NEW MONEY: A CREATIVE OPPORTUNITY FOR BUSINESS

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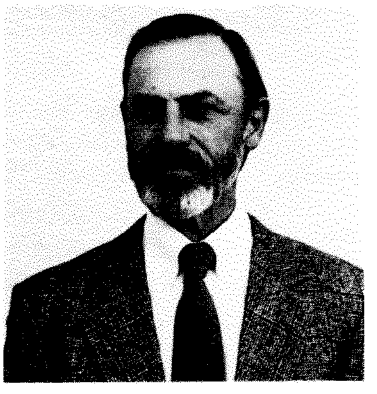

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E-cash, cyber bucks, direct deposits, electronic fund transfers - what's happening to money today? It's hard for most people to imagine a world without money, but that's what's on the horizon. The nature of money has changed drastically over the past 100 years and even more dramatic changes are in the offing. These changes, which have already begun, are revolutionary in nature. They mark a fundamental reversal of direction in the flow of power.

For at least the past two hundred years, the changes in money and banking have been designed to centralize and concentrate power. Now the flow is being reversed. While the global system of banking and finance, composed of interlocking central banks and central governments, appears to be monolithic, recent developments in communications and information technologies have created unprecedented opportunities for the liberation of money and the exchange process.

The locus of power is now shifting from banks and governments to players in the economic arena-businesses and individuals who are organizing their own exchange systems and using their own nonpolitical systems of account. This is already happening at the grassroots level, and, to some degree, at the level of regional business. What remains is to establish it in international trade.

These points are emphasized in the article "The Future of Money," which appeared in a recent issue of the Dow Jones publication *MaRKETS.* In it, the author states that "Experts foresee a looming challenge from the private sector (by both banks and non-banks) to the monetary monopolies long enjoyed by the world's governments. Central bankers, one might say, are about to be given a run for their money."[1]

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In this article, I describe what needs to happen next. I'm proposing that businesses take the initiative and do it *themselves, establishing a federation of cooperative credit clearing exchanges, and adopting an objective, nonpolitical, universal unit ofaccount.* Doing this will change everything-for the better.

The world's financial difficulties today arise mainly from our failure to recognize the true nature of money. We still think of it as something substantial, as a *thing* to be created, exchanged, borrowed, and accumulated-an object of speculation and gain. In reality, money is just an accounting system. Once recognized as such, it will cease to be an instrument of power used to exploit the powerless.

Historically, money has taken many forms. Its evolution has progressed roughly from commodity money, to symbolic money, to credit money. In early times, commodities, most commonly precious metals, were used. This kind of money could be seen and weighed and held in one's hand. Coins were first produced in order to obviate the need of traders to weigh and assay the precious metals they used as money. This made trading much more convenient. Traders could now simply exchange coined metal, the weight and purity of which had already been determined and certified. Naturally enough, kings and emperors assumed the role of certifier, imprinting their royal seal upon each coin. Unfortunately, they could not always be trusted. They often asserted their "royal privilege" to periodically recall and reissue their coinage, which provided opportunity for them to plunder their subjects. While asserting that the new coins would have the same face value as the old, they would reduce the gold or silver content of the coins, either by making the coins smaller or by adding base metals. By holding back part of the precious metal for themselves, they could increase their wealth at the expense of everyone who happened to hold the coins when they were recalled.

During the Gothic period, some sovereigns recalled the coinage several times a year, making a big profit each time. Of course, the sovereign's legal monopoly on the issuance of coinage ensured that competing (and more honest) coinage would not come into the market.[2]

Later on, when paper currency came into use, it was usually as a symbolic "claim check" for precious metal coins for which it could be redeemed at any time. As time went on, the metal "backing" for paper currency was reduced (fractional reserve banking) and then eliminated completely. Paper currency then took on a different form. It became what is called "credit money." Most credit money today exists not in the form of paper notes, but as bank deposit balances.

The well-known Gresham's Law says that "bad money drives out good money from the market." This is true enough, but only under conditions of forced circulation. When did you last see any silver dollars being spent? Since the law says that a dollar debt may be discharged by tendering either a silver dollar or a paper dollar note, the dollar note will invariably be tendered. The debtor will choose to spend the paper and hold the coin of the same denomination since the silver it contains is worth much more than what the note will buy. If the creditor were free to refuse inferior money, however, the good money would drive out the bad. Nobody would accept inferior paper, or, if they did, it would be at a discount from face value.

