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# The Declining Dollar: The Money Supply, Gold, the Federal Reserve System, and Socialism

**Table of Contents**


Introduction ..... 1
The Money Supply Must Grow to Accommodate Economic Growth ..... 2
Who Controls the Money Supply? ..... 3
If We Were to Change to a Gold Standard ... .. 5
Why Is the Dollar Losing Value? ..... 7
Fiscal Policy and Inflation ..... 9
Summary ..... 11
Notes ..... 13
About the Author ..... 14


## Introduction

Many people are concerned about the decline in the value of the U.S. dollar relative to other currencies. One measure of this concern is the rise in the price of gold. Gold was selling for about $800 per ounce on November 20, 2007 as reported in the Wall Street Journal[1]. A growing number are blaming monetary authorities for this decline in the dollar and are advocating for the elimination of the Federal Reserve System and returning to the gold standard. The thought underlying this advocacy is that a gold standard will restrict the growth of the money supply and impose a discipline upon the economy that will prevent an erosion in the value of the dollar.

Advocacy for change is good; but, it must be responsible advocacy. Responsible advocacy requires that the advocates for change address three questions: (1) what is the problem you are trying to solve; (2) how do you propose to solve it; and (3) why is your proposal better? The proposed solution must be a complete solution, not a partial one. For example, eliminating the Federal Reserve is only a partial solution. The responsible advocate also must propose a complete system to replace it. If we eliminate the Federal Reserve, then how will we manage our money supply? Who will control the money supply? Changing to a gold standard also is a partial solution. If we change to a gold standard, then how will we finance economic growth, where will we get the gold we need, what will be the exchange rate converting money into gold, and who will control this exchange rate? These questions must be answered for responsible advocacy.

One of the guiding principles of a good engineer is "Do not make a change to a system unless you understand how that change will propagate throughout the system." This is necessary so that one does not create two or three new problems in the course of trying to solve one problem. This paper applies this philosophy to the advocacy mentioned above and challenges advocates to determine how their proposals will impact the overall economy and then tell us why their proposals are better.

The overriding point of this paper is that the role of monetary authorities in any economic system is to provide enough money to finance economic activity, regardless of who controls the money supply or what, if anything, backs the money. If they fail to provide enough money, then recession, depression, or total collapse may result. Monetary authorities in a gold-backed monetary system will have to

increase the money supply to accommodate population growth, economic expansion, and inflation, just as they do in a fiat money system.

While monetary authorities can fuel inflation by providing too much money, the source of inflation in an economy is not limited to monetary policy. Fiscal policy and other actions of government and the concerted, price-fixing actions of economic agents within the economy also can contribute to inflation. These sources are outside the control of monetary authorities. Monetary discipline cannot be imposed upon them without causing economic recession, depression, or total collapse because monetary authorities do not have enough power over them. The economy, and the people within it, will suffer before the politicians, bureaucrats, and external economic agents accept the discipline.

Those who think that eliminating the Federal Reserve and changing to a gold standard will solve the problem of a declining dollar are "barking up the wrong tree." The objective of this paper is to try to shift their focus to the real culprit – fiscal policy and other actions of government, particularly the rise of socialism in the United States and the movement toward communism.

## The Money Supply Must Grow to Accommodate Economic Growth

The money supply finances economic activity (and job creation). If the money supply is not large enough, then economic activity, and job creation, will be slowed. If the money supply is restricted too much, then a recession or depression could result, depending upon how severe the restriction. If there is too much money, then higher prices could result. The role of the monetary authorities is to make sure that the economy has just the right amount of money, not too much and not too little.

To manage the money supply properly, monetary authorities must know the value of each transaction that takes place within the economy and be able to reliably predict the value of future transactions. They also must know the velocity of money, that is, how fast a given amount of money changes hands. Obtaining all of this information is impossible, which is why managing a nation's money supply is a highly refined art rather than a science. Today, monetary authorities keep their eye on economic growth and inflation when determining monetary policy. They try to slow economic growth in order to slow inflation, but not to the point of choking off the growth.

Economic output, Y, represents the transaction value of all goods and services consumed within the economy. It is the sum of the transaction price times the quantity purchased for every transaction and is generally expressed as $Y = P*Q$, where P is a price vector and Q a quantity vector. Gross Domestic Product (GDP) and Gross National Product (GNP) are statistical estimates of Y.

The money supply consists of a money stock component, $M_s$, and a velocity of money component, $v$. The fundamental relationship that guides monetary policy is $Y = P*Q = M_s*v$. The money supply, $M_s*v$, must be large enough to finance Y. Monetary authorities have some control over $M_s$, but no control over $v$ because it is determined by the collective spending decisions of all the economic agents within the economy. The velocity of the M3 money stock has varied between 1.3 and 1.75 over the period 1960-1996[2].

