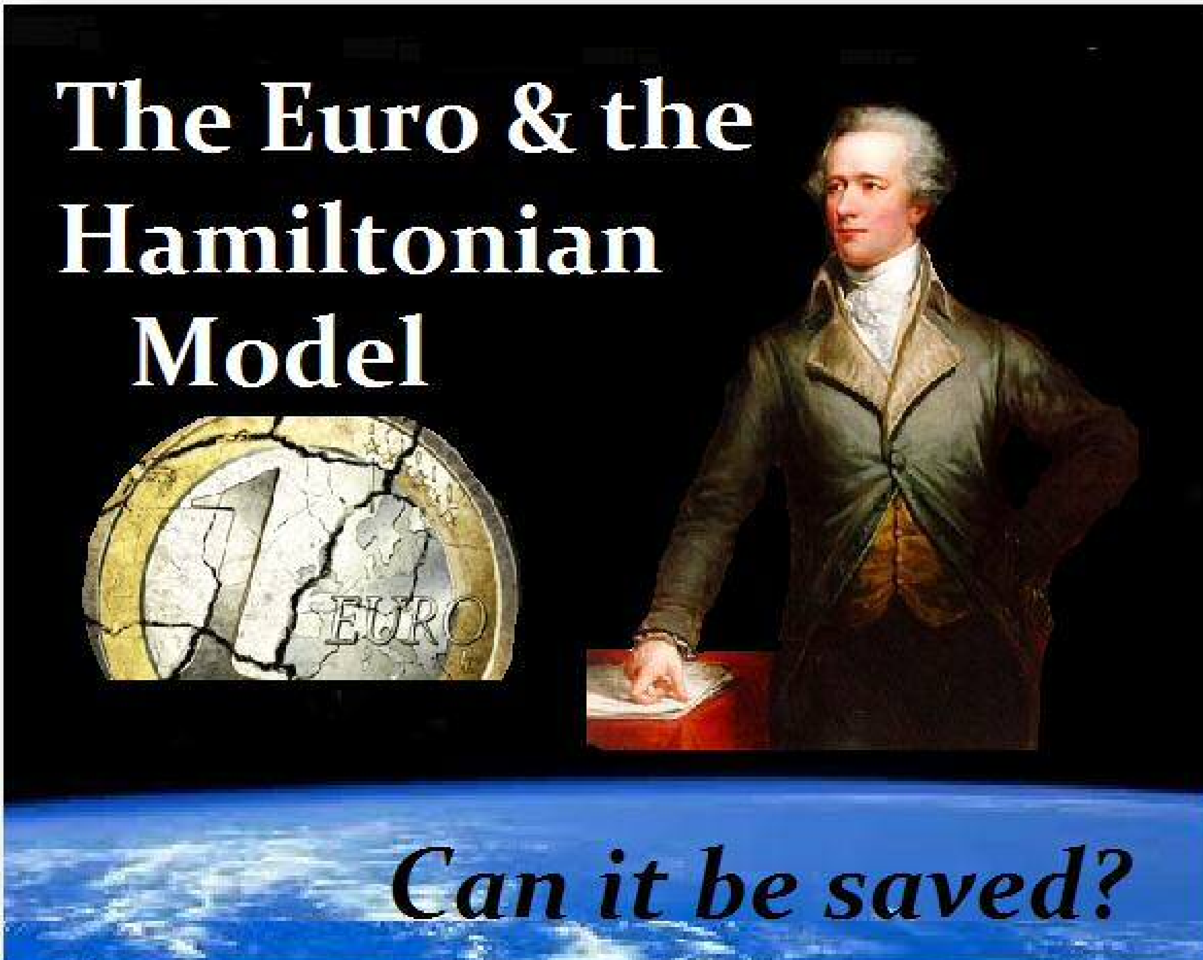
PRINCETON ECONOMICS

Research Institute

The International Think Tank



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THE EURO & THE HAMILTONIAN MODEL EUROPEAN REDEMPTION PACT

The European Parliament

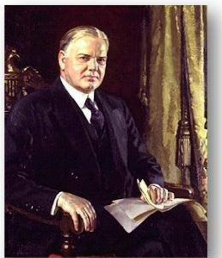
By: Martin A. Armstrong
former Chairman of Princeton Economics International, Ltd.

WE have been warning that as long as each nation in Europe has their own debt denominated in euros, then there is no single currency because each country can still be isolated and traded based upon the confidence of that country. Consequently, the bonds of each country merely became a derivative of the old individual currency thereby Europe failed in its objective to create a single currency. If you wanted to short just Greece, you sold their Euro-Bonds that replace the drachma. From a practical trader's perspective, the Greek Drachma still traded. The German Chancellor Mrs. Merkel has rejected any idea of a single Eurobond. She simply has no idea about the capital markets and this serves as a brilliant example why politicians and the economy never work together. They consult academics that have no realistic experience as a trader looking at the world purely in a satirized theoretical model. The world does not function that way.

The world financial markets have been evolving over decades and the very concept of money is no longer conforming to the old notions of tangible objects or wealth. This fascinating journey of the financial markets id probably the least observed and most certainly the most misunderstood. To truly grasp the intricate dynamics of the financial world we live in and how stocks, futures, options, debt, politics, and social structure work as a dynamic mechanism together, it is currency that provides the measurement took like a old wooden ruler. If I were to offer you 1 billion Zimbabwe dollars or 1 billion or 1 billion Bangladesh taka, you would immediately seek to convert each currency into your home currency to create a mental picture of value to make your decision. Currency is a language. It is the means by which we measure economic trends and values in our head. It is the very basic foundation of commerce for it serves the function of allowing us to make judgments. This is the real window of the world for we must look through this pane of glass to see the real world around us and comprehend how it functions. It is strangely only through this perspective that we can grasp how humanity truly functions for without understanding how we arrive at this thinking process of value, we will never understand on a global scale the evolution of civilization, trade, and the spread of knowledge.

In England, they have a saying "I will come knock you up at" a specific time. It means what it says – I will come knock on you door at 7PM to pick you up for dinner. In America the term migrated and now implies a girl became pregnant out of wedlock. It evolved into a term meaning I went and picked (knocked) her up and you know what happened. The term "knock up" became the act of sex despite the word "knock" has nothing to do with the act of sex itself. Nonetheless, this is also how bathing in Europe ended in the latter days of Rome and remained a taboo until the Crusades after 1000AD. Bathing in Europe vanished after the fall of Rome because it became associated with brothels with the collapse of morals in latter Roman culture. To say one went to take a bath became the indirect way of saying you went to have sex. Bathing became immoral for this reason. Not until the Crusaders returned to Europe did they bring back with them the Arabic custom of bathing. It was international trade and travel that restored bathing in Europe as a more common function. There are still records of bath houses in London during the middle Ages. However, it is not clear whether or not they were associated with sex prior to the Crusades. Nonetheless, the spread of all knowledge and customs, trends, and ideas, historically always took place alongside international trade. Even the surviving record of the Medici show that 42% of their business involving trade was profit derived from money changing – a foreign exchange broker.

1931 Sovereign Debt Crisis



Herbert Hoover
(1874 - 1964)
(President 1929 - 1933)

"During this new stage of the depression, the refugee gold and the foreign government reserve deposits were constantly driven by fear hither and yon over the world. We were to see currencies demoralized and governments embarrassed as fear drove the gold from one country to another. In fact, there was a mass of gold and short-term credit which behaved like a loose cannon on the deck of the world in a tempest-tossed era."

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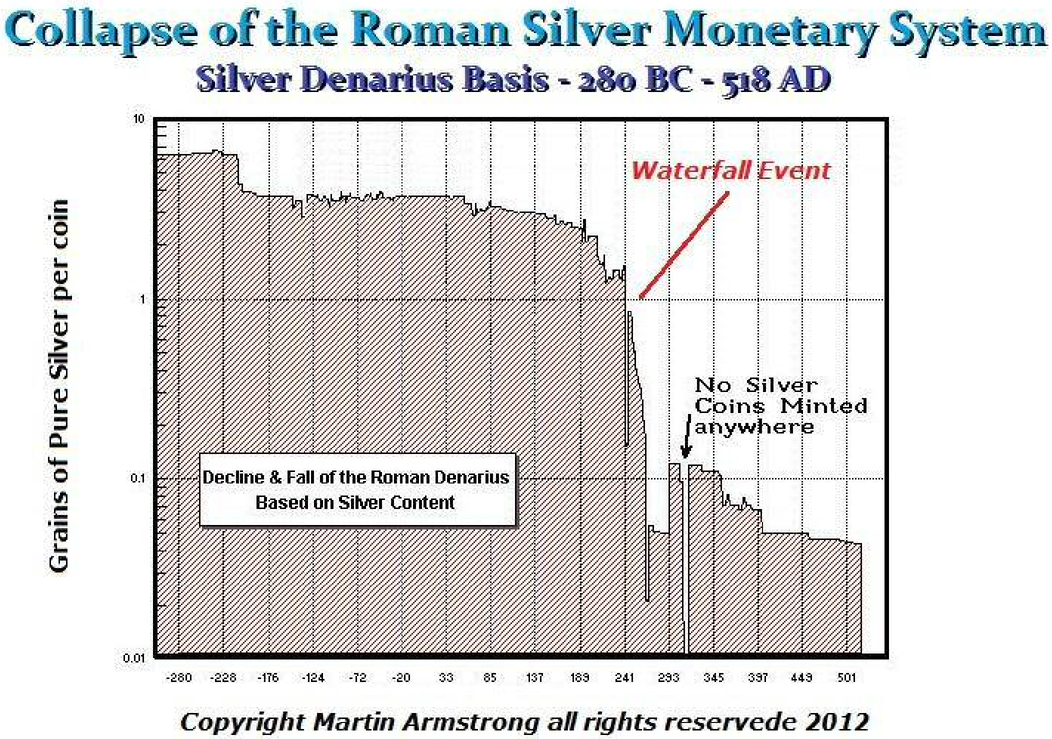
Most people never leave their own country or region. Typically, less than 5% of a population travels internationally unless there is war or some economic driving force as was the case with the migration of the Irish and Italians to the United States during the 19th century. Hence, a global perspective and understanding how and why capital flows internationally has been the least understood. It was President Herbert Hoover who commented on how capital flowed internationally from one currency to the next during the Sovereign Debt Crisis of 1931 that international capital flows were at least starting to be observed.

