Lecture 9:

 August 26, 2002

GOLD STANDARD UNIVERSITY

Summer Semester, 2002

Monetary Economics 101: The Real Bills Doctrine of Adam Smith

Lecture 9

LEGAL TENDER SMALL BANK NOTES

- Tolerance Standards - Special Privileges for Banks -

- Small is Ugly - Theory of Reflux -

- Sources of Government Conduct -

Today the concept of legal tender refers to coercion. The government orders its subjects to accept irredeemable promises in payment for the real goods and real services they produce. If people refuse to comply with the order, then they put themselves outside of the law. But the term legal tender hasn't always meant coercion. It originated in a right, not an obligation, of the people. As recently as in 1933, in the United States 'legal tender' referred to the right of the people to take their worn gold coins still within the established tolerance standards and exchange them free of charge for full-bodied ones. The government, by law, was obliged to pick up the cost of wear and tear in the coinage.

Unscrupulous employers were prevented from short-changing wage earners by putting underweight gold coins into the pay envelope. This refresher of the semantics of legal tender is a helpful reminder how the government uses the subtle process of twisting the meaning of words to introduce coercion where there was none before, to turn a right into an imposition and, ultimately, to help itself to the wealth of its subjects without due process of the law.

While irredeemable paper currency relies on the strong arm of the government for its circulation, full-bodied gold coins have circulated freely without any legal tender provision or other government interference. There was no need for coercion. Everybody was happy to take the gold coin in payment of wages or against the sale of goods. The government facilitated trade through non-coercive measures. Legal tender referred to measures to make it possible for the gold coin to circulate by tale rather than by weight. Circulation by tale simplified commerce enormously. Instead of *weighing* coins you simply *counted* them. This was achieved by committing the government to absorb the cost of wear-and-tear of the coinage, just as it is committed to absorb the cost of keeping highways in good repair. Tolerance standards were introduced, that is, a threshold of weight was established above which worn gold coins would still be received at face value at the Mint for re-coinage. Only gold coins below the threshold were valued by weight and were received at their actual bullion value. Banks and traders followed suit in accepting worn coins within the tolerance standard at face value. They knew that the Mint and the Treasury would take these coins from them. Thus the term legal tender, in the old sense, simply meant that the government stood behind the value of the coin of the realm even if it was slightly worn.

Another legitimate use of the concept of legal tender was the regulation of the circulation of silver and other subsidiary coins under the gold standard. As the gold/silver bimetallic ratio was variable, two problems could arise. If the bimetallic ratio rose, there could be reluctance to accept silver coinage in large quantities. If the bimetallic ratio fell, there was another threat. Silver coinage could disappear from circulation through wholesale melting or exporting of coins. To counter these problems, subsidiary silver coins were not made full bodied any more by the Mint. This took care of melting and exporting. To ensure smooth circulation of subsidiary coins without discounting which was in the interest of everybody, the Treasury was obliged to take them at face value, up to a certain limit per transaction regulated by legislation. Again, the market followed suit: banks and traders accepted subsidiary coins up to the same limit. By and large, these legal tender provisions worked as intended. Domestic and international circulation of silver and gold coins grew with the growth of world trade.

Serfs of the Leviathan

Legal tender legislation made the impression on the minds of some people that the government had the power to create value out of nothing by stamping a higher value on a lower-valued piece of metal. They saw the legislation, not as an obligation imposed on the government in accordance with the original intention but, rather, as an obligation imposed on the citizens. Out of this misrepresentation of the original legal tender legislation, which in no way intended to limit the freedom of the individual, grew the Leviathan. It disenfranchised the savers and laborers. If legal tender legislation can make worn gold coins and cheap silver coins circulate at a face value higher than that of metallic content, then it can also make paper circulate at arbitrary values.

Enemies of freedom argued thus: Making paper money legal tender could be used to subjugate a free people, reducing them to the status of serfs in the service of the Leviathan, without their realizing just what is happening to them.

Yet there was a problem. All the bank notes in circulation were issued in large denominations. They were used only by people knowledgeable about the market, the condition of the banks, and about the credit of the government. The goldsmith did not issue bank notes of small denominations. His clients would have no use for it and would not take them. If the Great Fraud was to succeed, then it was necessary for the government to pull off a *coup*. Small bank notes should be put into circulation, and the laboring classes had to be mesmerized into accepting them.