In this era of high speed transport and instant global communications, geographic separation is no longer the obstacle to trade it used to be. The development of electronic funds transfers, global payment systems (like VISA and Master-Card), and the emergent "e-cash' that provides for anonymous payments over the Internet, demonstrate clearly that money is really nothing but an information system.

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Functions of Money

The classical definition of money combines a diversity of functions-standard of value, unit of account, medium of exchange, and store of value. These functions, although contradictory, were all inherent in the qualities of commodity money. Everything could be priced in relation to the value of some specified weight of gold or silver. The value of a gold or silver coin was determined by the amount of precious metal it contained. A gold coin could be spent or saved, it could be used to buy something, or it could be held for a "rainy day" with reasonable assurance that it would retain its purchasing power over time.

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But today's money is different. The essence of money is now information. But what does that information tell? It tells that *someone owes something to someone else. The truth* is, as Bilgram and Levy point out[3], that every *piece of money is essentially a credit instrument;* it is, essentially, an IOU. This is true whether that "piece of money" is a paper note, a ledger entry, or a computer byte representing a unit in a bank account. The important information that must be included in any credit instrument tells who owes whom, what is owed, how much is owed, and how it will be paid. Compared to the bank notes that circulated seventy or eighty years ago, today's Federal Reserve Notes leave much of this in doubt. As Nobel Prize winner Frederick Soddy once put it, "Money now is the nothing you get for something before you can get anything."[4]

Value Measurement

What does it mean to say that something is worth a dollar? Do we mean that it has value equivalent to 371.25 grains of fine silver? For that was the original meaning of the word "dollar." Or do we mean it has a value equivalent to whatever can be obtained in the market for a Federal Reserve note having a denomination of one? To my knowledge, the definition of the dollar has never been officially changed, rather, through political manipulation, the paper note (or unit of bank credit) has been declared to be equivalent to the silver coin in discharging debts and therefore has usurped the role of value measure. But the paper note has no defined relationship to reality. It is a unit of currency that is managed by the banking establishment and made to serve political purposes. The use of the same word to describe both the fixed weight of some commodity and the note of an issuing bank creates an ambiguity of meaning that falsifies the whole monetary system.

Does that mean that I favor a return to a monetary system based on gold or silver? The answer is an emphatic no. Does it mean that I favor a return to a currency that is redeemable for gold or silver? Again, no. What I favor is an *unambiguous definition of a standard of value and unit of account.* This will end the monetary confusion and inequitable manipulation of the exchange process.[5]

The main purpose of this article is to describe how a more honest, equitable, and efficacious system of exchange can be established by a voluntary association of trading partners. This system can operate parallel to the present system of national currencies. If properly designed, it will be inherently more stable, it will allow businesses to reduce both their transaction costs and interest costs, and it will eliminate the risk of loss resulting from currency exchange rate fluctuations.

There are two foundational requirements for the creation of such a system. First, we *need to have some way to measure values*. Dollars, marks, yen, or any of the other undefined national currencies are just not good enough. Nor can we rely upon a "market basket" of such "managed' currencies, like the ECU, the proposed European common currency. What we need is a concrete standard of value, like a physical commodity that would provide a basis for us to express the prices of everything else. This unit of account would be stable, nonpolitical, and universal (international).

Second, we *need to have a way to make payments and settle accounts*. Again, we can do much better than using established national currencies. In monetary terms, we might say that the power to issue exchange media should be more democratic. If money is just an IOU, why not issue our own? This kind of payment medium can also be more abundant and less expensive.

All this may sound like a tall order, but, conceptually, it is quite simple, and every element of it has already been proven. Given the insubstantial, ethereal nature of today's money, we can and should segregate the functions money is supposed to serve.

I propose that an association of businesses embark upon a cooperative program to accomplish the following tasks:

1. Define a stable, nonpolitical, universal (international) unit of account based on a standard "market basket" of basic commodities.

2. Organize an international credit clearing exchange in which each member is allocated a particular line of credit denominated in the new universal unit of account. These lines of credit may be secured or unsecured depending on their magnitude and the demonstrated payment record and financial condition of the particular member.

