42. MONETARY POLICY AND THE CONSTITUTION

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Former Senator Schmitt Challenges the 112th Congress to Take Control of Monetary Policy

The Founders gave Congress the constitutional power in Article I, Section 8, Clause 5, "To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures". The intent of this Clause clearly lay in having a stable national currency, with a defined relationship to foreign currency, and tied to a standard weight and measure of silver or gold, the universally accepted media of coinage. Clause 6 of Section 8 further emphasizes the Founders' intent to protect the value of the "Coin of the United States" by providing to the Congress the power to punish counterfeiting.

The Founders understood the basic principle that consumer demand and the supply of money determined the prices of goods and services. Growing economies require a stable value of national "coinage", or money, and a quantity of money that grows in cognizance with growth in demand. Without monetary policy that met these criteria, an economy would be subject to either inflation or deflation if there were, respectively, a money supply excess or deficiency.

Other factors cause lags in the time correlation between money supply and prices, including overall economic demand and asset valuations, consumer use of discretionary funds to pay down debt rather than consume, and changes in the velocity of money (rate of money's movement through the economy). Nonetheless, history and logic clearly show that if an increase in the money supply occurs in excess of the increase in the demand for goods and services, inflation results, lagging the money supply increase by a year or so depending on the rate of growth in demand.

As recently reminded by Seth Lipsky (*Wall Street Journal*, 11/17/10), the use of the word "dollar" at the time of the ratification of the Constitution and in the 1792 Coinage Act referred to a specific "weight and measure" of the Spanish Milled Dollar, namely, 371.25 grains (0.849oz) of silver. The standard value for silver relative to gold was set at 15:1 with the small level of copper alloyed with either silver or gold defined as well. In modern times, the previously practical tie between the value of silver and gold has weakened as the demand for silver has become partially tied to its more extensive use as an industrial metal.

Worth noting is that the penalty stated in the 1792 Coinage Act to be imposed on the officials of the United States Mint for fraud, embezzlement, or debasement of the currency was death. The Founders clearly anticipated that a tie of the American dollar to silver and gold would be their means of regulating the value of the dollar, as well as its value relative to "foreign Coin", and were deadly serious about preserving that value.

Although gold generally has been a hedge against inflation, in the 1500s and 1600s rampant inflation swept Europe due to rapid increases in gold and silver supplies from new European production and then Spain's production from the New World. That temporary inflationary effect receded as the industrial revolution raised the supply of consumer goods throughout Europe. Variations in gold supply increases (production about 2.5 metric tonnes per year) have been relatively minor in the last 150 years relative to the estimated current global historically mined inventory of ~180,000 tons (worth ~$5.76 trillion with a gold price of $1000 per ounce), with global official government reserves of about 36,000 tons (worth ~$1.15 trillion at $1000/oz).

A largely politicized Federal Reserve System now has created a critical emergency in monetary policy. Led by Chairman Ben Bernanke, the Federal Reserve plans to again violate the Founder's intention of having a stable currency by further monetization of the still rising national debt through printing another $600 billion out of thin air, euphemistically called "quantitative easing" or QEII. The Fed's monetary policies, created at the behest of the Obama Administration, have created the potential for rampant future inflation, once some semblance of sustained economic recovery appears. Whatever its domestic political intent, QEII also has seriously threatened the economic growth of our trading partners. One must wonder if the 1792 Coinage Act's penalty for debasement of the currency still applies.

The recent disclosure by the Fed that large banks and businesses took advantage of $3.3 trillion in Fed loans beginning in December 2008 dwarfs QEII. What of substance stands behind such largess other than the Feds printing press or the taxpayer's implicit guarantee of the loans? How did this loan policy remain secret for so long? Were the loans actually bribes to get banks and businesses to support the new Administration's fiscal policies? Congress not only must take back its power over monetary policy but it must investigate this additional travesty in the exercise of dictatorial power.

In matters relative to Federal Reserve's unconstitutional, 1978 congressional mandate (Humphrey-Hawkins) to promote the goal "of maximum employment", the alleged rationale for QEII, the Congress has no direct constitutional power to regulate or legislate relative to employment or industrial policy, other than through tax and defense policy. In addition to its unconstitutionality, the bipolar mandate to both stabilize the dollar and destabilize the dollar and increase debt to further employment is inherently contradictory.