"Small Is Ugly"

The introduction of bank notes of small denomination was inextricably intertwined with the granting of special privileges by the government to the banks of issue (banks authorized to issue bank notes). Invariably, these special privileges were highly detrimental to the public interest, and should have never been granted. The patent (monopoly) was reward for the favor of banks to monetize government debt. In practice, this meant that the banks were allowed to have a *fiduciary issue* of bank notes against government paper in addition to (but indistinguishable from) bank notes issued against gold and self-liquidating bills of exchange. The paper backing the fiduciary issue included government bonds and notes that the Treasury was unable to sell to the general public. These bonds and notes were automatically reissued upon expiry. In effect, the bank was carrying a *perpetual* government debt. This it could do only because the bank was able to pass the burden on to the shoulders of the general public in the form of non-interest-bearing paper: small bank notes. Thus fiduciary currency, far from being a present good as suggested by Mises, is the worst possible type of future good one can have! The burden was passed on to the public, and the banks pocketed *riskless profits* in the form of interest payments by the government. Please note that it would not work with the issue of large bank notes. Holders of large notes would hang on to them for as short a period of time as was absolutely necessary, and then would pass them on to others, or would return them to the bank. Small is beautiful from the bank's point of view, but it is certainly ugly from that of the public.

A case in point is the establishment of the Bank of England. King Charles II had borrowed gold from the goldsmiths of London who held it on deposit from some 10,000 depositors. In 1672 the king refused to repay the loan and, naturally, the crown was having great difficulties in borrowing money thereafter. The goldsmiths presented their claims against the king in 1691 and, out of the agreement hammered out, the Bank of England was born. William Paterson, a Scotsman, offered to advance 1 million pounds to the government against its bonds on the following conditions: (1) the bonds were to pay interest at 6½ percent per annum, (2) there was also a management fee to be paid, (3) the government granted the bank monopoly to issue bank notes in the London area. The notes of the Bank of England became legal tender in 1694, and the intervening three centuries did not afford an opportunity for the government to retire the bond against which the original 1 million pound worth of bank notes were issued. It will probably be retired only when the pound will have lost the remainder of its value.

Mises also considers the problem of small bank notes. "For reasons which were connected with certain views on the nature of notes it was thought that the circulation of notes of small denomination ought to be opposed. The battle against the one pound note in England ended with the complete victory of the sovereign (the one pound gold coin)", *op.cit.*, p 321. "Old British banking doctrine banned small bank notes (in their opinion, notes smaller than five pounds) because it wanted to protect the poorer strata of the population, supposed to be less familiar with the condition of the banking business and therefore more liable to be cheated by the wicked bankers", *op.cit.*, p 494.

There is a disturbing misprint on p 494 where Mises talks about his proposed new gold standard for the United States (apparently this is no translation but was written in English by Mises himself in 1952). "It does not require any special mention that the new-stock legal-tender notes to be issued by the Conversion Agency must be issued only in denominations of one dollar or fifty dollars and upward". For this to make sense, I think, the words "one dollar or" should be deleted. That is to say, Mises in 1952 advocated a new gold standard for the United States which would have excluded small bank notes. Unfortunately, he did not exclude legal-tender status for the larger ones.

Special Privileges Granted to Banks

It should be clear at once that under the pact between the government and the banks of issue the smooth redemption of bank notes has been seriously undermined, if not made outright impossible. It was no longer true that one-ninetieth of the banks assets matured every single day of the year, bringing in plenty of gold coins to satisfy normal demand. Nor was it likely that the banks could meet abnormal demand through liquidating assets.

Whereas real bills were highly marketable and could be easily liquidated through discounting at any time on short notice, government bonds had low marketability and their liquidation could involve the bank with losses. In fact, these losses could be quite substantial, in some cases they would wipe out the bank's entire capital. The banks were no longer in the position to operate on the same basis as before. They could no longer make good on their promise to redeem their notes in gold coin on demand.

The banks could continue operation only under special dispensation from the government. The dispensation was designed to protect the banks against the ire of their creditors in case of insolvency. The banks were given special privileges in the form of a patent which made it virtually impossible for their creditors to have legal recourse in forcing liquidation in case the banks failed to perform on valid contracts and obligations. But for the patent, should the bank fail to live up to its promise to pay, creditors would satisfy themselves from the proceeds of the liquidation of the banks' assets.