Defining the Unit of Account

When the Constitution of the United States was written, it simply recognized the monetary standard that had already been established by popular usage. That was the Spanish milled dollar, a silver coin that circulated widely throughout the American colonies. The only problem to be resolved was to specify the *exact* weight and fineness of silver contained in the dollar, since dollar coins issued at different times varied slightly from one another. This was easily accomplished by appointing a committee to survey the money stock and assay a representative sampling of dollar coins. It was quickly settled that an American dollar should be a silver coin containing 371.25 ounces of fine silver.[6] Gold coins, valued in dollars, were also issued.

As the country developed, paper notes were used increasingly to make money more abundant. Unfortunately, this also provided opportunities to concentrate economic and political power into fewer hands. First came *fractional reserve banking,* which allowed banks to issue more paper notes than they had gold and silver to redeem. Later legal tender laws decreed that the paper had to be accepted *as if it were gold or silver.* Thus, the unit of account was falsified.

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Today, money takes the form of bank credit that must be *borrowed* into circulation. This kind of money commonly exists as "bank deposits." Of course, there really isn't anything on deposit anymore; we now use this word to designate accounting balances in checking or savings accounts. Federal Reserve Notes are simply physical tokens of money that was first created as bank credit. While these forms of money are denominated in dollars, they bear no resemblance to the dollar unit of value that was originally defined.

An Objective, Nonpolitical Measure of Value

The unit of account I think will work best can be defined as some specified fraction of the value contained in a carefully selected assortment, or "market basket," of basic commodities. I would like it to be named the "Riegel" in honor of E. C.Riegel,[7] one of the most astute thinkers on the subject of money, and because the word is a homonym with "regal," which connotes sovereignty. It is ironic that the use of such a unit of account opens the way for the individual to assert his or her sovereignty.

The use of a market basket standard rather than a single commodity standard has two major advantages. First, it provides a more stable measure of value since fluctuation in the market price of any single commodity is likely to be greater than the fluctuation in the average price of a group of commodities. The transitory effects of weather and other factors affecting production and prices of individual commodities tend to average out. Secondly, the use of many commodities makes it more difficult for any trader or political entity to manipulate the value standard for his or her own advantage. It may be possible for a large trader or a combine to control the market price of a particular commodity, but it is unlikely that any particular entity will be able to muster the resources necessary to simultaneously control the markets in several commodities.

The question of which particular commodities to select is mainly a problem of statistical observation to determine which ones will best promote the primary attributes of stability and security from manipulation, as discussed above. The following selection criteria seem to be appropriate. Each commodity should be:

1. Traded in several relatively free markets.
2. Traded in relatively high volume.
3. Important in satisfying basic human needs.
4. Relatively stable in price over time.
5. Uniform in quality or amenable to the application of quality standards.

Since gold is often suggested as a standard, either by itself or as part of a composite, something needs to be said about it. Several peculiarities about gold must be considered. To begin with, most of the gold that has ever been mined is still around; it is being held by someone somewhere. It does not corrode or decay. Very little of it has been "used," and most of that which has been used has been recycled. Further, it is not particularly useful, except in limited electronic and ornamental applications. It is not consumed like grain, petroleum, and other commodities, so the supply does not have to be continually renewed. There is a mystique about gold that causes people to desire it, quite apart from any basic human need. Most gold, until recently, has been used as money or as "backing" for money and most of it is still held by banks or governments. All of these facts make the gold market a very peculiar one. Given these features of gold, it does not seem to be a good candidate for fulfilling the most fundamental of the criteria listed above.

The purpose of a standard is to define a unit against which all other things can be measured. To measure length we use inches or centimeters; to measure weight we use pounds or kilograms. To measure values we must choose some standard value. The size of the actual unit can really be quite arbitrary. The most important thing is that, once specified, it *should not change.* Once the market basket has been defined, changes in its composition should not be made except in cases of extreme departures from the above criteria. Even large changes in the trading volume of a particular commodity, for example, will not greatly reduce its usefulness as part of the standard so long as it continues to be freely traded. Changes in the standard should be infrequent and require a broad consensus. Any commodity that is deleted from the standard should be replaced with another of equal value averaged over a long period of time.