We must come to grips with the realization that the assumptions of academic planners and their often flawed concepts of money, society, and how to manipulate it can result in very dangerous outcomes. Just look at Karl Marx whose core idea has been followed by every economist ever since – the presumption that government can eliminate recessions by regulating the business cycle. Academics have advocated government intervention into the economy and free markets. It was John Maynard Keynes who declared that Lassie-Fair Economics was dead. This issue of flawed theories becomes even more critical when their interventions threaten to create political and social instability as is the case with the euro. Look at Marx and his ideas that result in the deaths of tens of millions of people if not in the hundreds of millions on a global scale. Theories, not well thought out, can create a negative feedback loop which will ultimately lead to the collapse of society.

Perhaps there is no greater subject that has been overlooked more than what is money. Breaking down the subject matter and a deep examination of history, reveals both the understanding of money and most importantly, what it is not. The manipulation of money values by governments is at the heart of how empires, nations, and city states collapse into a financial crisis caused by manipulation and mismanagement.

There are those who have constantly tried to fix the value of money and often wages and prices as well since the legal code of Hammurabi circa 1700BC. What they are attempting to do is stop the fluctuations within the business cycle as was the goal of Marx and even Keynes. For those who believe in the gold standard concept, they too fail to understand that the lack of such a 'standard' is not the causal factor. You cannot flat line the economy because the driving forces of supply and demand also swing with the collective mood of society just as bathing went out of fashion and then returned.



Governments have often implemented the wrong fiscal policies that end up creating bad monetary policies that in the end create chaos and civil unrest within society as we are witnessing today throughout Europe. Government becomes the problem and the catalyst behind the business cycle increasing its volatility instead of eliminating it. This pattern repeats because human nature never changes. Regardless of the currency in use be it seashells, cattle, gold, silver, bronze, or paper, governments have perpetually debased the currency to create more to serve their own self-interests. This is certainly documented by the fall of the silver content of the Roman denarius throughout the course of the Republic and Imperial eras.

Valentinian I (364-375AD) Tax Collector's Gold Bar

The debasement of currency became so bad and the influx of counterfeits pervasive when the metal content was well below the stated value of the coin making the venture profitable, even led Rome to base its taxes on metal content rather than the denominated currency it actually issued. Here is a gold bar of Valentinian I (364-375AD) which was poured by a tax collector who imposed taxes based upon metal content. In other words, the Roman state would not accept its own coinage back in payment of taxes for they were imposed on metal content.

Money has always been a pure confidence game from the very beginning. Gold has value only because of the balance between supply and demand. If nobody wanted gold, it would have no value regardless of the supply. Hence, a nation's currency is indistinguishable from a share in a corporation. This is what the designers of the Euro did not understand. It is what the Euro has been torn apart because they did not create a single currency leaving **ANYTHING** to trade separately that was identifiable with an individual state. Failing to consolidate all the debts of the member states allowed those bonds to be isolated and traded based upon the rise and fall in confidence of that member state. The bonds merely replaced the individual currencies defeating the entire idea of the euro.

All money has always been "fiat" when created by government because they always sought to make a profit. The degree of "fiat" varied from time to time and state to state. Money is not backed by "nothing" as some think, but rather it is backed by the confidence in that nation which is determined by its rule of law, military might, infrastructure, labor pool, education systems, protection of private and intellectual property, institutions, and human rights. Money is truly indistinguishable from a corporation's shares. Currency is the public share in a nation. It represents the total productive capacity of that culture and society. Historically, the "reserve" currency accepted among all nations defined as the most accepted in international trade has always been the empire with the greatest military force.

It is true that money has evolved from raw commodities and seashells to paper. The Chinese invented paper money and always had a fiat system based upon the **CONFIDENCE** that the emperor was chosen by God to rule. If you believed the emperor was god, and possessed the Mandate from Heaven to rule ***(Tian ming)*** then whatever he had to say about the value of the money he created was simply accepted.

China did not rely on silver or gold for coinage, but used bronze and iron. Precious metals were used as external money for international trade only. China effectively maintained a two-tier monetary system. Precious metals in china were in ingots and not used for domestic circulation. There have often been two-tier monetary systems throughout history. Even South Africa adopted a two-tier system when capital was pouring out of the country before the release of Mandela. They created the financial rand used for international transactions and the domestic rand for local assets. To move money out of the country required the conversion to the financial rand based upon authority.

United States Two-Tier Monetary System

US Silver Dollar 412.5 grains - .900 Fine

US Trade Dollar 1873 -1878
420 grains

Two-Tier monetary systems have existed throughout history. Both Britain and the United States minted "trade dollars" acknowledging the different monetary standards in Asia compared to their own. Money has not been the same at any time on a global scale. There is a difference between two nations using silver or gold as a medium of exchange compared to two nations agreeing upon a monetary standard with a fixed weight and value. These are two entirely separate animals.

Until we examine what actually constitutes money, how can we devise a new monetary system? Precisely as a corporation, the nation's debt and fiscal management will play a major factor in the valuation of its currency by the free markets. It is true that a nation, unlike a private corporation, has the capacity to send in troops to try to impose its decrees upon the people making government always the most dangerous 800 pound gorilla in the room. Government will **ALWAYS** turn to violence against its own people when its fiscal mismanagement threatens its own existence. This is simply the law of survival. What is underestimated about the dollar is its military capacity. This plays no role in the concept of currency valuation in above surface discussions. Nonetheless, when Europe is in trouble militarily, he calls upon the United States to come to its rescue. Can the US dollar go to zero simply because of a lack of hard money backing? The military capacity of the United States plays a vital role in its acceptance even as a reserve currency. The military capacity of a nation has been one factor into the valuation and acceptance of its currency among nations.

There is a substantial difference between a simple medium of exchange and what is officially declared to be money in a state and establishing it as a unit of value. The Minoans used copper ingots as a medium of exchange based upon weight. They did not yet invent coinage. **MONEY** became fiat only when government began to declare its value to make a profit from the concept. Then military capacity entered the equation.

Minoan Copper Ingot

The first attempt to create a international uniform currency was under Alexander the Great (336-323BC) He standardized the coinage of every place he conquered bringing the Greek monetary system with him. But who established that standard? The standard was really adopted from Athens which was the powerful state both in trade and in military capacity. Only when Sparta defeated Athens during the Peloponnesian War do we see major debasement in Athenian coinage to pay for the costs of the war where silver was replaced with bronze and the coins were silver plated. Here is a contemporary forgery of an Athenian Owl produced in the balkins. This demonstrates that the Athenian coinage was the "reserve" currency used in trade before Alexander the Great and after the defeat of the Persians. Similar forgeries of Alexander's coins are found in Germany and poor imitations exist among Celtic coinage in Britain. This demonstrates that the major dominate economy established with military power to prevent invasions by rival forces have always been the reserve currency at that moment in time.

Contemporary Forgery Produced in the Balkins

It has always been the supply and demand or free market forces that will place a value on the currency based on the aforementioned factors. Its valuation is a delicate balance of expectations and confidence in the prospects of that state for a given moment in time relative to every other nation around it. This is vital to understand because capital will also migrate on a global basis predicated upon confidence that it will be safe in that state. Hence, your perspective of everything from its security to survive and its willingness to defend your rights and honor a rule of law are critical components of a currency's value. This is a fair and accurate description of the macro value of a national currency in modern times both historically and even more so revealed when money has shed any hint of being tangible.

1985 Plaza Accord

From left are Gerhard Stoltenberg of West Germany, Pierre Bérégovoy of France, James A. Baker III of the United States, Nigel Lawson of Britain and Noboru Takeshita of Japan

Therefore, the attempt to manipulate currencies for trade purposes that was the reason to create the G5 at the Plaza Accord in 1985 set in motion the 1987 Crash and told capital to get out of the United States. The idea that lowering the value of the dollar would increase jobs and exports was a singular view of currency that disrupted the world economy thanks to politicians who lacked any comprehension of what lies beneath the value of a currency. They failed to realize that the objective to devalue the dollar by 40% to reduce the trade deficit also meant you were devaluing the foreign holding of U.S> assets including government bonds. They forced the Japanese to see and everyone else creating the 1987 Crash. They then forced the Japanese to repatriate their capital investing back home creating the asset bubble for 1989. The Japanese government did not understand the mechanism by which everything function within the global economy, and then did everything in its power to prevent selling of assets by Japanese companies thinking that would sustain the value of the markets. There were no more buyers only people who wanted to sell and the government tried to prevent that promising to support the Japanese share market yet failed. They succeeded in creating only a 23 year depression.