In effect the new dispensation meant the establishment of a double standard, one for the banks, and another for everybody else, in adjudicating cases that involved contract law. The banks, under the protection of the patent, enjoyed special privileges. They could disguise their breech of faith with creditors under solemn-sounding euphemisms. They could declare a 'bank holiday' or a 'suspension of convertibility', they could 'stand still' or 'go off gold' - and the use of any number of linguistic innovations to cover up the fact of fraudulent bankruptcy. By contrast, other firms had to face the music if they could not perform on their contracts: their creditors could force their liquidation.

Mesmerizing the Laboring Classes

Still, the conspiracy between the government and the banks of issue would have been transparent and easy to expose if it wasn't for the trick that was employed to throw dust into the eyes and confuse the minds of the people. The trick was to maintain the pretense that there was a great unsatisfied demand for bank notes of small denomination out there. It was the government's responsibility to mint gold coins for circulation, so it had to provide a substitute in case of a dearth of gold. The idea was to put over on the public the notion that the fiduciary issue was necessary in order to meet the demand for small bank notes.

The argument is disingenuous. The allegation that gold coins would be in short supply if they were dispersed in the hand of the saving and consuming public is spurious. As we have seen, the producers of consumer goods did not need gold to finance their operations. They could use real bills as a means of exchange. Every urgent and legitimate business transaction in the service of the consumer gives grounds for drawing bills. The greater the urgency, the easier it is to discount commercial paper drawn against the movement of merchandise destined to satisfy consumer demand. Long-term business investments, on the other hand, should be financed by appealing to the saving public for accommodation, and the going rate on long-term funds should be paid. As long as these guidelines were followed, there could be no dearth of gold coins.

There was no genuine demand for bank notes of small denomination. Had there been such a demand, the goldsmith would have put them into circulation. The idea of a dearth of gold is a red herring. The issuance of bank notes of small denomination was clearly a ploy to fool labor. Gold and silver coins were drained from the pockets of laborers and other people of small means. When wage earners lost their right to demand gold and silver in exchange for their services, and dust was thrown into people's eyes in the form of bank notes of small denomination, the stage was set for the Great Fraud.

Thou Shalt Not Press down upon the Brow of Labor This Crown of Thorns!

We may paraphrase Daniel Webster (already quoted in Lecture 3) as follows:

"Of all the contrivances for cheating the laboring classes of mankind, none has been more effective than that which deludes them with *small-denomination* paper money."

It was not the bank note *per se*, but the bank note of small denomination, that were instrumental in cheating the wage-earner out of his fair wages. The distinction is significant. The wage earner is supposed to be paid in gold or silver coin. This is his Constitutional right. With gold and silver coins jingling in his pocket he was the unquestioned master of the market place. His wishes were sacrosanct to all vendors and producers. He was the proverbial boss who was 'always right'. Bereft of his gold and silver coins he was reduced to the station of a serf. Important decisions such as what to produce, when, and how much, are now made without consulting him. He is now inundated with a lot of obnoxious merchandise from unhealthy food through gimmicks with built-in obsolescence, to the lowest quality entertainment including pornography.

As pointed out above, the excuse of a dearth of gold is lame. But even if we assume, for the sake of argument, that there had been a dearth of gold, for that the blame belongs to the government and the banks. A dearth of gold is always an indicator of one or both of the following:

- 1. the banks are pursuing unsound credit policies, such as constructing a debt-pyramid upon a slim or non-existent gold base, or conducting illicit interest arbitrage in borrowing short to lend long (this will be the subject of the last two Lectures in this course);

- 2. the government is trying hard to monetize its debt, that is, make the banks buy the bonds it could not sell to the public.

The dearth of gold is merely a reflection of public distrust in the unsound and dangerous policies of the banks and the government.

William Jennings Bryan, fiery orator, populist politician, and unsuccessful presidential candidate said at the National Democratic Convention in Chicago in 1896: "Thou shalt not press down upon the brow of labor this crown of thorns. Thou shalt not crucify mankind upon this cross of gold." Bryan thought that gold was the enemy and silver the friend of the working people, and the gold standard was the rich man's ploy to enslave labor. Unfortunately, in looking for adversaries he missed the real enemy of the laboring classes: paper.