The value of economic output, Y = P*Q, increases when the P and/or Q components increase. Population growth and economic expansion cause the Q component to increase, and higher prices cause the P component to increase. Since the money supply, $M_s*v$, must grow to finance any increase in Y, monetary authorities increase the money stock, $M_s$, because they have no control over the velocity of money, *v*.

Any monetary system must expand to accommodate population growth, economic expansion, and inflation. The failure to accommodate economic growth and expansion will result in higher levels of unemployment and poverty. The failure to accommodate inflation will result in recession, depression, or total collapse, further exacerbating the poverty problem and possibly causing social upheaval.

Monetary authorities in the Federal Reserve System have managed the U.S. economy through tremendous growth since 1940, averaging over 7.5% annually[3], and have successfully accommodated all of the various "shocks" that have hit our economy over the last 6+ decades – the oil shocks of the 1970s; rapidly increasing housing prices and interest rates in the 1970s; the savings & loan crisis in the late 1980s/early 1990s; the dot.com bubble in the late 1990s; and several wars. They are now dealing with the sub-prime mortgage problem and further increases in oil prices. All this without a major depression, so far. The job of monetary authorities is to make sure that the economy has enough money to finance its activity, and, particularly, to ensure that the economy does not falter due to a lack of money.

**Who Controls the Money Supply?**

The money supply can be controlled by privately-owned entities; by a government-controlled entity; or by a joint private sector-government entity. Control can be centralized or decentralized.

Free banking is one form of monetary organization. In a free banking system, individual banks would issue their own notes and currency, backed by a commodity such as gold. All individual banks' currencies would be convertible into a fixed amount of gold, providing valuation stability for each bank's notes. If there were 100 different banks in an economy, then there could be 100 different sets of bank notes and coins in circulation as legal tender. There is no central bank or monetary authority in a free banking system, and control of the money supply is decentralized to each individual bank[4].

Instead of carrying a U.S. dollar, American consumers could be carrying a Bank A dollar and a Bank B dollar and a Bank C dollar, etc. Merchants would be handling numerous sets of currencies in all denominations, and so would the bank clearinghouses. This would greatly increase the cost of handling money, causing higher prices itself.

The money supply in any monetary system can be expanded by agents minting or printing counterfeit coins and currency. A sufficient amount of counterfeit money in an economy will cause inflation and, if present to a great enough extent, economic collapse. In a free banking system with 100 different sets of currencies, how can a consumer or merchant tell if he is receiving a real or counterfeit bank note or coin? A person would have to compare the note in his hand to each of 100 different legal notes and spot any small discrepancy. So would the people at each bank, because each bank would be handling

other banks' notes. Because of this complexity, a free banking system would be highly susceptible and vulnerable to counterfeiting. A free banking system, or decentralized monetary system, is complex and inefficient relative to a centralized banking system, making it impractical for large economies.

A centralized banking system utilizes a central bank that issues common bank notes and coins to banks throughout the economy. Money in a centralized banking system could be backed by gold, or other commodity, or be fiat money backed by nothing. Merchants and consumers handle only one currency, and the central bank is responsible to control counterfeiting. The money supply is controlled, that is monetary policy is determined, at the central bank level. Central banks can be privately owned, government controlled, or have mixed ownership and control. The Federal Reserve System is an example of mixed ownership and control.

In a nutshell, the major problem with a central bank being privately owned is that it concentrates too much power into too few hands. Power corrupts, and it was corruption and fraud that led to the end of the Second Bank of the United States' tenure as a central bank in 1836[5]. The major problem with a central bank being controlled by the government (politicians and bureaucrats) is that politicians may use monetary policy to foster their re-election rather than to pursue valued economic objectives such as economic growth and price stability. They could use monetary policy to buy votes leading into an election by subverting sound monetary policy to create an illusion that the economy is good.

**U.S. Economic Contractions**
**Months per Decade**

| Decade | Months |
|---|---|
| 1860 | 46 |
| 1870 | 78 |
| 1880 | 51 |
| 1890 | 51 |
| 1900 | 48 |
| 1910 | 54 |
| 1920 | 49 |
| 1930 | 52 |
| 1940 | 19 |
| 1950 | 18 |
| 1960 | 11 |
| 1970 | 26 |
| 1980 | 22 |
| 1990 | 8 |
| 2000* | 8 |

* Most recent decision of NBER's Business Cycle Dating Committee is that the last contraction ended in November 2001.

Source: National Bureau of Economic Research, "U.S. Business Cycle Expansions and Contractions," 2 Dec 2007 <http://www.nber.org/cycles/>.