Once the Riegel has been established as a unit of account it will be possible to determine the value of any circulating currency in relation to it. Such exchange rates between the Riegel and the leading national currencies should be computed and regularly published for the benefit of traders whose accounting is in Riegels but who wish to settle accounts using any of those currencies as a payment medium.

ORGANIZING THE CREDIT CLEARING EXCHANGE

> ***Were a number of business men to combine for the purpose of organizing a system of exchange among themselves, they could clearly demonstrate how simple the money system can really be made.***
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> ***-Bilgram and Levy, 1914*** [8]

Besides lacking an objective, concrete value standard, the economy is presently handicapped by the fact that the exchange media are controlled and allocated by banking cartels. These cartels engage in practices that are damaging to the interests of the vast majority of players in the economic arena. These practices include:

1. The use of bank credit as the medium of exchange and the imposition of an interest charge for its use. This causes virtually everyone to be indebted to the banks. Worse still, it causes debts to grow exponentially, at a rate that exceeds the growth of the supply of money available to repay it, making it inevitable that some debtors will default.
2. The monetization of government debt that is ever-increasing and unlikely ever to be repaid. This legal counterfeit debases the money already in circulation and causes general price inflation.
3. The artificial restriction of the supply of money made available for legitimate and productive business use. This is done to try to compensate for the inflationary effects of monetizing government debt, and to maintain bank control over the economy.

The truth of the matter is that *money is merely a system of accounting for the transfers of real value between buyers and sellers*. Businesses and individuals can, in effect, create their own exchange media by monetizing their own credit within cooperative circles or credit clearing associations.

by doing this they can:

1. Avoid the "interest" costs associated with "borrowing" bank credit.
2. Be assured of an ample supply of exchange media at all times to carry out whatever volume of trading sound business dealings might require.
3. Avoid the surreptitious theft of value (through inflation) from bank balances and financial assets that are denominated in terms of the debased and manipulated national currencies.

There is a great deal of historical precedent upon which to base the formation of a trade exchange or what has in the past been called a credit clearing society. It is reported that such credit clearing exchanges existed in the American colonies prior to the Revolutionary War. The contemporary enterprises known as "barter exchanges" or "reciprocal trade associations," through which billions of dollars of trading are accomplished each year, perform a credit clearing function. They are not always properly managed, however, and are usually flawed in that they trade also for their own account. This can create a conflict of interest, which often leads to debasement of their credits (credit inflation) as they pay excessively high prices (in credits) to attract new customers.

The grass-roots credit exchanges known as LETS (Local Employment and Trading System) more closely approach the ideal. These small local systems, which now number over a thousand worldwide, are typically operated, not as profit-making businesses, but as not-for-profit cooperative associations.[9]

Credit Clearing Through Federated Credit Circles

The clearing of accounts in a credit clearing system would be very similar to the system presently used by banks for clearing checks. Alternatively, debit cards and electronic transfers can be used. Each business member opens an account in a local credit circle and each account is assigned a credit limit, which allows the member to buy from others in the circle without necessarily having to earn credits first. The line of credit for each member can be based upon any of several criteria as judged necessary to provide adequate security to the system and ensure the continued value of the credits. The most conservative approach would be to require that each line of credit be secured by the pledge of collateral of some kind and of sufficient value to cover any possible default.

When a purchase is made, the purchaser gives the seller a credit check, which the seller deposits to his or her account. The same amount is debited to the buyer's account. An account is allowed to carry a negative (debit) balance up to the limit of the line of credit authorized for that account.

Here's an example that demonstrates the process. The ABC company has opened an account in a credit circle. It has deposited corporate stock valued at 10,000 Riegels as security and been granted a 7,000-Riegel line of credit. During the first month the ABC company has purchases from credit circle members of 8,000 Riegels and sales to members of 6,000 Riegels. That leaves it with a month-end debit balance or "commitment" of 2,000 Riegels, well below its available line of credit. Of course, at no time during the month has its debit balance been allowed to exceed that line of credit. In the following month, its purchases were 6,000 Riegels and its sales were 9,000 Riegels. The consequent credit surplus of R3,000 for the month leaves it with a month-end credit balance of R1,000. In the third month, it had purchases of R10,000 and sales of R8,000. The consequent deficit of R2,000 for that month leaves it with a debit balance of R1,000. So, without any national currency at all, the ABC company was able to purchase merchandise worth R24,000 and sell merchandise worth R23,000.