Thou Shalt Not Crucify Mankind upon this Cross of Paper!

The Constitution of the United States provides for a metallic monetary standard for the country. *This still stands*. Those who run the monetary system of the country could not face a Constitutional debate to change that (although they forced Switzerland to change her Constitution). This is indicative of the bad faith that permeates our present monetary system. Its managers would sooner open themselves to charges that theirs is an unconstitutional monetary regime than muster the necessary courage to propose changing this provision of the Constitution. They obviously have something to hide.

The Constitutional provision for a metallic monetary standard was not a rich man's ploy. It was grounded in the Founding Fathers' genuine regard for the welfare and advancement of the laboring classes. The gold and silver coins are the protectors of the wage earner. The rich man can usually protect himself against monetary mischief even without them. But collective agreements and wage contracts are not worth the paper on which they are written, if gold and silver coins in circulation do not give them substance. History proved the wisdom of the Founding Fathers. In 1971, as the Republic was approaching its bicentennial, there was nobody to cry loud and clear: "Thou shalt not crucify mankind upon this cross of paper money!" The world was quietly submerged in a sea of worthless paper.

The debasement of the dollar that started in 1971 has reached unprecedented proportions in American history. As a side effect, the labor movement in the United States was greatly weakened, unions getting decertified as bargaining agents by the hundreds, in no small measure because labor leaders have failed to stand up for the monetary provisions of the Constitution. This was a betrayal not only of the Constitution, but also the traditions of the labor movement, as shown by the leadership of Ely Moore, the first union official ever to have been elected to the Congress in 1834. The ploy of turning the Constitutional monetary regime into a paper-mill aimed at depriving wage-earners of their right to wages payable in silver and gold coins has succeeded beyond the wildest dreams of its authors. There was not one single labor leader, in 1971 or since, to protest and to initiate a public debate exposing the unconstitutionality of this high-handed and arrogant way of trampling on the people's most elementary rights.

Tormenting Widows and Orphans

In forcing the issue and circulation of small bank notes the government has singularly failed in its solemn task to protect property rights of ordinary citizens against the crime of fraudulent bankruptcy. Traders in the bill market do not need government protection. They make it their business to keep themselves informed about credit conditions, the credit-worthiness of merchants who draw and accept bills of exchange. It is the wage-earners and other people of small means, the savers and, above all, the widows and orphans, who are in need of protection. They cannot be expected to have a clear notion of the risks involved in accepting bank notes purportedly equivalent to the gold coin. They cannot be expected to understand the intricacies of monetary circulation. They cannot be expected to realize that the privileged banks may indeed cheat the public by loading their portfolios with illiquid assets of dubious value. They cannot be expected to know about illicit interest arbitrage, balance sheets, matching maturities, borrowing short to lend long, or about a hundred technical tricks of the banking business which may adversely affect their financial well-being in the absence of gold and silver coins in circulation. They can hardly be expected to understand the legal concept of fraudulent bankruptcy through which they stand to be victimized, not only by the banks, but also by the government, their alleged Lord Protector.

It is this failure of the government to protect the property rights of the economically weak and defenseless, against unsound banking practices that has subsequently adulterated the gold standard and created monetary and economic havoc. *The circulating gold coin and uninhibited access to it is all the protection widows and orphans, wage-earners and others may ever need to protect their property rights*. With gold coins at their disposal they were the unquestioned masters, the sovereign savers and consumers, holding veto-power over the distribution of loanable funds, and the disposal of the social circulating capital, as well as other banking decisions. Bereft of the circulating gold coin, they no longer need to be consulted and, worse still, their protection against plunder is gone. With the removal of the gold clauses from government bonds, they have become the prime target to be victimized by deliberate currency debasement and devaluations. In abandoning them to their fate, the government has ignored the repeated admonition to the tormentors of widows and orphans in the Bible.

The government is bringing upon itself the Biblical curse that all those found guilty of this crime that "cries to heaven" are predestined to suffer.