This is one reason why the Federal Reserve System is set up as a system of mixed ownership and control – to take the determination of monetary policy out of the hands of politicians and to control the power placed in private hands. Note that since they cannot use monetary policy to buy votes, politicians now use fiscal policy to do it through give-away programs, subsidies, tax cuts, and pork-barrel, or "earmark," spending. Using the power of government to buy votes can, and does, have a significantly harmful effect on the economy and on the lives of people as discussed later in this paper.

The Federal Reserve system has worked well overall since its inception. We have experienced tremendous economic growth and improvements in quality of life and have had only one economic depression. The duration of economic contractions has dramatically declined from an average of 53 months per decade from the 1860s-1930s to 19 from the 1940s-1980s. We had only 8 months of contraction in the 1990s and 8 months in the 2000s, so far[6]. The activities of the Federal Deposit Insurance Corporation, created in 1934, and monetary authorities providing liquidity during financial crises are major factors behind this dramatic improvement.

We see the value of our money declining, and some blame it on the Federal Reserve System and its monetary policy. They propose eliminating the Federal Reserve System and moving to a commodity-backed monetary system, such as a gold standard. The challenge to them, as responsible advocates for change, is to tell us (1) to what will we change our monetary system, (2) who will control the money supply and the gold-dollar exchange rate in this monetary system, and (3) why this proposed system is better. Do they want private sector entities controlling our money supply, like back in the days of the Second Bank of the United States; or do they want politicians and government bureaucrats controlling our money supply; or do they want another system of mixed private sector-government control?

In addition, responsible advocates must analyze the transition process in going from a fiat money system to a gold-backed system to ensure that the economy does not go into recession, depression, or total collapse because of the transition itself. What are the consequences of changing to a gold standard? The next section discusses some of the details that must be addressed in changing to a gold standard.

**If We Were to Change to a Gold Standard ...**

The thought underlying the advocacy to change to a gold standard is that this will impose a discipline upon the economy that will prevent an erosion in the value of our currency by restricting the growth of the money supply. The transition from a fiat currency to a gold-backed currency must be managed in such a way as to not disrupt economic activity, otherwise significant economic upheaval could result including total collapse. We do not want to throw a monkey wrench into the gears of the economic machine. The following discussion provides an analysis of the transition from fiat to gold in order to determine the likely economic impact of the change.

The Gross Domestic Product (GDP) of the U.S. economy reached $14 trillion in 2007[7]. Official U.S. gold reserves are 260 million ounces[8]. Allowing for a 1.6 velocity of money, the money stock would have to be $8.75 trillion. For 260 million ounces of gold to finance a $14 trillion economy, the exchange rate would have to be $33,654 per ounce for full backing, a 42-fold increase over the currently high $800 per ounce price. Note that these figures do not include any allowance for dollars used in international trade among other countries. The exchange rate would have to be even higher if we were to accommodate these dollars.

If we wanted to keep the exchange rate at the current $800 per ounce, we would have to buy over 10.6 billion ounces of gold. This would cost more than $8.5 trillion. Where would we get the money for this? Where could we find this much gold? The world's output of gold is currently only about 130 million ounces per year[9].

If we allow banks to hold only 10% of the money stock in gold, then the exchange rate would be $3,365 per ounce. If we wanted to keep the exchange rate at $800 per ounce, we would have to buy over 1 billion ounces of gold costing us more than $800 billion. However, all money would not be backed by gold – only the first 10% is backed, the rest is the same as fiat money – setting up the risk of economic bankruptcy by a run on the gold.

A run on the gold could collapse the banking system and the economy with it. This is one reason why President Nixon released the dollar from its gold backing in 1971. We did not have enough gold to survive a "run" by foreign governments. Other countries, acting in concert, had the power to bankrupt our economy, putting our nation at great risk.

All it would take to start a run on our gold is (1) our enemies working together or (2) a perceived weakness in the dollar much like what we see now with $800 an ounce gold prices. Today, our 260 million ounces of gold are worth $208 billion at $800 an ounce. This is only 27 % of the trade deficit for last year[10]. This means that almost 4 times the amount of dollars that it would take to bankrupt our economy flowed out of our country last year, if we were on the gold standard. Our trade deficit with China was $233 billion last year[11], enough in itself to bankrupt us if they demanded payment in gold instead of dollars. Other countries joining forces would be able to do the same.

One response to a run on the gold would be to change the gold-dollar exchange rate, devaluing the dollar, to avoid bankruptcy and economic collapse; but, this defeats the purpose of having a gold standard in the first place. This is why it is important to know who will control the exchange rate in a gold-backed monetary system. Another response to a run would be to suspend the convertibility into gold, making the money fiat money, which is what President Nixon did in 1971.