One must ask the question, how do we divorce politics from the economy? Should we replace government issued currency entirely? Or perhaps we just need to stop the manipulations? Clearly, money of each nation is really just a share in something with intrinsic value that emerges from all the factors of a collective society. It is the synergy of the combination that creates national wealth. Adam Smith argued against the Physiocrats who claimed money was only land and agriculture. They say the highly agrarian economy as the center and a blacksmith as a parasite who lived off of the framers toil. Smith showed that if a farmer sold his wheat to a foreign land as did a blacksmith, they both returned with gold and those both contributed to the wealth of a nation. Hence, a currency is a share in the total productive forces within society regardless of the product produced whether it is tangible or some service. What does not contribute to the wealth of a nation is a bloated bureaucracy for they are indeed public servants consuming what others produce just as a maid is a luxury in a private home contributing nothing to the income of the household. Money is not some stagnant object of intrinsic value, but the collective productive forces of a society represented by that currency.

Then the argument that government can and should manipulate the economy to achieve full employment becomes impossible when it does not even understand what constitutes the wealth of a nation. The idea that it can raise taxes and somehow this will create employment is an exercise in mental delusion. The idea it can borrow and this is somehow less inflationary is amazing when its debt itself has become currency that simply pays interest. There is no plan to pay back any borrowing and they have institutionalized issuing debt as a substitute for printing non-interest bearing currency. Money has become precise as it began adopting paper in the United States after the Revolution. The term "greenback" meant that there was no interest payment schedule on the back of the currency to entice people to accept it in commerce. They even issued interest bearing currency where the interest was compounded to encourage circulation. Today, all national debts are simply currency that pays interest with no intent of paying anything off. So why borrow?

We serious need to start examining what we call money, what it represents, and how it functions before we embark on creating single currencies and trying to create pegs and fixed rates while everything else floats. We really need to think and think differently on monetary issues. We need to take that next step in understanding what took place when the floating exchange rate system was born out of necessity in 1971. It seems we are headed for a 'global reset' in monetary policy on a scale of untold proportion. If we do not journey down this path, we risk rising civil unrest, the disintegration of western society, and a new world war to punish someone for losing everything.

We are in a serious ***Sovereign Debt Crisis*** and no government seems to understand that the day of reckoning is on the horizon. The recently released Federal Reserve report that shows the Flow of Funds for all of 2011 revealed that Federal Reserve purchases US Treasury debt has covered up the seriousness of what is taking place. There is a reduced demand for sovereign obligations around the world and the USA, the strongest of all, is no exception. The Fed purchased an amazing 61% of the total net Treasury issuance of debt. This was a marked dramatic increase from the miniscule amounts prior to the 2008 financial crisis. This has greatly contributed to people falsely thinking that things are ok. Meanwhile, politicians, ignorant of how the capital markets really work, bask in the artificial light that their shit does not stink. The idea that there will forever be a limitless demand for US debt is the cause of the lack of attention to what is taking place. Of course there are the hyperinflationists who see this as the reason gold will soar. They ignore the opposite force of deflation and rising taxes in the short term. Nonetheless, the rise in gold on the horizon is real, but that high may not manifest until (1) we see interest rates rise signally capital has shifted from the **PUBLIC** to the **PRIVATE** sector and (2) this insane attack upon capital hunting it down worldwide is causing a rise in hoarding and a decline in the **VELOCITY** of money. It is this latter trend that will cause capital to flee banks that will turn in any investor to government and seek alternative investment in shares and even real estate alongside gold. But gold is coming under intense pressure for reporting, whereas some other tangible assets are more easily transported such as shares.

In Europe, we have the ***European Redemption Pact*** proposal that followed the basic structure I suggested that there should be a single national debt for Europe if you wanted also to create a single currency. I informed Commission that attended our seminar in London on this subject back in 1996. However, there is still resistance to the whole consolidation of the debt and Europe has run out of time to fix this time bomb. Mrs. Merkel rejected the ***European Redemption Pact*** last November as "***totally impossible***", even though it was drafted by Germany's Council of Economic Experts or what is commonly known as ***Five Wise Men*** and is broadly-viewed as the only viable route out of the current impasse. Recently, Germany has signaled that there may be a shift in this refusal to issue a single debt, but once again, we are only talking about a €2.3 trillion redemption fund for Europe. This does not create a single debt and is still trying to pretend to be half-pregnant.


Angela Merkel
(born July 17, 1954)

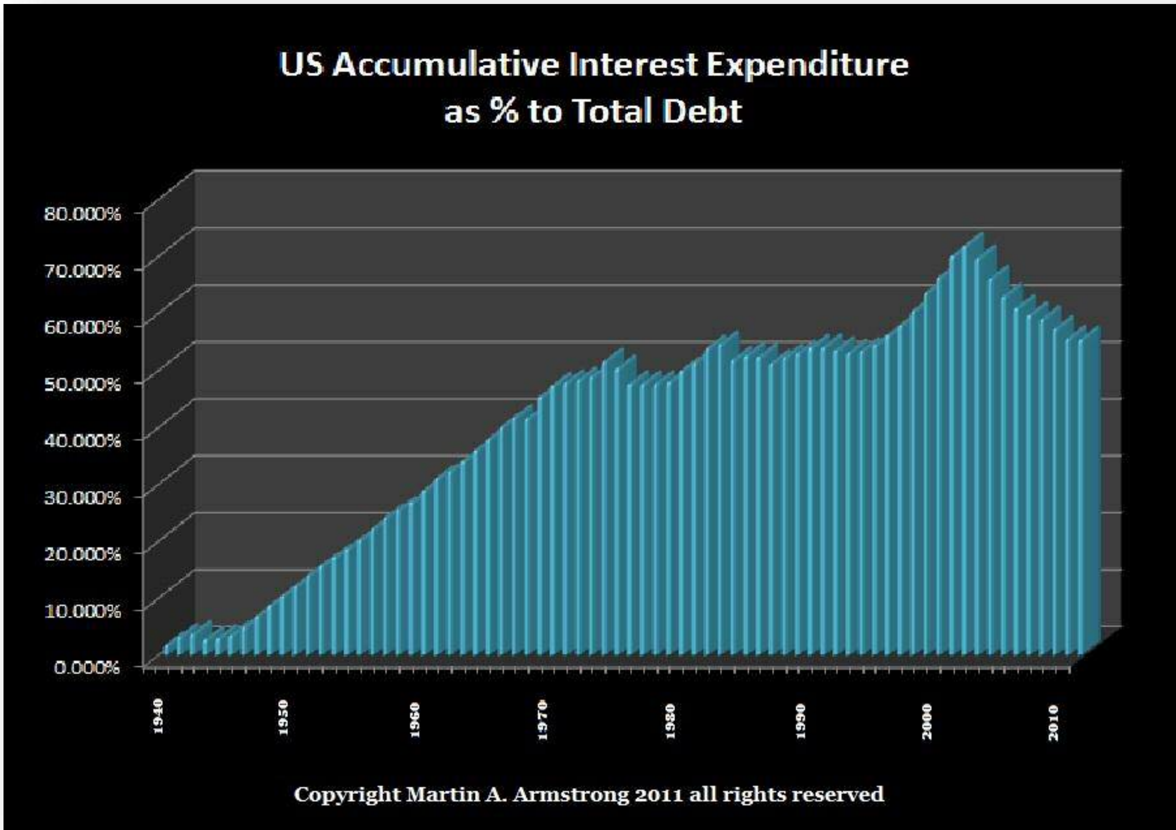
Angela Merkel (born July 17, 1954) is the Chancellor of Germany and Chairwoman of the Christian Democratic Union (CDU). She is the first female Chancellor of Germany. She has been regarded as the world's most powerful woman and in effect the real de facto leader of the European Union. However, her background is a physical chemist by profession. She entered politics in the aftermath of the Revolutions of 1989 that saw the fall of the Berlin Wall. Following reunification in 1990, she was elected to the Bundestag, where she has represented the state of Mecklenburg-Vorpommern. She was Secretary General of the CDU 1998–2000, and was elected chairperson in 2000. From 2002 to 2005, she was also chair of the CDU/CSU parliamentary coalition. So she has no real private sector perspective and is a professional career politician who sees the world solely in a political light.

In 2007, Merkel was President of the European Council and chaired the G8, the second woman to do so since Margaret Thatcher was the first. Nonetheless, she has taken a political view, not a practical economic view regarding Europe. Her obstinacy to a unified European debt has helped create the crisis we see today in Europe. She simply looks at things from a political view – not economic.

The German government has begun, however, opening the door to the idea of a shared debt for the first time. This demonstrates that the ***Sovereign Debt Crisis*** is still brewing. Academics should never be allowed to design economic systems for they do not understand markets lacking trading experience. Politicians should never be allowed to play with the economy for it will always take a back seat to their self-interest. The solution is clear: (1) politicians should be restricted to one brief term of office and no other in government creating a term limit to ensure only the **PEOPLE** truly are represented, and (2) only real live traders should be allowed to design a system. You would not go to a virgin for sex therapy or to a doctor who accepts gifts from drug companies to only use their products. This is our survival that is at stake and this nonsense has to stop. Government will always be corrupt as long as career politicians are in office who can be bought so they can maintain their "elected" job as a politician.