Theory of Reflux

Not only did the government fail to protect legitimate property rights, but it became an accomplice in allowing insolvent banks to declare bankruptcy fraudulently. There is no need for government regulation of bank notes in circulation. Before they were given privileged status, the banks had not been in the position to 'overissue' their bank notes. The unwanted bank notes flowed back to the issuing bank, and would be exchanged for gold or for highly marketable earning assets such as bills of exchange. In the absence of special privileges, the public would regulate the quantity of bank notes in circulation.

This "theory of reflux" was criticized by Ludwig von Mises and other monetary scientist, who ridiculed the idea that the public can regulate the quantity of bank notes in circulation. They argued that even redeemable bank notes stay permanently in circulation and can cause mischief. However, these critics ignore the fact that the theory of reflux refers to bank notes of large denomination only. Their holders will have them only as long as necessary, and will exchange them for earning assets or for gold as soon as practicable. To assume that bank notes of large denomination can stay in circulation indefinitely contradicts the basic assumption of rational behavior of actors in the market place, led by an 'invisible hand' to protect their own interest.

Mises and other critics of the theory of reflux confuse this problem with an entirely separate one, namely, the problem of small bank notes which, indeed, stay in circulation indefinitely after they have been issued. People of small means, who have been coaxed out of their possession of silver and gold coins, will hold them as a form of saving. Later on, bank notes issued by private banks have been adorned with government stamps and embellished with signatures of government officials to foster the public's (mistaken) belief that, even if there were crooks in the privately owned banks, the government was surely above the crime of fraudulent bankruptcy. Holding bank notes of small denomination as a form of saving was safe in the public's eye.

Critics also ignore the role of special privileges of banking institutions in discouraging the reflux. To the extent that they enjoy privileges the circulation of bank notes cannot be considered free. Bank notes of small denomination get into the hands of the great masses of people who know nothing of the need for protecting their savings through the redemption of idle bank notes. Using subtle (and sometimes not so subtle) methods the privileged banks can easily dissuade their small depositors and holders of small bank notes from exercising their right of redemption. If gentle dissuasion is not enough, the government is not far behind to help protect the interest of the privileged banks against that of the public by less gentle means. The legal obligation to redeem small bank notes (or any bank note) in gold could be abolished by a government edict while still maintaining the pretense of a gold standard under the euphemism of gold bullion standard (respectively, gold exchange standard), as it was done in several countries including Britain in 1925 (respectively, in the United States in 1934). The history of bank notes clearly shows that governemnts are led by considerations other than protecting the legitimate interest of their citizens and creditors against fraud, upholding property rights, and the sanctity of voluntary contracts.

Sources of Government Conduct Regarding Money and Banking

There is no valid reason why governments should exempt banks from the full weight of the provisions of contract law. There is no valid reason for granting special privileges to banks and other financial institutions. There is no valid reason for introducing and maintaining a double standard of conduct - one for the privileged banks and another for everyone else. There is no valid reason for granting privileges without imposing countervailing responsibilities.

The real sources of government conduct regarding money and banking are not hard to find. The government, notwithstanding its profession of high democratic ideals and dedication to public service, is first and foremost interested in perpetuating and aggrandizing its own power - most often by allying itself with a powerful minority against the interest of the powerless and ignorant majority. This matter is certainly not allowed to enter the domain of party-politics. With the rarest exceptions, the governing party is in collusion with the opposition party over the issue of exploiting the ignorance of the powerless majority on all matters pertaining to money, credit, and banking. The party in opposition expects to assume power before long; it is not going to spoil the broth that is cooking not only for the benefit the present incumbent, but also for that of future incumbents as well. Bank regulation, special privileges and exemptions granted to banks are ideally suited to throw dust into the eyes of the public.

From Double Standard to Double Dealing

As suggested by John Maynard Keynes, only one man in a million may understand the subtlety of pauperizing people through the legalization of fraudulent bankruptcy, deliberate currency debasement, and in depriving people of small means of the protection of the gold coin. The past three hundred years, ever since the introduction of central banking in England, bear eloquent witness to this proposition. There is no length governments would not go on the slippery road of subverting voluntary contracts, breaking solemn promises, defrauding their own citizens and creditors when it comes to aggrandizing their own power. Moreover, all this is done in such a way as to maintain the pretense of legitimacy, even the high-mindedness of government action. The villain of the piece is always outside the government, the speculators, the arbitrageurs, the hoarders of gold and silver, the traders in foreign exchange, managers of productive enterprise - they are the ones who display unpatriotic behavior and greed. They are the ones who must be punished for their 'anti-social' behavior. The party in power would never admit, and the party in opposition would never charge that this witch-hunt is designed to find scapegoats and pull the wool before the eye of the public.