How would we finance economic growth with a gold standard? A 3% growth in GDP would require the money stock to grow by $260 billion. We would have to buy 325 million ounces at $800 per ounce to finance this growth with full gold backing. Where will we get this money – from higher taxes or increased borrowing? If we cannot buy this much gold – 325 million ounces is 2.5 times the current world output – would we devalue the dollar to prevent higher unemployment?

We could avoid the need to buy more gold, at least for a while, by using the gold we have. If we used only 25% of our gold reserves to back the money stock, then the exchange rate would be $134,615 per ounce for full backing. Our gold reserves would finance our economy for only 50 years or so at this exchange rate with a 3% annual growth rate. Then, we either would have to buy more gold or devalue the currency by changing the exchange rate. **The key to success of having a gold standard is to have enough gold to finance population growth, economic expansion, and inflation for eternity**.

A tremendous increase in the price of gold would disrupt financial and other markets throughout the world. The price of gold-related stocks would skyrocket and other stocks could decline because of the tremendous shift in demand toward gold investments. The cost of jewelry and other products in which gold is used would skyrocket. Other metals and materials used as substitutes for gold would increase in price. Government spending would skyrocket to make gold purchases. Taxes would increase, causing significant economic disruption and higher unemployment. Borrowing to buy gold would cause higher interest rates, increasing borrowing costs for businesses and consumers and leading to higher prices and higher unemployment in the economy. Housing would become unaffordable for many more people, and auto sales would likely decline due to higher purchase and financing costs.

Backing the U.S. dollar with gold is not practical because we do not have enough gold now, and it would be too expensive to buy additional gold. In addition, our money supply would be dependent

upon the production decisions of private-sector gold producers. If the commodity standard were diamonds, would we want DeBeers to have control over our money supply and our economy? We also do not want our money supply to be dependent upon a commodity that must be imported from another country. We already are too heavily dependent upon imported oil. If we were to change to a gold standard, the likely result would be either (1) a severe slowing of economic activity with hyper-inflation, high unemployment, and a degree of social unrest bordering on revolution or (2) economic bankruptcy from a run on our gold organized by our enemies. A return to a gold standard would be short-lived and very expensive.

## Gold as a Store of Value???

The price of gold reached an all-time high of $850 per ounce on January 21, 1980[1]. The price of gold on November 20, 2007 was about $800 per ounce[2], a 5.9% decline over 28 years. In contrast, an $850 investment made in early 1980 would grow to $1,123 by 2007 at a mere 1% annual rate of return, 40% more than gold. The $850 investment would grow to $3,332 at a relatively low 5% annual rate of return, over 4 times the value of the 1 oz of gold.

Any asset, such as gold, silver, fiat money, etc., is worth what it will buy. The Consumer Price Index for All Urban Consumers was 230 (1967=100) at the end of 1979 and 626 at the end of October 2007[3], almost a three-fold increase (2.722). Adjusting the investment performance for inflation, the value of the 1 oz of gold **declined** by 65% in real terms while the value of the 5% annual return investment **grew** by 44%. With experience like this, how can anyone say that gold is a store of value?

[1] "Recent Trends in the Price of Gold" American Institute *for* Economic Research – Research Reports LXXIII (2006): 106.

[2] "Cash Prices for Tuesday, November 20, 2007," Wall Street Journal 21 Nov. 2007: C8.

[3] United States, Department of Labor Bureau of Labor and Statistics, Consumer Price Index – All Urban Consumers, 2 Dec. 2007 <http://data.bls.gov/cgi-bin/surveymost?cu>.

The role of monetary authorities is to ensure that there is enough money to finance, or accommodate, the activity within an economy, regardless of how the currency is backed. Trying to impose discipline on an economy using the money supply would likely result in economic recession, depression, or total collapse before the discipline is achieved, particularly if the source of the problem lies outside the economy as in the case of high oil prices. U.S. monetary authorities cannot cause the price of oil to decline by restricting the U.S. money supply. If they were to try this, our economy would go into a recession or worse.

If monetary authorities accommodate, then who causes? Why is the dollar losing value? The next section discusses factors that affect the value of the dollar and its exchange rate relative to other currencies.

## Why Is the Dollar Losing Value?

Money is worth what it will buy. Domestically, money loses value because of inflation. As prices rise, a given amount of money will buy fewer and fewer goods and services. Internationally, the dollar loses value relative to other currencies because of changes in supply and demand for the dollar in the foreign exchange markets.

