removed Silver Certificates from circulation and in 1968 discontinued their redemption in silver.

In 1971 Pres. Richard Nixon, after a two-day meeting on Maine's Minot Island and without congressional approval, completely and permanently severed the US currency's relationship with gold. This was the demise of the 1944 Bretton Woods Accords. US currency became only fiat currency, no longer having either intrinsic value or convertibility into precious metal; and only changeable into denominations of itself.

In 1975 Pres. Gerald Ford once again allowed the American public to hold physical gold.

In 1976 the US government made it official what was already a reality and the definition of the dollar in terms of gold was removed from the statutes. The US monetary system was now officially recognized as a fiat currency system.

THREE WAYS TO HOLD WEALTH

Wealth can be held in three formats: Printed currency, electronic assets and real assets.

(1) ***Printed Currency Assets:*** The folding money in your wallet is labeled "Federal Reserve Note" which is a debt to the Federal Reserve and not the U.S. government as were the previously issued United States Notes (1862-1971) and not backed by gold or silver as were Gold Certificates (1863-1933) or backed by silver as were the Silver Certificates (1878-1964). It is imprinted with "legal tender" which only means it has to be accepted in the U.S. for domestic monetary transactions and to settle debts. "United States Of America" appears in print but with only an implied U.S. government guarantee. The Federal Reserve Note in your wallet is fiat money having no intrinsic value and is no longer redeemable in, or backed by, gold or silver. And finally it is imprinted with "In God We Trust" but don't count on him backing either.

(2) ***Electronic assets:*** These are the assets you see on your brokerage or bank statement or website that indicates the value of your stocks and bonds or the cash balance in your bank account. It is just a string of 1's and 0's on a computer that can be easily manipulated, as illustrated the Bernard Madoff scandal; or deleted by a Russian teenager sitting in his cold basement keystroking your identity away.

(3) ***Physical assets:*** The best example is income producing real estate. It is not just a coincidence the first word is "real." It will work for you 24 hours a day seven days a week. You can go to bed at night knowing that when you wake up it will still be there. Property rights are some of the most enduring rights afforded to U.S. citizens.

GOLD

Gold is a fear commodity with very limited practical use. It is a currency without a country. It is difficult to safely store, difficult to easily move, and it does not pay rent or dividends.

In an apocalypse, you can't eat it, you can't defend your family with it and it won't run your generator. As soon as you take it out in public to trade, you and your family will be targets. Betting on the world's ending has been a losing bet for over 65 million years. The only future value is the hope that someone else, more scared and less intelligent,
will come along and pay more for it.

EARNED IOU's

This is my own terminology. When you get a paycheck the paycheck itself has no intrinsic value, just the promise that it can be converted into electronic 1's and 0's by being deposited into your bank account or into Federal Reserve Notes if the paycheck is cashed.

The 1's and 0's in the bank's computers and the cash in your wallet also just other forms of IOUs. These IOUs are given or credited to you because you performed work using your time, effort and energy to provide goods or services of value and you are now owed something in return. These are your "earned IOUs".

These earned IOU's, whether in the form of paper currency or electronic deposits in a bank, have no as of yet realized value to you in their current form. The real value of these IOUs is only realized after they have been converted into either Fun Stuff or gifting.

COMMENT BOX

My "spend it and die broke" philosophy, as outlined in the Dying Broke chapter, is based on the philosophy that all of your earned IOUs have been of no benefit to you until you choose to responsibly convert them into real assets, enjoy converting them into Fun Stuff, or experience the satisfaction of gifting them to deserving people; all before the government keystrokes them away from you and redistributes them as "unearned IOUs" in the name of "fairness."

UNEARNED IOU"s

If my earned IOUs taken from you by taxation and the government redistribute them to someone who did not work for them, they become someone else's "unearned IOUs".

Unearned IOU's or their money equivalent are obtained by ways other than using work, time and effort:

(1) *The "lucky sperm club"* – Those born into wealth definitely have a head start in life but few seem to end up at the wealth finish line.

(2) *Winning the lottery* - Few winners go on to build wealth or have satisfying lives.

(3) *Criminal activity* – Don't do the crime if you can't do the time. Definitely not a good wealth building plan.

(4) *Marrying wealth* – Great for those who want to work for it 24/7. Their only promotion is called "divorce."

(5) *Redistribution*: Government forced transfer of the IOU's from someone who used their work, time and effort to earn them only to have them taken away

to be redistributed to someone who did not provide any work, time and effort to earn them.

Those who spend their lives dependent on the government's redistribution of someone else's earned IOU's do not really live at all.

The only Fun Stuff within their reach is beer, cigarettes and wrong lottery tickets. They will not experience either the pride or satisfaction of amassing a pile of earned IOU's or the pleasure and thrill of converting the pile into really Fun Stuff or the satisfaction of gifting it to friends or relatives.

SUMMARY

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Money is a medium of exchange and often what is used to keep score.

Prior to currency, barter was the long standing system of exchange.

Coinage allowed wealth to travel.

Bank notes allowed wealth to be kept in a safe place while the depositor exchanged bank notes representing the assets.

"Commodity money" has a value based on its intrinsic value of precious metal.

"Sovereign money" is coin or currency issued by a sovereign government.

"Fiduciary money" is sovereign issued currency with no intrinsic value but is representative of and redeemable in a stated value of gold or silver. It is a promise made by the sovereign issuer, which is the entity holding the gold and silver reserves.

"Fiat money" is coin or currency that has no intrinsic value and cannot be redeemed in gold and silver because the issuing entity lacks the sufficient gold or silver reserves. It is deemed domestic legal tender and must be accepted for commerce and to settle debts. This is what you have in your wallet.

The U.S. Federal Reserve Bank adds money to the economy (called Quantitative Easing –
"QE") to stimulate the economy by keystroking electronic dollars into the commercial bank accounts held at the Federal Reserve. There is no actual "printing money" to stimulate the economy. Currency is only physically printed to replace damaged or lost currency in circulation or to replace old currency with a newer design more difficult to counterfeit.

There is a long history of U.S. currency, both coinage and paper; devaluation, debasement and occasional default.

The U.S. currency or Federal Reserve Notes in your wallet are no longer valued in, backed by or redeemable in gold or silver. They are the debt of the quasi-private/public Federal Reserve Bank and not the U.S. Government.

The three most common ways to hold wealth are: printed currency (cash), electronic deposits (bank and brokerage account deposits) and real property (income producing real estate). With real property you can avoid seeing your wealth evaporate in a bank failure or Ponzi scheme or having it computer keystroked off into cyberspace.

Currency and electronic deposits are simply IOUs you have earned for the work, time and effort you performed that had a value to someone. Those "earned IOUs" have a value that is only realized once they are converted into necessities, Fun Stuff or gifting.