The government has been successful in confusing the issue. Not only did the public fail to see the self-serving and self-aggrandizing intention: the government's image as the benevolent protector and the source of countless public benefits was preserved intact, if not enhanced. The truth, however, is that in the domain of contract law, money, banking, and credit, governments have always applied a double standard. Their motto is: "Do as I say, not as I do!" Governments did not stop at introducing double standards. They went on to use them as the basis for double dealings.

Present versus Future Goods

Credit involves exchanging present for future goods. It is therefore essential for us to clarify where the dividing line between the two lies. I wish to return to what in Lecture 7 I called a mistake of Mises not to recognize clearing as a source of credit (Mises on Fiduciary Credit). In the *Theory of Money and Credit* he states: "A person who accepts and holds a [bank] note grants no credit; he exchanges no present good for future good . . . The [redeemable bank note] is a present good just as much [as the gold coin]" (*op.cit.*, p 304-305). Elsewhere in the book Mises emphasizes the gratuitous nature of credit. The act of issuing a bank note (or creating a bank deposit) imposes no sacrifices on the part of the bank - apart from the insignificant cost of printing and book-keeping - so that, in this view, the bank has the power to create present goods virtually out of nothing.

This notion appears to be at odds with the author's well-known position that it is ludicrous to believe, as inflationists would have us believe, that the government can create wealth out of little scraps of paper by sprinkling some ink on them. But if the banks can do it, why can't the government?

You might argue that this latter view Mises expressed later, and it is not fair to set the contrast between two views of an author expressed half a century apart. Indeed, it wouldn't be fair if Mises had recanted his view he expressed in the 1912 first edition, that a bank note is a present good. But I found no trace of any intention to recant in later editions. I am at a loss to explain why Mises himself, or Mises scholars, have failed to focus on this apparent contradiction. I shall be grateful for any hints that can help dispel the mystery. It is possible that Mises, who was a careful thinker, dismissed the problem as a necessary semantic compromise. However, the problem is real and cannot be conjured away through semantic disputes. It goes right to the heart of the theory of money and credit. It will come back to haunt when we are ready to develop the theory of interest. If we blot out the difference between a present good and a promise to deliver a present good to bearer on demand - as Mises appears to be doing - then we give a powerful incentive to the banks and the government "to keep up the good work", and continue to create through credit expansion present goods out of nothing to abolish scarcity for the benefit of society. As we know, this is what the banks and the government have been trying to do in the twentieth century, with disastrous results.

When a Liability Ceases to Be a Liability

Of course, Mises acknowledges the fact that the bank note issue is a liability of the bank and it must be so represented in the balance sheet (*op.cit.*, p 305). I have dealt with this argument already in my Lecture 8 (The Holder of a Bank Note Is a Creditor to the Bank), and I wish to return to the problem once more. There are many other problems arising out of the assertion that a bank note as a present good. They gain new relevance now, in view of the accounting scandals on Wall Street. According to Mises the bank note is a 'present good' which, nevertheless, is a liability at the same time. Therefore the bank note is the only present good in our experience from which the 'producer' cannot walk away, it being also a liability. This does not seem to agree with our common-sense idea of a present good which, one may assume, should not be so encumbered. The producer of a present good ought to have unconditional right of disposal, including the right of walking away from it.

We may try to solve the problem by ruling that the bank note is a present good in the hand of the public, but not in the hand of the bank. But this line of argument raises awkward questions how it is possible that, of two bank notes with identical physical attributes, one is a present good and the other is not, and those attributes could not give you a clue to which of the two kinds it belongs. Actually, Mises maintains that the bank note is a present good in the hands of the issuing bank. It could be put into circulation even without loan transactions, e.g., by purchasing supplies or services with it.