Imports pump money outside the country, increasing the supply of dollars in the international marketplace and putting downward pressure on the value of the dollar. Exports increase demand for the dollar, putting upward pressure on its value. A trade deficit will put a net downward pressure on the dollar, and an increasing trade deficit will tend to push the value of the dollar lower and lower.

The U.S. trade deficit has been increasing over time from $80 billion in 1990 to $760 billion in 2006. Over that time, exports have increased from $550 billion to $1,470 billion, while imports have increased from $630 billion to $2,230 billion[12]. Defense spending outside the U.S., which has the same effect as an import, has increased from $13.5 billion in 2000 to over $31 billion in 2006[13] likely due to the war on terror. The supply of dollars in the international marketplace has been increasing over time, tending to push the dollar lower and lower.

In particular, the dollar has been weakening relative to the British pound. Fundamentally, this will occur if those with British pounds (1) do not spend as much on dollar-denominated goods and services as in the past and/or (2) already have enough dollars to pay for their dollar-denominated purchases and do not have to convert their pounds into dollars in the foreign exchange market. Our exports to the United Kingdom went from $41 billion in 2000 to $44 billion in 2007, while our imports from the United Kingdom went from $43 billion in 2000 to $53 billion in 2006. Our trade deficit with the United Kingdom, therefore, went from $2 billion in 2000 to $9 billion in 2006. The British received $7 billion more in 2006 than in 2000, so they did not have to convert as many pounds to dollars to finance their other dollar-denominated purchases. The demand for the dollar in the foreign exchange market went down, weakening it; and the supply of British pounds went down, strengthening the pound. A similar circumstance exists in our trade with Japan, which is why the dollar is weakening relative to the yen, too[14].

Another factor to investigate to explain a decline in the value of the dollar is net investment flow by the private sector. Foreigners buying U.S. stocks, bonds, Treasury securities, and real estate and building manufacturing facilities in the U.S. will increase the demand for the dollar; while U.S.-based businesses investing in other countries will increase the supply of dollars in the international marketplace. Declining interest rates in the U.S. can make investment in U.S. Treasury securities less attractive to foreigners, reducing investment inflow and demand for the dollar. A booming stock market, on the other hand, may attract foreign investment, increasing demand for the dollar.

A reduction in net investment inflow will tend to push the value of the dollar lower. Net private investment inflow declined by about $142 billion from 2005 to 2006 while the trade deficit increased by $48 billion, putting significant downward pressure on the dollar[15]. Lower interest rates in the U.S. and a volatile stock market in 2007 also may have contributed to the recent decline in the dollar.

Inflation has increased the cost of living and cost of doing business in the U.S. to the point where U.S.-based businesses have difficulty competing in the global economy. Costs are too high in the U.S. relative to the rest of the world, so U.S.-based businesses have been moving production and other parts of their operations to lower-cost countries. When a manufacturing plant that was producing product for our domestic market and for export moves to another country, our imports increase and our exports decrease, tending to produce a trade deficit. In addition, investment dollars flow out of the country in building the plant and making capital improvements. This puts downward pressure on the U.S. dollar. Multiply this scenario many times over and one gets an idea of why our trade deficit is so large and why the dollar has been performing poorly in the international marketplace. One also can see how re-industrializing the United States will help strengthen the dollar. To re-industrialize the United States, we must reduce the cost of living and cost of doing business.

**Inflation, leading to a high cost of living and high cost of doing business, is the underlying factor causing the value of the dollar to decline, both domestically and internationally**. So, why are the cost of living and cost of doing business so high in the United States? The next section investigates this question by looking at the activities of government and its fiscal policy.

## Fiscal Policy and Inflation

The government attempts to control economic activity through two major policy areas, fiscal policy and monetary policy. Fiscal policy relates to the decisions that go into the government budget – spending, taxation, and whether to operate at a deficit or surplus. Monetary policy relates to the decisions made by the monetary authorities, such as money supply growth, interest rates, etc. Fiscal policy decisions are made by Congress and the President, and monetary policy decisions are normally made by the Federal Reserve Board. The decision to move to a gold standard would be a monetary policy decision made by Congress and the President. Note that Congress and the President also impact the economy through regulation and laws creating, or regulating, legal liability. These are not normally considered fiscal policy decisions, but they impact the economy just the same.

The purchasing power of money is eroded by inflation. Monetary authorities can cause inflation if they provide too much money, but inflation also has sources outside the monetary system and outside the control of the monetary authorities. Government, through fiscal policy and other actions, and economic agents, joining forces through industry consolidations and the formation of cartels, can cause inflation through the use of political and economic power.

Demand pull and cost push are two major characterizations of inflation. Demand pull inflation results from providing an economic stimulus to the demand side of the economy. Social spending, or redistribution-of-wealth programs, and tax cuts for individuals are examples of demand-side stimuli. Monetary authorities providing too much money can be a source of demand pull inflation, too, and so can banks and other lenders when they lessen requirements for credit.