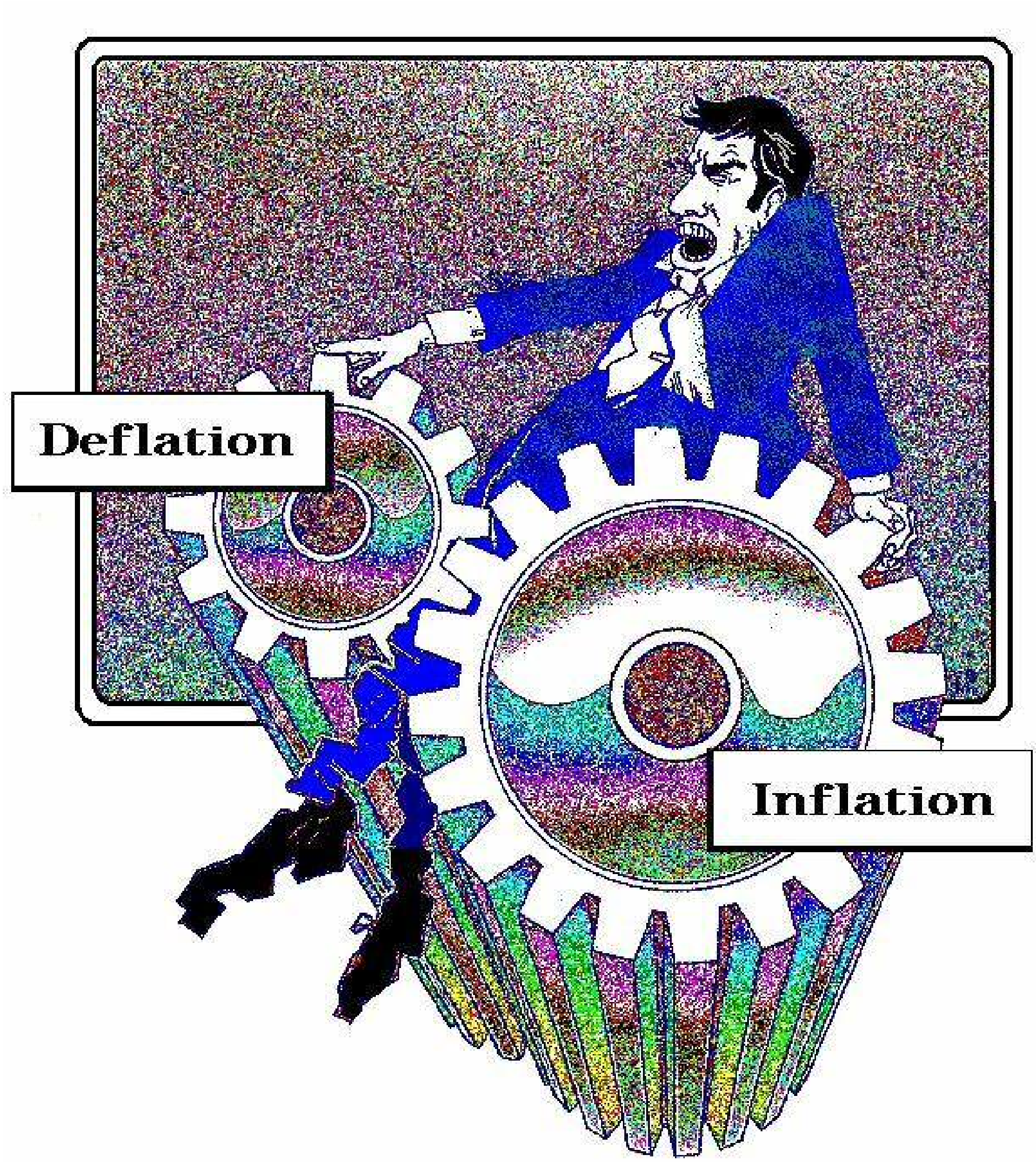
Nonetheless, there is a profound change of policy in Germany by agreeing to explore proposals for a €2.3 trillion ***European Redemption Pact*** stabilization fund in order to stop the Eurozone's crisis escalating out of control. Unfortunately, it is too little too late. I reported that our sources in Berlin said that if Germany had to choose between inflation and the collapse of the Euro, they will choose to former. Officials in Berlin are now saying privately at last that Chancellor Angela Merkel is finally willing to drop her obstinate opposition to plans for a ***European Redemption Pact***, which is a "***sinking fund***" that would pay down excess sovereign debt in the Eurozone.

Merkel is still refusing to consider the entire proposal we set forth. She is willing to consider as long as there is proper supervision of tax revenues. Sources continue to warn that there would be no master plan to emerge from the EU summit. Chancellor Merkel rejected the ***European Redemption Pact*** last November even though it is the only viable route out of the current impasse, albeit still shy of the required single debt structure. Events have been very fast-moving in Europe and she remains blind to the fact that government is the problem. She remains under intense pressure from the US, China, Britain, and Latin Europe to change course for Europe for the ***Sovereign Debt Crisis*** in Europe is exposing the entire world to a contagion unseen since 1931. The crisis has engulfed Spain and Italy, threatens France, and in the process is bringing Western Civilization to the very brink of a global cataclysm of untold consequences.



Europe is facing a crisis in socialism and with it, the entire debt structure of all countries is being expose, stripped naked, and laying prostrate for the entire world to see. Countries regardless of their reforms are engulfed by forces beyond their control. This is a ***Sovereign Debt Crisis*** that is a systemic problem on a global scale. Government have simply been borrowing money since World War II with no intention of every paying anything off. They are under the delusion that borrowing money is somehow less inflationary than printing it. Yet they fail to comprehend that a close inspection of the US National Debt shows that near 70% of the outstanding debt was created to pay interest – not to help people.

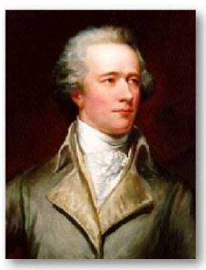
Politicians are unwilling to stop the borrowing because how else will they get elected if they cannot spend what they do not have? This conflict of interest prevents reality and prolongs the crisis. I am not sure the urgency of this crisis is fully understood in all the capitals around the world or in the marketplace as yet. Yet the market has driven yields on the 10-year Spanish debt just under 6.8% on doubts that the EU's €100bn rescue for the country will solve the crisis. After Spain, we will see Italy attacked as the next domino to fall. Italy had to pay 3.97% to raise €6.5bn of 12-month debt compared with 2.34% in May. The markets are showing there is a rising concern. Despite the fact that Italy has been aggressive in taxing the rich, they will only destroy their economy trying to support the bonds.



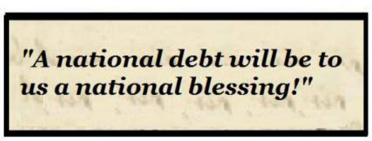
Some think this is merely a pure contagion. What they fail to grasp is that we face a systemic crisis globally. Japan is doubling its consumption tax. The tax rate on investment will jump from 15% to about 45% come January. We are looking at a real crisis around the globe as government try to satisfy the bondholders, they are creating a massive deflationary surge that is crashing the economies. That will reduce GDP and cause higher prices, but not as a function of **DEMAND** on a consumer perspective, but from a bondholder perspective. This produces nothing but **STAGFLATION** – rising prices as costs rise but declining economic growth since demand shrinks.

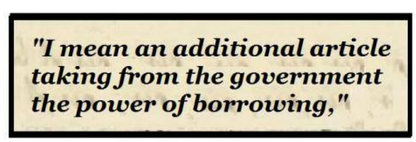
The ***Sovereign Debt Crisis*** is on its own agenda. Either Europe move to fiscal pooling creating a single national debt to stem the tide immediately, or we are heading straight into defaults in euros and the breakup of the Eurozone. Italy's premier Mario Monti told the Italian Parliament on that he expects the ***European Redemption Pact*** to be fully "***on the table***" at the EU summit, even if it does not come into force immediately at this round. In Germany, the opposition Greens and Social Democrats both back the plan and this now puts tremendous pressure on Chancellor Merkel meaning she cannot possibly ignore them when she needs their votes to ratify the EU Fiscal Treaty. She needs a two-thirds majority. That is politics as usual.

The German Green leader Jürgen Tritten, warned that his party would block the Treaty in the upper house unless the ***European Redemption Pact*** was adopted. He made it clear that "*it is central for us. The Europe of austerity is ending,*" he said. We even now see cross-party talks in the Bundestag fell apart the week over demands by the opposition for a "*growth compact*" to help lift Southern Europe out of its downward spiral. The Christian Democrats will have to now give ground to keep any political hope alive.


Alexander Hamilton
(1755 - 1804)


Thomas Jefferson
(1743 - 1826)





The ***European Redemption Pact*** covers all public debts of EMU states above the Maastricht limit of 60% of GDP. This is about €2.3 trillion. It is structurally modeled in part on what Alexander Hamilton created in 1790, a ***Sinking Fund*** to clear up all the legacy debts after the American revolutionary war – the **Hamiltonian Model**. But there were consequences that we must look at in detail. For this plan led to Federalism and civil unrest. In 1781 Alexander Hamilton wrote a letter to a friend in which he discussed government spending. "***A national debt, if it is not excessive, will be to us a national blessing.***" Thomas Jefferson, however, took quite a different view. Jefferson said that public debt was a danger and to be greatly feared. In 1798 he wrote a letter to his friend John Taylor in which he addressed amendments to the constitution. Jefferson wrote: ***"I mean an additional article taking from the government the power***

of borrowing." Hamilton was the politician. Jefferson the statesman and as all government descends down the dark staircase of corruption until it is compelled to extinguish its own life by suicide, Jefferson was already under assault by those who hated him for his honor, dignity, and steadfast belief in the **LIBERTY** of the people. When asked what which he would choose, government or the free press, he chose the latter.