But then it is legitimate to ask at what point in time the bank note has become a present good. Perhaps it was the moment the ink dried on the paper; or the moment when the bank took delivery of their shipment from the printing-shop. Either answer is unsatisfactory. In the latter case we would, once again, look at two identical bank notes one of which is a present good and the other is not. The former is even more awkward because it suggests that it is the printer, not the banker, who has the power to create present goods out of nothing.

Mises suggests that looking at the balance sheet does not reveal the true nature of the process of making a present good out of the bank note. A better approach is to go to the profit-loss account where we find a tell-tale entry: profit on loans. Since the profit accrues to the bank, and not to the holder of the bank note, Mises concludes that, in issuing the note the bank is granting credit rather than seeking it. And by the act of granting it, the bank has created a present good out of nothing, in the form of a bank note.

Upon closer scrutiny, we are still not closer to the solution of the problem. How do we know that the bank's profit is legitimate? Perhaps it is the result of extortion, and the bank is just pocketing it without having good legal, ethical, or economic title to it. In the last Chapter of *The Second Greatest Story Ever Told* I shall tell you about the Acceptance House that has conspired with the issuers of fictitious bills of exchange, and pocketed the difference between the rate of interest and the discount rate - a case of extortion. Could it be that the Acceptance House is the precursor of the illegitimate business of the banks of issue?

Reference

Ludwig von Mises, *The Theory of Money and Credit*, Indianapolis (Liberty Classics), 1981

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Do Not Give in to Evil, but Proceed Ever More Boldly Against It

Bill O'Connor SanBill@aol.com tells me that I have the "wrong approach". He writes: "Sir, your intellectual approach will never work. It is a little like reading the Ten Commandments to Big Al Capone while he is in the midst of a bank stickup. The only thing we have on our side is time - if we live long enough. Bill.

Bill, I am addressing the younger generation. I am not preaching to the culprits. I will have achieved my goal if the young people start thinking about these problems. You are right in saying that time is on our side. I hope that by telling it as it is time I can shorten it.

It is part of our Western cultural tradition not to give in to fate as if it was inevitable, but fight evil by all means at our disposal, and redouble our efforts when our situation looks most forlorn and hopeless. This is also the characteristic of being human: we do it even if we know we shall not live long enough to see and enjoy the result of our efforts. I guess this is the meaning of the lifetime motto Ludwig von Mises chose as a student from Virgil: "Do not give in to evil, but proceed ever more boldly against it."

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GOLD STANDARD UNIVERSITY

SUMMER SEMESTER, 2002

Monetary Economics 101: The Real Bills Doctrine of Adam Smith

Lecture 1: Ayn Rand's Hymn to Money
Lecture 2: Don't Fix the Dollar Price of Gold
Lecture 3: Credit Unions
Lecture 4: The Two Sources of Credit
Lecture 5: The Second Greatest Story Ever Told; (Chapters 1 - 3)
Lecture 6: The Invention of Discounting; (Chapters 4 - 6)
Lecture 7: The Mystery of the Discount Rate; (Chapters 7 - 8)
Lecture 8: Bills Drawn on the Goldsmith; (Chapter 9)
Lecture 9: Legal Tender. Bank Notes of Small Denomination
Lecture 10: Revolution of Quality; (Chapter 10)
Lecture 11: Acceptance House; (Chapter 11)
Lecture 12: Borrowing Short to Lend Long; (Chapter 12)
Lecture 13: Illicit Interest Arbitrage

FALL SEMESTER, 2002

Monetary Economics 201: Gold and Interest

Lecture 1: The Nature and Sources of Interest
Lecture 2: The Dichotomy of Income versus Wealth
Lecture 3: The Janus-Face of Marketability
Lecture 4: The Principle of Capitalizing Incomes
Lecture 5: The Pentagonal Structure of the Capital Market
Lecture 6: The Definition of the Rate of Interest
Lecture 7: The Gold Bond
Lecture 8: The Bond Equation
Lecture 9: The Hexagonal Structure of the Capital Market
Lecture 10: Lessons of Bimetallism
Lecture 11: Aristotle and Check-Kiting
Lecture 12: Bond Speculation
Lecture 13: The Blackhole of Zero Interest

IN PREPARATION: COURSES TO BE OFFERED IN 2003

Monetary Economics 201: The Bill Market and the Formation of the Discount Rate

Monetary Economics 202: The Bond Market and the Formation of the Interest Rate