Cost push inflation results from an increase in the cost of doing business. The cost of raw materials could increase, such as with rising oil prices; or other operational costs could increase, such as with increased employment taxes (Social Security, Medicare, and unemployment), health, workers' compensation, and product liability insurance premiums, wages, cost to comply with government regulations, etc. Note that an increase in the cost of living resulting from demand pull inflation will put pressure on wages to increase, leading to cost push inflation. Demand pull inflation can fuel the next round of cost push inflation.

Fiscal policy is a source of both demand pull and cost push inflation. Welfare, Social Security, Medicare, and Medicaid spending and tax cuts for individuals stimulate demand and impart an inflationary bias into the economy. Taxation of business activity – payroll, profit, and excise taxes – increases the cost of doing business, resulting in higher prices.

Taxation of business activity also restricts the expansion of the supply side of the economy. Anything that increases the cost of doing business (payroll taxes, excise taxes, regulations, lawsuits, insurance

premiums, etc.) will restrict the expansion of the supply side of the economy because increasing cost increases the risk of starting or expanding businesses, particularly small businesses. Risk is a barrier to supply-side expansion.

Profit taxes reduce the return on investment, which restricts businesses' ability to attract the capital needed to expand (return attracts investment capital). Profit taxes also take expansion capital from businesses. They can replace this lost capital from the capital markets; but, it costs more, further reducing the return on investment. It costs even more if the government operates with a budget deficit – another fiscal policy decision. With profit taxes, we take expansion capital from businesses and make it more costly for them to replace it and to raise more capital for expansion. This restricts the growth of the supply side of the economy.

**Table 1. U.S. Fiscal Policy Inflationary Bias**
(in millions of dollars)

| Year | Demand Stimulus[1] | Year to Year Change | Supply Restriction[2] |
|---|---|---|---|
| 1990 | 553,109 | | 318,876 |
| 1991 | 617,149 | 64,040 | 338,496 |
| 1992 | 695,668 | 78,519 | 352,684 |
| 1993 | 744,521 | 48,853 | 379,727 |
| 1994 | 788,600 | 44,079 | 426,348 |
| 1995 | 834,918 | 46,318 | 456,725 |
| 1996 | 873,010 | 38,092 | 480,545 |
| 1997 | 914,142 | 41,132 | 508,903 |
| 1998 | 941,229 | 27,087 | 532,266 |
| 1999 | 964,036 | 22,807 | 561,011 |
| 2000 | 1,014,793 | 50,757 | 602,580 |
| 2001 | 1,092,386 | 77,593 | 564,291 |
| 2002 | 1,196,099 | 103,713 | 565,413 |
| 2003 | 1,278,321 | 82,222 | 555,791 |
| 2004 | 1,338,101 | 59,780 | 625,930 |
| 2005 | 1,418,404 | 80,303 | 748,439 |
| 2006 | 1,483,674 | 65,270 | 846,787 |

[1] Data from Budget of the United States Government Fiscal Year 2008 – Historical Tables, Table 3.1 Outlays by Superfunction and Function: 1940-2012, 5 Dec. 2007 <http://www.gpoaccess.gov/usbudget/fy08/pdf/hist.pdf>. Demand stimulus includes the Health, Medicare, Income Security, and Social Security functions.

[2] Data from Budget of the United States Government Fiscal Year 2008 – Historical Tables, Table 2.1 Receipts by Source: 1934-2012, 5 Dec. 2007 <http://www.gpoaccess.gov/usbudget/fy08/pdf/hist.pdf>. Supply restriction includes Corporate Income Taxes, employers' portion of Social Insurance and Retirement Receipts, and Excise Taxes.

Our current fiscal policy of redistribution-of-wealth-based social spending and taxation of business activity stimulates the demand side of the economy and restricts the growth of the supply side, providing a driving force for inflation. We have been doing this for the last 6+ decades. Table 1 shows the federal government's activity since 1990. **We stimulate demand and restrict supply expansion year after year. The supply side never catches up to the demand, and we see continual inflation**. Couple this with cost of living adjustments (COLAs) and minimum wage laws, which lock in past inflation and fuel future price increases (today's wage increase leads to tomorrow's price increase), and we get an inflationary spiral. Note that Table 1 shows only the federal level. States tax and spend similarly, further increasing the inflationary bias.

If this is not enough, we further impose high costs on businesses through regulation and legal liability laws. Regulation and lawsuits – product liability, discrimination, harassment, worker compensation, etc. – aimed at "deep-pocketed" businesses raise the cost of doing business and prices.