Today, **LIBERTY** is all but gone. In the quest to pretend to care for the people, the fruits of the labor of the people have been usurped by the politicians and are handed over to the bondholders. Jefferson's twilight years were spent, in part, defining and defending his legacy. It is unimaginable that such a great man would be ridiculed and debased by the self-interest of the corrupt politicians who had to take him down in order to grab the spoils of their victory. Even John Quincy Adams (1767–1848; 6th US President 1825–1829), remarked upon leaving office that as a Republican who had defeated the Federalists of Hamilton, ***"We have defeated the enemy. We occupy their hill. We have become the enemy."***

During Jefferson's final decade, he drafted an autobiography, created political memorandum books, became increasingly concerned about the preservation of historical documents, and staunchly defended his role as author of the ***Declaration of Independence***. At key points in his life, Jefferson had drawn up lists of his achievements, and on the verge of death he designed his own gravestone and epitaph deeply concerned about his reputation. He wrote: ***"Author of the Declaration of Independence [and] of the Statute of Virginia for religious freedom & Father of the University of Virginia."*** Critics actually questioned his role in writing the ***Declaration of Independence*** trying to rewrite history and to kill the messenger because he had written: ***"We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness***…" This passage offended the Democrats who were the slavery proponents at that time. They had to destroy Jefferson's reputation to justify their own existence. Whenever a corrupt self-interest gains control of government as the bankers have achieved today, honesty, integrity, and LIBERTY are quickly dispensed with.

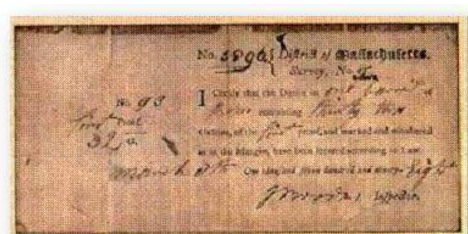
Jefferson suffered the pains of the arrows of the pro-slavery contingent. Yes he owned slaves. He fathered children after his wife died living with a black women who took care of him. But Jefferson did not release his slaves for they would be unable to find work and could have been taken by others. Instead, he humanly cared for his slaves that landed him in great debt. His opponents saw him as a traitor to their cause and objected to his emerging role as a symbol of individual freedom. Jefferson insisted upon his authorship of the ***Declaration of Independence*** and reasserted his moral opposition to slavery. Nevertheless, Jefferson undoubtedly knew at his death on July 4, 1826, that the vagaries of life had left a vulnerable legacy. His slaves, land, and library would have to be sold to satisfy his creditors.

Fear for his reputation and public legacy led him to beg his closest friend, James Madison, to ***"take care of me when dead."*** That is how betrayed he felt by a country he loved. In his final letter to Roger Weightman, Jefferson eloquently espoused the central role of the United States and the ***Declaration of Independence*** as signals of the blessings of self-government to the world. His opposition to debt and the ability of government to even borrow stands as a shameful reminder how government has always followed the worst possible path.

Hamilton's plan that is now the basis of the proposals for Europe must be understood. The United States had borrowed money from Europe and at home during the American Revolution. The Continental Army had not been paid what was due to them, and many of the independently-wealthy officers of the army had spent their entire fortunes on equipment and supplies for their own forces. The various states had borrowed money to finance the war effort. Indeed, some states owed private citizens for the purchase of supplies, exchanged for a promissory note due sometime in the future.

Hamilton was a Federalist. He knew the way to truly unite the states was to create a single national debt by absorbing all the debts of the states. This would in reality create a strong central government. This was Hamilton's goal. It was not a magnanimous effort to relieve the debt burden of the states. The US national debt in 1790 was about US$54 million. Adjusted for inflation, that would be about $5 trillion in 2012. The Congress endorsed Hamilton's plan to pay off the US$11 million owed to foreign creditors, however, they recoiled from paying the domestic debt of some US$27 million, They certainly did not want to absorb the state debts of US$25 million. That introduced a tone of problems. Some states would have larger debts than other and thus the debt relief would not be fair. This is no different than what we have heard in Europe since 1998.

Hamilton proposed that all debts were to be paid at face value. The Federal government would assume all of the debts owed by the states, and it would be financed with new U.S. government bonds paying about 4% interest. The government would not pay back the principal on the bonds, merely the interest, which would be paid by a new tariff and a stiff excise tax on liquor. That of course led to the Whiskey Rebellion of 1791. The tax was unfair and the big distillers used their political clout to driver smaller distillers out of business. Unlike tariffs paid on goods imported into the United States, the excise tax on distilled spirits was a direct tax on Americans who produced whiskey and other alcohol spirits. The 1791 excise law set a varying six to 18-cent per gallon tax rate, with smaller distillers often paying more than twice per gallon what larger producers paid. All



1798 receipt for the whiskey tax

payments had to be made in cash (coin) to the Federal revenue officer appointed for the distiller's county

After several thousand armed rebels gathered at Braddock's Field during the last week in July 1794, President Washington met on August 2nd with his Cabinet and the governor of Pennsylvania, Thomas Mifflin, to consider the situation. The President issued a proclamation on August 7th calling on the rebels" to disperse and retire peaceably to their respective abodes." The proclamation also invoked the Militia Act of 1792, which, after Federal court approval, allowed the President to use State militiamen to put down internal rebellions and "cause the laws to be duly executed." The same day, Secretary of War Henry Knox sent a letter to the governors of Maryland, New Jersey, Pennsylvania, and Virginia requesting a total of 12,950 militiamen to put down the rebellion.

Washington sent men to meet with rebel leaders. They met with a 15-member committee appointed by a rebel assembly representing counties in Pennsylvania and Virginia. The rebel committee included Hugh Henry Brackenridge, David Bradford, and Albert Gallatin, who has been remembered on a stamp no less. Today he would have been simply called a terrorist and imprisoned without ever getting a trial. Indeed, the Feds returned recommending it was "absolutely necessary that the civil authority should be aided by a military force in order to secure a due execution of the laws." Those in power always use force against the people.

President Washington, summoned almost 13,000 militiamen. On September 19, 1794, George Washington became the only sitting U.S. President to personally lead troops in the field when he led the militia on a nearly month-long march west over the Allegheny Mountains to the town of Bedford to kill citizens of the United States for daring to oppose the tax to pay off creditors. On September 25th, the President issued a proclamation declaring that he would not allow "a small portion of the United States [to] dictate to the whole union," and called on all persons "not to abet, aid, or comfort the Insurgents."

Those in power always see any resistance of the people as criminal. When taxes began in the 13^{th} and 14^{th} centuries, there were massacres of citizens who refused to pay taxes. In England, tax rebellions began with the Wat Tyler in 1381 and continued into 1645. In France it was the ***Jacqueline*** rebellion that became a popular revolt in 1358 in protest of taxation for the Hundred Years War.

Historically, civil unrest is always the consequence of rising taxation. Government feels it is its right to extract from the people whatever it desires. They are like a 14 year-old with their father's credit card and no sense of monetary limitation. When the people resist, they are called criminals and typically massacred or jailed. Washington proved to be no exception. He left a letter with General Lee with instructions to combat those ***"who may be found in arms in opposition to the National will and authority***" and ***"to aid and support the civil Magistrate in bringing offenders to justice."*** By late October 1794, the Feds entered the western counties of Pennsylvania and seized 150 rebels dragging them from their homes arresting them for daring to oppose the new central government that they could see no difference compared to the King. The Revolution to them merely replaces one tax thirsty tyrant with another. Both justify their actions by merely declaring the opposition to be criminal. They arrested 20 prominent leaders of the insurrection desperately trying to cut off its head. King George III had also sent troops personally to Jefferson's home to hang him for daring to write the ***Declaration of Independence***. Washington merely replaced George III in the eyes of the rebels.

In the end, the unpopular actions of Washington leading troops against American citizens prompted General Lee to issue a general pardon on November 29th for all those who had taken part ***"in the wicked and unhappy tumults and disturbances lately existing"*** with the exception of 33 men he named in the document. He kept troops there to now occupy the region until the following spring. Two of the 33 men were found guilty and convicted of treason. In July 1795, President Washington pardoned the two convicted men and those still in custody or under indictment. The disgraceful conduct of the new Federal government gave substance to Jefferson's warnings that (1) there should never be direct taxation as is the case currently, and (2) government should never be allowed to borrow.

Washington suppressed the violent opposition to the whiskey tax, but the political opposition to the tax continued and then rallied around the candidacy of Thomas Jefferson helping him to defeat President John Adams in the election of 1800. By 1802, Congress repealed the distilled spirits excise tax and all other internal Federal taxes at Jefferson's insistence. This tax increase and tyrannical attempt to force its collection by military action is what extinguished the Federalist Party.

Nonetheless, it was Hamilton's economic plan where federalism was its primary goal. He understood that to create a single currency required also unification. Hamilton believed that the Federal government would not be able to borrow money from anyone in the future if these debts were not paid. By selling bonds to pay the debt, bondholders would have a direct financial interest to help the new United States government survive and thrive. Creditors who purchased the bonds could use them as collateral for loans, stimulating the economy even more. So Hamilton did not distinguish between money and debt. The opposition was too great for the Federalists to overcome with respect to creating paper money. Thus, Hamilton realized as a bond would be the same as paper money when allowed to be used as collateral for loans.