As currently legislated in matters relative to the value of the dollar, the Federal Reserve System acts outside the intent of the Founders and the words of the Constitution. Although Clause 18 of Article I, Section 8, provides Congress with the power to "Make all laws necessary and proper for carrying into execution…" the Coinage Clause, Congress has no constitutional power to totally abrogate its responsibility to "regulate the Value" of currency. In establishing the Federal Reserve System in 1913, and in subsequent Amendments to the founding Act, Congress made no provision for itself to independently regulate actions of the Federal Reserve that may adversely affect the value of United States currency or the value of that currency relative to foreign currency.

Creation of a One House Legislative Veto process[1] relative to perpetuation of any Federal Reserve decision related to monetary policy would provide constitutional cover if Congress wishes to re-authorize the Federal Reserve as an arm of its Coinage Clause power. The Legislative Veto should apply to any policy that stays in effect for more than one year and is deemed, by Resolution of either the House or Senate, to create sustained monetary inflation or deflation of more than one percent, annually.

Clearly, the Federal Reserve System no longer operates in the national interest. Congress should take the opportunity given it by the 2010 elections to assert its constitutional responsibility to stabilize the dollar and build the foundations for a vibrant, worldwide economic and trading environment. A monetary standard that combines the stabilizing power of gold with adjustments related to real wealth creation would go far in achieving this goal. The basis for a gold-wealth creation monetary standard should consider the following:

1. "Coinage", hard or paper, evolved within human affairs to increase the efficiency of economic activity versus what would be possible in a barter or precious metal exchange economy. Setting the value of any form of money, however, has been increasingly important, particularly in the United States, as wealth creation accelerated after the industrial revolution and with the efficiencies of capitalism. Further, almost since the country's founding, U.S. Administrations repeatedly have tried to manipulate the money supply to satisfy either political objectives or the necessities of national defense.

2. A pure, 100% gold standard or "specie" standard would tie the total value of paper and coin currency to the amount of gold reserves held by the Federal Reserve. A 100% gold standard clearly provides a barrier to inflation if the reserves or value of gold remain constant and the supply of goods and services does not decrease, drastically. On the other hand, a 100% standard creates a brake on economic growth unless gold reserves or their value grow at the same rate as the private sector's potential for wealth creation. Unfortunately, such an inherent correlation does not exist.

3. An ideal modern coinage standard would be based on the market value of gold, adjusted by an index to a multiyear moving average of the rate of increase in true national wealth as measured by sales and investments rather than by the cost of creation of that wealth. The "cost" of goods or services created, but for which there is no demand, does not reflect the creation of new wealth.

4. Properly measured, an index of national wealth creation (INWEC) would inherently include the rate of increase in sales of domestically produced goods and services that contribute directly to the long-term growth of national wealth. A congressionally mandated basket of specific, domestically derived, INWEC for good and services should be limited to the following: commodities, manufactured goods, communications services, software, private education services, and research investments. Any regulatory attempt to change the composition of the final congressional INWEC basket should be subject to a One House Legislative Veto.

5. Other than funds invested in basic and applied research, direct and indirect federal expenditures should not be included in the index of national wealth creation. If they were, the potential for political manipulation of the value of the dollar would still exist.

A stabilizing gold-wealth creation monetary standard for the value of American currency would both prevent increases in inflation due to politically motivated additions to the money supply, as the Federal Reserve currently is attempting, and adjust the dollar's value over multiyear periods to reflect realistic economic growth variables. The 112th Congress needs to get to work immediately on permanently stabilizing monetary policy and other items on its economic recovery agenda.

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[1] The Founders clearly intended by Clause 18 of Article I, Section 8, that enactment of federal laws to be the responsibility of the Congress and not passed on to the Executive Branch through generalized regulatory authority. In order to return to the Founders' intent, Congress should create a One House Legislative Veto process relative to any decision, order, or regulation promulgated by the Executive Branch. That process of regulation review and potential disapproval should begin with 20 percent or more of the members of either House petitioning to discharge an introduced Resolution of Disapproval from the relevant Committee or Committees and move its consideration to the floor of the initiating House. If the Resolution passes either House, the Congress can maintain constitutional control of this On House Legislative Veto process by a sequence of one House passage of a Resolution of Disapproval, followed by the other House's opportunity to pass a Resolution of Disapproval of the first House's action. This sequence avoids the constitutional requirement for the President to sign any joint action by the House and Senate (Article I, Section 7, Clause 3). Should an Agency or Department refuse to honor the Legislative Veto of a specific regulation, the Congress should use the Appropriations Bill to rescind funding for its enforcement.