

Texas Wants to Create a Gold and Silver-Backed Currency

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Can the fiat system be reformed? Can this be done or at least initiated at a state level?

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The Current Fiat Money System is Fake and Broken

The current monetary system is based on fiat money, which is money that has no intrinsic value and is created by central banks and commercial banks. This system has enabled rapid economic growth and financial innovation, but it also has very serious flaws and limitations. Some of the main challenges facing the current monetary system are:

- *Inflation and deflation.* Inflation is a general rise in the prices of goods and services over time, while deflation is a general fall in the prices of goods and services over time. Both inflation and deflation can have negative effects on the economy, such as eroding purchasing power, discouraging investment, creating uncertainty, and distorting relative prices. A system based on fiat money where the money supply can be artificially inflated and contracted is much more prone to inflation and deflation. We have, of course, recently experienced some of the worst inflation in decades, which has eroded savings as well as employees' compensation.
- *Debt and leverage.* Debt is the amount of money that is owed by one party to another, while leverage is the use

of borrowed money to increase returns on an investment. Debt and leverage can be useful tools for financing economic activity, but they can also create excessive risk and vulnerability. High levels of public and private debt can constrain growth, limit fiscal space, and increase the likelihood of defaults and crises. Countries that control fiat currency that function as reserve currencies have a tendency to borrow much more than they are able to repay because of their ability to 'print' more money to 'pay' their debts. At the moment, the US is running a national debt of over \$31 trillion which amounts to 130% of GDP, which has reached levels that may never be paid back.

- *High and persistent current account imbalances.* Some countries, such as China and Germany, tend to run large and persistent trade surpluses, while others, such as the United States and the United Kingdom, tend to run large and persistent trade deficits. These imbalances create global financial instability and distort exchange rates, interest rates, and capital flows. Generally, fiat currencies make these imbalances more pronounced as countries can manipulate their exchange rates in order to run higher current account surpluses, as has been the case with China. China's current account surplus with the US has been running at around \$300 billion annually.

Texas Bill Proposing [100% Reserve Gold and Silver-Backed Transaction Currencies](#)

Texas has proposed a bill that would require the state comptroller to establish and provide for the issuance of gold and silver specie and also establish digital currencies that are 100% backed by gold and silver, and 100% redeemable in cash, gold, or silver. The bill would authorize the Texas Bullion Depository as the issuer of the specie and digital currencies and ensure that holders can use them as legal tender to pay debt and transfer them electronically to other

people. The bill would also require the trustee to maintain enough gold and silver specie or bullion to provide for the redemption of all units of the digital currency issued but not redeemed. In practice, individuals would be able to purchase transactional currency representing the smallest fractions of physical gold or silver and redeem them for dollars, gold, or silver on demand. The bill has passed the House State Affairs Committee by a 7-6 vote and has received strong grassroots support in Texas.

Benefits of Texas Gold and Silver-Backed Currency:

- *Increased stability.* Precious metals have a track record of retaining value over time, which makes them attractive to investors and individuals seeking a reliable form of currency. The reason such currencies tend to be good stores of value is that they are scarce, durable, divisible, portable, and fungible.
- *Protection against inflation.* Gold and silver have historically served as hedges against inflation, as their prices tend to rise when the value of fiat money falls. This would have been a great alternative over the past two years of extremely high inflation.
- *Potential diversification benefits.* Gold and silver tend to have low or negative correlations with other assets, such as stocks and bonds, which means they can reduce portfolio risk and enhance returns.
- *Avoidance of bank runs.* There have been a number of recent bank runs and collapses including Silicon Valley Bank, Silvergate Bank, First Republic Bank, Signature Bank, and Credit Suisse First Boston. If a person holds their assets directly in gold or silver-backed currency which is not fractionated through fractional reserve banking, the assets should be secure and not exposed to bank runs.

Reaction to the Texas Proposal has been mixed:

- Supporters of the proposal argue that it would provide an alternative to fiat money, enhance confidence and stability, and protect against inflation. They also claim that it would create a “reverse [Gresham's Law](#)” effect, where good money (gold and silver coins) would drive out bad money (Federal Reserve notes). This might be a very interesting effect and could further demonstrate that the US Dollar is a declining currency for a number of external factors including high rates of US debt, significant expansion of the money supply, splintering of the world order, and political gridlock.
- Opponents of the proposal criticize it as impractical, unnecessary, and risky. They contend that it would create logistical challenges, limit monetary policy options, and expose the state to market fluctuations. My guess is that the real opposition will come from the Central Banks themselves, if and when the currency gets traction as it is a further threat to the declining US dollar dominance.

A Store of Value or a Transactional Currency?

Good currency is both a reasonable store of value (maintains value over time) and a liquid medium of transactions. Bad currency goes from value to the transactional but then deteriorates further, and during periods of hyperinflation cannot even maintain the value while the transaction is being cleared by the banks. We are fast approaching this point with the US dollar.

While the bill in TX proposes the current as a transaction currency that has strong store of value attributes, it is much easier to achieve the store of value aspect than the translational aspect. By tying the currency to gold and silver, the store of value attributes should be automatically fulfilled.

However, for a currency to be a strong transactional currency,

it needs to have the following attributes.

- Liquidity. This means that the currency can be readily converted into other currencies or assets without losing much value. A liquid currency facilitates trade and reduces transaction costs.
- Convenience. This means that the currency can be easily accessed, stored, transferred, and verified. A convenient currency reduces the hassle and time involved in transactions.
- Low transaction costs. This means that the currency does not incur high fees, taxes, or commissions when used for transactions. A low-cost currency increases the net benefit of trade and encourages more transactions.
- Low volatility. This means that the currency does not fluctuate significantly in value over time or across markets. A stable currency preserves the purchasing power and reduces the uncertainty and risk of transactions.
- Wide acceptance. This means that the currency is recognized and accepted by a large number of people and entities as a medium of exchange. A widely accepted currency increases the marketability and demand of goods and services.
- Legal tender status. This means that the currency is legally recognized and enforced as a valid means of payment for debts and obligations. A legal tender currency ensures the enforceability and security of transactions.

As envisioned in the proposal, the currency would be legal tender, which is a major step toward a transactional currency. This should enable liquidity for the currency, especially as it is directly tradable into gold and silver, both of which have continuously quoted prices and extensive liquid markets. Convenience will be there if the currency is indeed tied to electronic payments either through

incorporation into existing applications such as PayPal, Venmo, and directly into the US banking system. Ultimately, wide acceptance is a function of the popularity of the offering, which I think may be high in these uncertain times. In my opinion, anything that offers a better store of value attributes than the US dollar will be good for the country.

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