Hamilton was born in the West Indies living in Saint Kitts & Nevis. His father James abandoned his mother and his two sons, apparently to spare her a charge of bigamy when her former husband would sue for divorce on grounds of adultery and desertion. Upon her death, her first husband seized her estate. Many items were auctioned off, but a friend purchased the family books and returned them to the young Hamilton. He became a clerk at a local import-export firm, which traded with New England giving him the grand idea of going to America. Alexander was adopted by a Nevis merchant, Thomas Stevens, who some have claimed was his real biological father.

Hamilton continued to clerk for a merchant, which in those days was the most elite profession that also tended to lead to banking. He was an avid reader and became a good writer. He wrote an essay published in the Royal Danish-American Gazette, which was a detailed account of a hurricane that had struck and devastated St Kitts on August 30, 1772. The essay impressed community leaders, who collected a fund to pay for his passage to the American colonies. Hamilton went to Columbia University. However, it was this early experience working in the field of international trade that allowed him to understand international capital flows.

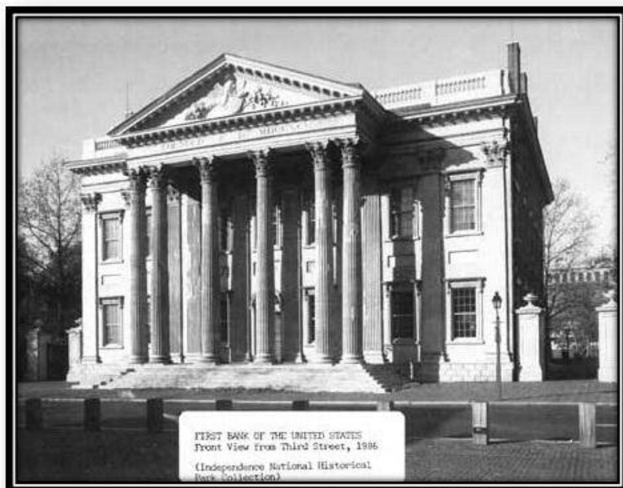
Leviathan Published 1651

With this experience in toe, Hamilton's plan for the finances of the nation was at least understood by someone with international experience. His plan would create a bureaucracy of agents across the country who would be tied to the Federal government instead of the individual states. He was constructing a federal government. He had the support of Washington for he had been Washington's clerk during the war and was in charge of even corresponding with Congress and other generals keeping everything coordinated. Hamilton realized that to create a federal government he had to create a central unifying interested and that would be assuming the debts of the states. This act would likewise couple financial elites in those states tying them now to the national government breaking their bonds to the state governments. He was employing Julius Caesar's divide and conquer strategy. This he saw as constructing a federal government reducing the risk of secession if interests diverged. Hamilton's scheme was dynamic, well planned, and far-reaching in 1790 terms.

Hamilton's idea to create a federal government was to assume the debts of the states while funding new national securities and thereby creating a national debt and establishing credit, faith, and trust in the new government. It was the binding of debts that would establish a viable entity through self-interest when many felt the United States would soon fail. Keep in mind this idea of abandoning monarchy was something people had just become familiar with reading about Rome and Greece. Thomas Hobbes (1588–1679) had published the Leviathan in 1651 supporting Monarchy. Hamilton, wrote in the Federalist No. 11, in 1787:

> ***"Let the thirteen States, bound together in a strict and indisoluble Union, concur in erecting one great American system, superior to the control of all trans-Atlantic force or influence and able to dictate the terms of the connection between the old and the new world!"***

Therefore, Hamilton realized that creating a large financial structure, was essential to the survival of federalism. He needed to tie wealthy citizens among the states together to support and belong to a new federal government. President George Washington appointed Hamilton as the first United States Secretary of the Treasury on September 11, 1789. Hamilton at least had real world experience and was not what we have today – career politicians who lack understanding of how capital even flows. If they did, they would realize to create jobs you lower taxes instead of raising them.



First Bank of the United States
Philadelphia, Pennsylvania - operated 1797-1811
(Independence National Historical Park Collection)

Hamilton knew precisely what he was doing. There was opposition then as there is today in creating a single European debt. Hamilton's proposal to charter a national bank was severely attacked in Congress on constitutional grounds. The opposition was led by James Madison, who was becoming increasingly hostile to Hamilton's program. Although the two men had supported strong national government in the convention and had worked together to secure ratification of the Constitution, neither man's constitutional philosophies nor their economic interests were harmonious.

Accordingly, Hamilton's plan was strategically designed after the Bank of England with the intent of supporting mercantilism that he saw as the path to wealth and to merge that with government interests to create a strong and lasting bond. Today, central banks are there only to really support government and have become highly political in their structure. Hamilton placed before the first session of the First Congress, his proposal establishing the initial funding for the ***Bank of the United States*** through the sale of $10 million in stock of which the United States government would purchase the first $2 million in shares. Hamilton, foreseeing the objection that this could not be done since the U.S. government didn't have $2 million, proposed that the government make the stock purchase using money lent to it by the Bank. Yes, the creation of a interesting equity-debt swap. This loan would be paid back in ten equal annual installments.

The remaining $8 million of stock would be available to the public, both in the United States and overseas, which Hamilton saw as establishing full faith in the formation of the United States and key was keenly aware of how capital flowed internationally. A near equal block of $2 million had been purchased by Europeans, and this attracted foreign imported capital to make the purchase. There had been both the South Sea and Mississippi Bubbles that burst in 1720. Both involved Europeans investing overseas. Hamilton further introduced interesting incentive to buy the stock. The primary requirement of these non-government purchases was that ***<u>one-quarter</u>*** of the purchase price had to be paid in gold or silver with the remaining balance could be paid using the bonds. This was brilliant. You converted your worthless paper currency for bonds and then you could use the bonds to buy stock. Brilliant!

By continuously insisting on these conditions, the Bank of the United States might technically possess $500,000 in "real" money that it could, and would, use as security to make loans up to its capitalized limit of $10 million. However, unlike the Bank of England from which Hamilton drew much of his inspiration, the primary function of the Bank would be commercial and private interests. The business it would be involved in on behalf of the federal government—a depository for collected taxes, making short term loans to the government to cover real or potential temporary income gaps, serving as a holding site for both incoming and outgoing monies—was considered highly important but still secondary in nature.

The key to Hamilton's plan was that Congress agreed to redeem Continental Currency at $100 to one new US dollar, with an indefinite maturity. This was an effort to give some value to the worthless currency and avoid an economic depression by wiping out the value of the currency held by the people. Many did not redeem their currency thanks to the Act of 1790 that they read as an ultimate guarantee of 1:1.

With the breaking of ties with England, the Colonies had begun to issue paper money like the flood gates had just been opened. Backing was, of course, not there. In fact, on one paper currency Issue in 1778 of Georgia, reference to its backing of the currency was plainly stated on its face. The notes stated that they were payable or **redeemable from the proceeds of properties confiscated from Tories**. Gold, silver and even copper coins disappeared from circulation completely once the war began. Paper money began to be printed for decimal coinage denominations as well. At first the money circulated freely and with support of the people. However, in 1777 what would become one of economic history's most drastic examples of paper money depreciation began. Here are the official exchange rates as published by each Colony and the Federal Government. These rates were used for $1 worth of gold or silver as originally valued in 1775. However, it should be pointed out that those who held Continental Currency were, for the most part, unable to exchange them even at the official rates. Eventually, holders of this currency received nothing in return which prompted the saying, "***not worth a Continental***".

Colonial Currency Rates

Continental	**$40 for $1**
N.Y. & Conn	**$40 for $1**
South Carolina	**$52.50 for $1**
Mass., N,H. & R.I	**$100 for $1**
New Jersey	**$150 for $1**
Penn. & Delaware	**$225 for $1**
Maryland.	**$280for $1**
North Carolina	**$800 for $1**
Virginia	**$1000 for $1**
Georgia	**$1000 for $1**

Despite the fact that the Continental Currency ceased to circulate in April 1780 and the official exchange rate was set at $40 to $1, holders of this currency were unable to redeem it. Yet Continental currency became a form of speculation. Even though the ***Articles of Confederation*** had promised payment, it was not until seven years later when the constitution of the United States in 1787 recognized that there was an obligation to redeem these otherwise worthless scraps of paper. By October of 1787, Continental currency was being traded at the going rate of $250 for $1 in gold. This meant that the 1780 official rate had further depreciated raising the value of gold from $800 an ounce in 1780 to $5,000 an ounce in 1787 in terms of Continental dollars.

The government was in no position to exchange the Continental Currency at any rate. The economy and lack of faith were simultaneously taking a swan dive straight down. Eventually, gold peaked in late December 1790 but only after Congress passed an Act August 4th, 1790. This Act provided a means for refinancing debts and from October 1st, 1790 to September 30th, 1791, congress agreed to redeem $100 in currency for $1 in bonds of indefinite maturity. Through this method of dealing with the worthless currency, Alexander Hamilton, Secretary of the Treasury, averted a U.S. economic depression.