As was common in the past, the members might periodically settle any residual balances by tendering or receiving official money. This could be done monthly, quarterly, yearly, or at any other agreed interval. Those with debit balances would pay off their balances in cash, and those with credit balances could withdraw their balances in cash. This is not necessary, however, and doing so would continue, to some degree, the members' dependence upon official currencies. As an alternative, balances might be cleared using any mutually agreeable financial asset such as mutual fund shares. But there is no reason why balances cannot be carried indefinitely, especially if they are adequately secured. They represent the exchange's own money supply, expanding automatically as the trading needs of its members expand and contracting as their trading needs contract.

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No interest should be charged on balances but fees should be levied against both debit balances and credit balances in portion to the size of those balances. This fee schedule will, in addition to providing some needed revenue for operating the exchange, encourage those with debit balances to clear them quickly by selling, and those with credit balances to spend their credits or invest them in real or financial assets. By adopting this approach the flow and turnover of credit will be stimulated, making for its efficient use and tending to prevent stagnation. Fees should also be charged for processing each transaction, and the total of fees should be sufficient to provide not only for the costs of operating the exchange, but also for an insurance fund to cover possible defaults and depreciation of pledged security.

Any number of credit clearing circles can be federated giving the members of each circle access to a wider range of goods and services and trading partners. An exchange would accept credit checks drawn on any federated exchange. Credit checks or electronic transfers would be cleared among the various circles just as bank checks are now cleared among the various banks. In the absence of government-granted legal privileges, competing credit clearing associations will emerge, helping to ensure that they are operated honestly and efficiently. A credit clearing exchange may be organized initially as a for-profit corporation to adequately reward the founders' efforts, but I believe its charter should provide for its eventual conversion to a cooperative, owned and controlled by its members.

The utility of such credit clearing exchanges is directly proportional to the number of businesses participating and the range of goods and services available within the system. It will naturally increase with time as the system expands and develops, but even in its early stages the members will find it beneficial. In summary, credit clearing helps a business by making credit more readily available at lower cost, reducing its need for cash, and making it a preferred source for other businesses that are members of the exchange. In addition, international transactions can be made without having to enter the currency markets and take the risk of exchange rate losses.

Besides its direct benefits to traders, the widespread adoption of the outlined plan will have profound effects within the realms of economics, politics, and international relations. It will go a long way toward reversing the long-standing trend toward concentration of power and wealth and counteracting the anti-democratic effects of the monetary and banking regime.

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1. Nilly Ostro, "The Future of Money." *MaRKETS,* Dow Jones, June/July 1997, p. 14-19.

2. *See,* for example, *History of Monetary Systems,* by Alexander Del Mar, London: Effingham Wilson, Royal Exchange, 1895; also *The Gothic,* by Hugo Fack, San Antonio, TX: Free Economy Publishing Co., 1945.

3. Hugo Bilgram and L. E. Levy, *The Cause **of** Business Depressions***.** Philadelphia: J. B. Lippincott Co., 1914.

4. Frederick Soddy, *Wealth, Virtual Wealth, and Debt,* 3rd Ed. Hawthorne, CA: Omni Publications, 1961. Reprinted from the 2nd edition, 1933.

5. This point is covered more completely in Part III of my book *Money and Debt: A Solution to the Global Crisis,* 2nd edition. Tucson, Arizona: author, 1990.

6. Edwin Vieira, *What is a Dollar.* P.O. Box 3634, Manassas, VA 22110: National Alliance for Constitutional Money, 1996.

7. E. C. Riegel, *Flight From Inflation: The Monetary Alternative.* Box *4,* Waterford, VA 22190: The Heather Foundation, 1978. Also, Riegel, *Private Enterprise Money: A Non-Political Money System. New* York: Harbinger House, 1944.

8. Hugo and Levy, *op.cit.*

9. For more details about LETS and other types of actual and proposed exchange systems, see my book New *Money for Healthy Communities.* Tucson, Arizona: author, 1994.

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