Skyrocketing health care costs increase the cost of living and cost of doing business in the United States. We stimulate demand for health services by subsidizing patients with low insurance co-pays and restrict supply with high costs and price controls. The medical profession is marked by a high cost

to enter (the expense of medical school and medical equipment); high administrative costs (dealing with insurance company payment policies and "c.y.a." liability protection measures); and high malpractice insurance premiums due to the high threat of lawsuits. The government controls prices through the payment policies of Medicare and Medicaid; and health insurance companies control prices through their payment policies, too. Stimulating demand while restricting supply is a formula for high prices.

In addition, our entire economy, and others', is based upon oil. The demand for oil increases as economies grow throughout the world. A significant amount of oil production is controlled by an international cartel; and, in the United States, supply expansion is restricted by the high cost and restrictions of environmental regulations, lawsuits, and the political power of environmental activists. Oil exploration in the United States has been heavily restricted and no new refineries have been built for 30 years or more, but the economy has been growing. Increasing demand while restricting the growth of supply is a formula for high prices, which is why we are paying $3.00 or more for a gallon of gasoline. Note that rising fuel prices also increase the cost of doing business throughout the economy, driving up prices on all other goods and services. This, in turn, tends to make U.S.-based businesses even less competitive in the global economy, widening the trade deficit and putting additional downward pressure on the dollar.

The factors discussed above are outside the control of monetary authorities. Monetary authorities cannot control the creation or expansion of inflationary government programs or the supply-side decisions of international cartels by "imposing discipline" through a restriction of the money supply of any country. They must accommodate the rising prices, otherwise the economy will go into recession, depression, or collapse due to a lack of financing. In fact, *any* monetary system, whether controlled by the private sector, government, or mixed, whether backed by gold, silver, or nothing, must expand to accommodate the activity within the economy to avoid economic decline.

The real culprit primarily responsible for the decline in the dollar has been the rise in Big Government – the socialization of the United States and our movement toward communism. The cost of living has skyrocketed since President Lyndon Johnson put us on a path to the "Great Society," rising more than six-fold over the last 40 years, as measured by the consumer price index, from 100 (1967 = 100) to about 626. In contrast, the cost of living index rose by only 3.37 times over the 55-year period from 1913 to 1967, from 29.7 to 100[16]. **It is the high cost of living and cost of doing business in the United States that is the driving force behind the movement of manufacturing plants to other countries (and the loss of jobs), our huge trade deficit, and the decline in the value of the dollar, both domestically and internationally**.

## Summary

It does not matter how money is backed, whether by gold, silver, or nothing; it does not matter how the monetary system is organized, whether controlled by government, private-sector, or mixed or whether centralized or decentralized; monetary "authorities" must provide enough money to finance the economic activity or else economic recession, depression, or collapse will result. They must provide

enough money to finance population growth, economic expansion, and inflation and to deal with "shocks" that hit the economy.

The cause of the decline in the value of the dollar, both domestically and internationally, is inflation, the source of which lies mostly outside the control of monetary authorities. Government, through fiscal policy, regulation, and creating legal liability, is a major source of inflation in the United States. Handout-based welfare spending, Social Security and Medicare spending, tax cuts for individuals, taxation of business activity, regulation, and lawsuits derived from legal liability laws impart an inflationary bias into the economy. Cost of living adjustments and minimum wage laws lock in this inflation and further fuel inflation in later years.

To reverse the decline in the purchasing power of the dollar, both domestically and internationally, the focus of attention should be on government fiscal policy and other actions that impart an inflationary bias into the economy rather than on monetary policy. We must reduce the cost of living and cost of doing business in the United States so that we can re-industrialize America and reduce the trade deficit. We must reduce the cost of the government's impact on the economy through taxation, regulation, and lawsuits; and we must expand the supply of oil and gasoline to reduce the cost of living and the cost of doing business. We must dismantle Big Government to make our economy more efficient and unwind the socialism – the attitude that "we politicians and bureaucrats know better than you" – that has taken over our country and eroded our individual freedom.

# Notes

[1] "Cash Prices for Tuesday, November 20, 2007" Wall Street Journal 21 Nov. 2007: C8.

[2] United States, Federal Reserve Bank of New York, U.S. Monetary Policy and Financial Markets – Chapter 1, 2 Dec. 2007 <http://www.newyorkfed.org/education/addpub/monpol/chapter1. pdf> 14.

[3] United States, Department of Commerce Bureau of Economic Analysis, Current Dollar and "Real" Gross Domestic Product, 2 Dec. 2007 <http://www.bea.gov/international/index.htm>.