Many people refrained from exchanging their Continental Currency for bonds that paid 6% interest because the Act of 1790 provided that the Currency would still be redeemed and that it was not mandatory to exchange it for bonds. The bonds were eventually paid in 1813 and those who held their currency in hopes of getting something more than an 1% return on what they had, received nothing!

Benjamin Franklin
(1706-1790)

Depending upon where you were and what Colonial currency you held, the exchange rate between paper currency and one ounce of gold varied from $800 to $10,000 per ounce. Despite Ben Franklin's early warning in his publication of 1729, ***"A Modest Enquiry into the Nature and Necessity of Paper Currency",*** America's game with paper-economics was far from over.

Hamilton's plan did create a feeling of optimism. The new nation quickly became a hot-bed for speculation. Just as the Dot.Com Bubble of 2000 was pricing decades of future possible earnings, the same was true in the United States at this point in time from everything that began with land to the birth of share trading in corporations. Thomas Jefferson had written to Edmund Pendleton in 1791, concerning Hamilton's general scheme, that, ***"As yet the delirium of speculation is too strong to admit sober reflection. It remains to be seen whether in a country whose capital is too small to carry on its own commerce, to establish manufactures, erect buildings, etc., such sums should have been withdrawn from these useful pursuits to be employed in gambling."***

Unknown to most,' the City of Philadelphia that was founded in 1681, was more than the location of Independence Hall and the Liberty Bell. It was also the city that became the first major banking center in America and it was the birthplace of the first Stock Exchange in 1790. The "curb" trading began in New York in 1792 when 24 men met under a buttonwood tree. It would be the ***Panic of 1873*** that began to shift the power from Philadelphia to New York that would be cemented by J.P. Morgan. Hamilton's plan created optimism in the new country and that became manifest in a real estate bubble of speculation.

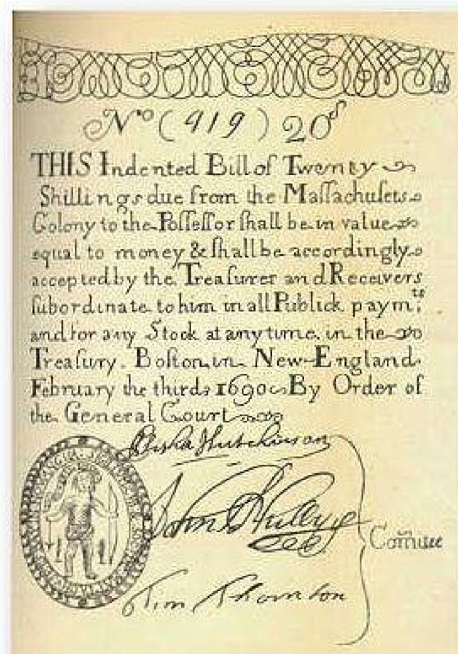
Philadelphia Independence Hall 1776

The ***Panic of 1792*** quickly followed and it was the first financial bubble to take place in the United States. It was a combination of land speculation and stock speculation that resulted in many famous men bankrupt and in debtor's prison. It was this first ***Panic of 1792*** that caused Benjamin Franklin (1706-1790) to write: ***"Nothing is certain but death and taxes."***

Hamilton's IPO offering for ***Bank of the United States*** saw shares prices sold at $400 each with 25,000 shares to be issued. Realizing that this was a fortune and typically several years' worth of income for the average man, they were sold on a subscription basis and thus the "script" or option to buy a share was sold for $25 payable in gold. The option holder was then required to pay $100 ($25 in gold; $75 in US Debt) by January 1st, 1792 and July 1st, 1792, with the next payment on January 1st, 1793 with the final $75 in debt swaps paid by July 1, 1793, according to David Jack Cowen *(The Origins and Economic Impact of the First Bank of the United States, 1791- 1797 (2000)).*

It was this script that began to trade - options if you will, from July 4th, 1791. Within just six weeks of trading was active. The price about doubled by the end of the month of July. By August 1791, they exploded reaching $264 bid - $280 ask in New York on August 11th, 1791. The main market was Philadelphia where they soared in price to $300. This meant that the actual share price would have been about $700. A panic broke out and the price tumbled in Boston collapsing from $230 on August 12th dropping to $112 by the 14th, the script rallied reaching $154-159 on the New York market by August 16th, 1791. In Philadelphia, the price rose to $125-137 on the same day.

In real estate, houses in Philadelphia rose sharply giving rise to real estate in Boston and New York as well going into a speculative bubble. The United States had become an emerging market. There were also private banks in America. The ***Bank of New York*** was founded in 1784 after the Revolution and it was chartered in 1791. The ***Bank of North America*** had been the creation of Robert Morris (1734-1806) who also ended up in debtor's prison with the ***Panic of 1792***. There had been a history pre-revolution of various schemes to create credit and money. As far back as ***King William's War in 1690***, Massachusetts Bay paid for its military expedition into Canada by creating paper currency script known as ***Bills of Credit*** in the amount of £50,000. To encourage their acceptance and circulation, they were acceptable to pay taxes at a 5% discount. Much of the early military expenses with Indian wars were met by issuing these paper currency scripts known as "Bills of Credit" at this time.


No (419) 20s
THIS Indented Bill of Twenty Shillings due from the Massachusets Colony to the Possessor shall be in value equal to money & shall be accordingly accepted by the Treasurer and Receivers subordinate to him in all Publick paym.ts and for any Stock at any time in the Treasury. Boston in New-England February the third 1690 By Order of the General Court

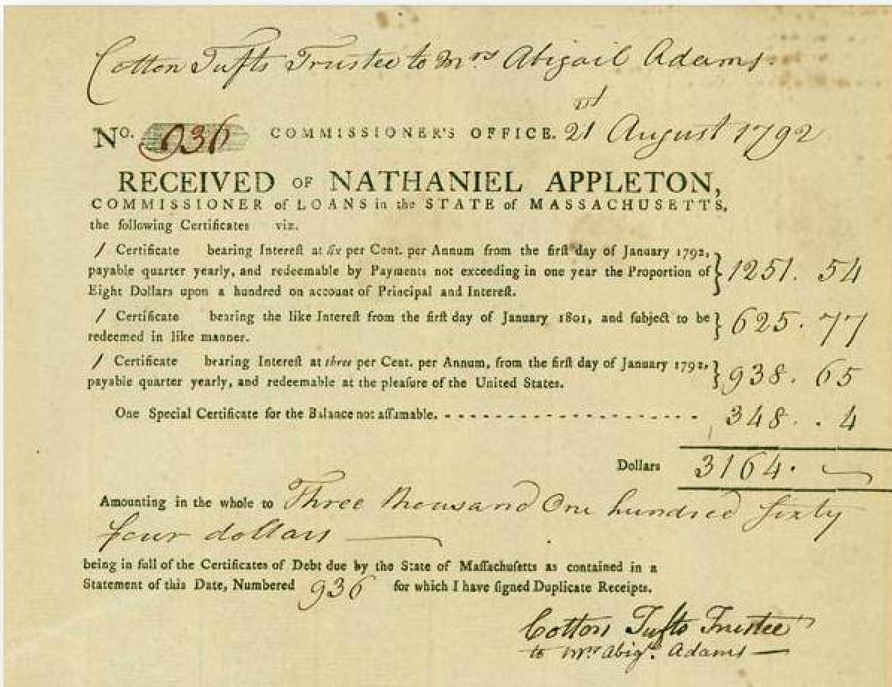
Massachusetts Bay Colony of New England
1690 *Bill of Credit* - £50,000 issue

Foreign exchange has been volatile in the America Colonies. In 1642, the Spanish silver dollars (8 reales) were trading at 4 schillings. By 1645, Spanish dollars rose in purchasing power (asset deflation) to 6 schillings and then crashed to 5 schillings that year and inflation surged. Eventually, British merchants complained of the fluctuations and in 1707 and Act of Parliament set the maximum value of Spanish dollars at 6 schillings. Much of the wild fluctuations were caused by war expenses with the lack of precious metals to cover the costs that led to the issue of these ***Bills of Credit***. The wars had continued for there was the King George War (1741-1748) followed by the French and Indian War (1754-1763).

By 1733, paper money ***Bills of Credit*** began to be issued also for public civil expenditures to construct things such as jails, lighthouses, courthouses, forts, and harbors. In 1769, Philadelphia issued paper money simply to cover welfare payments to the poor. This form of circulating credit gave birth to colonial Loan Offices that became an official type of pawn shop where individuals could pledge their land or silver as collateral. The first Loan Office was formed in 1712 in South Carolina and by 1737, every colony followed except Georgia. In many cases, the loan was repayable in script yet the interest was due exclusively in coin. In 1741, the English Parliament required the redemption of all such private script for now there were those opening loan banks printing their own money. In 1749, England sent sufficient coin to redeem state ***Bills of Credit*** at the ratio of 7.5 to 1. This Act became effective September 29th, 1751. This had the effect of creating deflation driving the price of gold higher.-

So the American colonists were accustomed to the wild fluctuations and against this backdrop we must see the ***Panic of 1792*** was hardly taking place out of a vacuum. There had even been ***Shays' Rebellion*** in 1785 in Massachusetts during August that year which was an uprising by land owners against further foreclosures due to the economic decline that lasted between August 1786 and February 1787. This rebellion forced changes in bankruptcy laws. There was also the French Revolution in 1789 and that cause French capital to flee to the United States. That contributed to creating the capital concentration that was necessary for the ***Panic of 1792***.