[4] Richard M. Salsman, Gold and Liberty (Great Barrington, MA: American Institute *for* Economic Research, 1995) 15-24.

[5] "Second Bank of the United States," Wikipedia The Free Encyclopedia, 2 Dec. 2007 <http:/en.wikipedia.org/wiki/Second_Bank_of_the_ United_States>.

[6] National Bureau of Economic Research, "U.S. Business Cycle Expansions and Contractions," 2 Dec. 2007 <http://www.nber.org/cycles/>.

[7] United States, Department of Commerce Bureau of Economic Analysis, Table 1.1.5. Gross Domestic Product, 2 Dec. 2007 <http://www.bea.gov/national/nipaweb/TableView.asp#Mid>.

[8] "Recent Trends in the Price of Gold," American Institute *for* Economic Research – Research Reports, LXXIII (2006) 106.

[9] "Recent Trends in the Price of Gold," 107.

[10] United States, Department of Commerce Bureau of Economic Analysis, Table 1.1.5.

[11] United States, Department of Commerce Bureau of Economic Analysis, Table 2a. U.S. Trade in Goods, 2 Dec. 2007 <http://www.bea.gov/international/bp_web/simple.cfm?anon=57663&table_id= 20&area_id=1>.

[12] United States, Department of Commerce Bureau of Economic Analysis, Table 1.1.5.

[13] United States, Department of Commerce Bureau of Economic Analysis, Table 4.2.5. Exports and Imports of Goods and Services by Type of Product, 29 Nov. 2007, 4 Dec. 2007 <http://www.bea. gov/national/nipaweb/TableView.asp#Mid>.

[14] U.S. Department of Commerce Bureau of Economic Analysis, Table 2a.

[15] United States, Department of Commerce Bureau of Economic Analysis, U.S. International Transactions Account Data, Table 1. U.S. International Transactions, 1960-Present, 14 Sept. 2007, 2 Dec. 2007 <http://www.bea.gov/international/index.htm>.

[16] United States, Department of Labor Bureau of Labor and Statistics, Consumer Price Index – All Urban Consumers, 2 Dec. 2007 <http://data.bls.gov/cgi-bin/surveymost?cu>.

# About the Author

Roger Thoney is an economic troubleshooter whose objective is to demonstrate that a 2% or less unemployment rate can be achieved and sustained in an economy by providing venture capital to invest in new businesses and expand small businesses and by reducing the cost of living and cost of doing business, making the economy more efficient. This is a challenging objective which he has been pursuing for more than 19 years. Creating more jobs and reducing the cost of living will enable many more people to rise out of poverty, thereby solving many social problems that exist because of poverty. Reducing the cost of living and cost of doing business will reduce the overhead costs of businesses and their break-even points, enabling more small businesses to succeed. The venture capital investments will replace much of today's welfare spending, reducing the inflationary bias of current fiscal policy. Instead of increasing spending on social programs to stimulate the economy, policy-makers can increase the pool of venture capital to start and/or expand more businesses.

Roger is an electrical engineer with master degrees in electrical engineering, business administration, and economics from the University of Kentucky and The Ohio State University. In addition, he has taken doctorate level courses in macro and micro economics, monetary economics, international trade and finance, banking, corporation finance, and investments. He is a registered professional engineer in Kentucky. He has developed the Freedom Plan, which is an economic plan to reduce unemployment and the cost of living in the United States, and the Kentucky Freedom Plan, which is a state-level version of the Freedom Plan. He also has developed a Health Care Reform Plan, a Liability Loan Program to provide auto liability coverage for low-income individuals, a Job Creation Flowchart, and a Clean Air and Water Financing Proposal.

Roger was a candidate in the 2000 and 2002 Republican primaries for Kentucky's 4$^{th}$ District U.S. Representative and a candidate for Lt. Governor of Kentucky in 2003. He was an economic and campaign advisor to a Ky. gubernatorial candidate and a Ky. State Senator. He authored HB 725, a venture capital bill introduced into the Kentucky House during the 2006 Session, and was a panelist in *America Under Attack*, a DVD discussing the transformation to socialism/communism that has been taking place in the United States over the last 6 decades. He also has been a consultant for several small businesses.

The fundamental purpose of economic activity is to serve as a means to distribute the basic necessities of life – food, clothing, shelter, health care, etc. – among a population of people. Poverty results from unemployment and the cost of living being too high and is a sign that the economy is not working efficiently. Roger has been trying to "get to the bottom" of the problem and develop solution plans to reduce unemployment and the cost of living. He has found that policy-makers put political interests, particularly the desire to get re-elected, ahead of sound economic policy and is trying to persuade them to treat job creation and reducing the cost of living as top priorities above other political concerns, that is, to put the people first.