The influx of capital into the ***Bank of the United States*** stock was just the tip of the iceberg and coincided with the French Revolution, which added an incentive for foreign investment to absorb about 20% of the entire issue. This was a wave of foreign capital was from France, predominantly, and fueled the domestic real estate bubble in the United States. The new bank shares took off in price with all the foreign capital pouring in. This caused the price of United States Bank stock that had originally been sold in an IPO at $100 a share soared in price reaching $195. A 1792 Bubble developed and the price of the stock collapsed back to 110. It eventually rallied back to $145. A private bank was founded in 1784 and was chartered in 1791. This became known as the ***Bank of New York***. Hamilton turned to the ***Bank of New York*** asking them to buy government bonds and ***Bank of the United States*** shares to inject cash into the economy to relieve the cash shortage that had developed.



Cotton Tufts Trustee to Mrs Abigail Adams.

No. 936 COMMISSIONER'S OFFICE. 21st August 1792

RECEIVED OF NATHANIEL APPLETON,
COMMISSIONER of LOANS in the STATE of MASSACHUSETTS,
the following Certificates viz.

1 Certificate bearing Intereſt at *six* per Cent. per Annum from the firſt day of January 1792, payable quarter yearly, and redeemable by Payments not exceeding in one year the Proportion of Eight Dollars upon a hundred on account of Principal and Intereſt.	1251. 54
1 Certificate bearing the like Intereſt from the firſt day of January 1801, and ſubject to be redeemed in like manner.	625. 77
1 Certificate bearing Intereſt at *three* per Cent. per Annum, from the firſt day of January 1792, payable quarter yearly, and redeemable at the pleaſure of the United States.	938. 65
One Special Certificate for the Balance not aſſumable.	348. 4
Dollars	3164.

Amounting in the whole to Three thousand One hundred Sixty four dollars

being in full of the Certificates of Debt due by the State of Maſſachuſetts as contained in a Statement of this Date, Numbered 936 for which I have ſigned Duplicate Receipts.

Cotton Tufts Trustee to Mrs Abig. Adams

Abigail Adams purchases $3,164 in US Treasury Bonds

From the outset, the United States attracted especially French foreign capital. Even by the ***Crash of 1987***, there was still little understanding of international capital flows and how they increase the money supply. When one domestic player buys and the other sells, nothing will alter the domestic economy for money supply remains unchanged. However, if the foreign investor brings in cash, they increase the domestic money supply. If you scare that foreign investor, they will withdraw all capital and that will create a cash shortage since the economy became accustomed to that excess capital inflow. Abigail Smith Adams (1744-1818) had complained that her husband, John Adams (1735-1826) was a Villa Economy man believing in agriculture so he had not invested in Hamilton's bank scheme commenting on how prices and profits had been made on this early bubble.

Abigail Adams (1744- 1818)
wife of John Adams

Hamilton's insistence that the ***Bank of the United States*** be a private company but strangely would have a twenty year charter running from 1791 to 1811, after which time it would be up to the Congress to renew or deny renewal of the bank and its charter. However, during that time period, no other federal bank would be authorized while the states would be free to charter however many intrastate banks they wished.

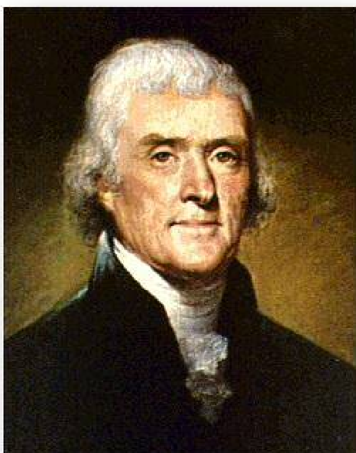
That the ***Bank of the United States*** to avoid any appearance of impropriety, would be forbidden to buy government bonds. That is very interesting compared to how the central banks operate today. Furthermore, the bank was to have a mandatory rotation of directors. The ***Bank of the United States*** would neither issue notes nor incur debts **beyond** its actual capitalization. Hamilton further insisted that foreigners, whether overseas or residing in the United States, would be allowed to be ***Bank of the United States*** stockholders, but would not be allowed to vote.

That the Secretary of the Treasury would be free to remove government deposits, inspect the books, and require statements regarding the bank's condition as frequently as once a week. To ensure that the government could meet both the current and future demands of its governmental accounts, an additional source of funding was required, ***"for interest payments on the assumed state debts would begin to fall due at the end of 1791...those payments would require $788,333 annually, and... an additional $38,291 was needed to cover deficiencies in the funds that had been appropriated for existing commitments."*** To accomplish this goal, Hamilton repeated the suggestion he had made previously nearly a year before that an increase the duty on imported spirits, plus raise the excise tax on domestically distilled whiskey and other liquors would be put in place. It was the local opposition to the tax led to the ***Whiskey Rebellion***.

Hamilton wished to push still further in the direction of a powerful central government. Madison, now conscious of the economic implications of Hamilton's program, became aware of the hostility building in his own region against nationalism. Madison now favored a middle course between centralization and states' rights. The issue, you keep in mind, was they had just fought a revolution against a centralized government. As we see in Europe today, there was just too much resentment festering against a national all powerful government.

In the Constitutional Convention Madison had proposed that Congress be empowered to *"grant charters of incorporation,"* but the delegates had rejected his suggestion. In view of this action, Madison now believed that to assume that the power to incorporate could rightfully be implied either from the power to borrow money or from the ***"Necessary and Proper"*** clause in ***Article I, Section 8*** in the Constitution, he chose to lay back and saw a fight as being unwarranted and dangerous precedent. But this is the whole problem with lawyers. They take an ambiguous clause such as the authority to enact all laws that are ***"Necessary and Proper"*** and can fit whatever power they desire within the four corner of such ambiguity. This has been our undoing. For virtually any tyranny can be rationalized to fit within the ***"Necessary and Proper"*** clause.

It was during February 1791, that the ***Bank Bill*** was passed by Congress. However, President George Washington, who still considered himself a sort of mediator between conflicting factions, wished to be certain of its constitutionality before signing it. Among others, Thomas Jefferson was asked for his view, which in turn was submitted to Hamilton for rebuttal.



Thomas Jefferson
(1743 - 1826)

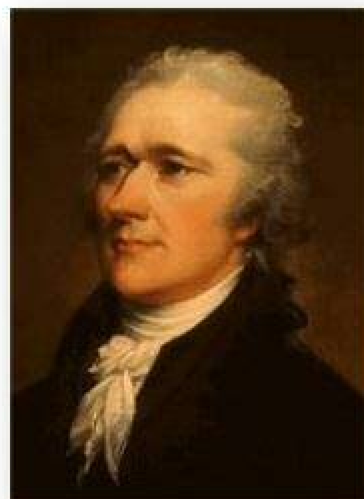
Jefferson made a very profound argument advocating the doctrine of ***Strict Construction*** maintaining that the bank bill was unconstitutional. The common-law tradition has produced various precepts, maxims, and rules that guide judges in construing statutes or private written agreements such as contracts. ***Strict construction*** occurs when ambiguous language is given its exact and technical meaning, and no other equitable considerations or reasonable implications are made. Using this ***Strict Construction***, Jefferson took as his premise the ***Tenth Amendment*** (which had not yet become a part of the Constitution), whereas he contended that the incorporation of a bank was neither an ***enumerated power*** of Congress nor a part of any ***Granted Power***, and that ***Implied Powers*** were inadmissible. Of course today, the courts often create ***Implied Powers*** and do not use ***Strict Construction***. They routinely rewrite the constitution fitting things into vague phrases and clauses to justify any action. The Obama Healthcare was upheld as constitution under a Taxing Authority. So call something a tax, and they can do anything.

He further denied that authority to establish a ***Bank of the United States*** could be derived either from the "***General Welfare***" or the "***Necessary and Proper***" clause. The constitutional clause granting Congress power to impose taxes for the "***General Welfare***" was not of all-inclusive scope, he said, but was merely a general statement to indicate the sum of the enumerated powers of Congress. In short, the "***General Welfare***" clause did not convey the power to appropriate for the general welfare but merely the right to appropriate pursuant to the enumerated powers of Congress.

With reference to the clause empowering Congress to make all laws necessary and proper for carrying into execution the enumerated powers, Jefferson emphasized the word "***Necessary,***" and argued that the means employed to carry out the delegated powers must be indispensable and not merely "***Convenient.***" Consequently, the Constitution, he said, restrained Congress "***to those means without***

which the grant of power would be nugatory." In rebuttal, Hamilton presented what was to become the classic exposition of the doctrine of the broad construction of federal powers under the Constitution. He claimed for Congress, in addition to expressly enumerated powers, resultant and implied powers. Resultant powers were those resulting from the powers that had been granted to the government, such as the right of the United States to possess sovereign jurisdiction over conquered territory. Implied powers, upon which Hamilton placed his chief reliance, were those derived from the "***Necessary and Proper***" clause. He rejected the doctrine that the Constitution restricted Congress to those means that are absolutely indispensable. According to his interpretation, "*necessary often means no more than needful, requisite, incidental, useful, or conducive to.... The degree in which a measure is necessary, can never be a test of the legal right to adopt; that must be a matter of opinion, and can only be a test of expediency.*"

Then followed Hamilton's famous test for determining the constitutionality of a proposed act of Congress that led to the creation of ***Implied Powers***: **"***This criterion is the end, to which the measure relates as a mean. If the end be clearly comprehended within any of the specified powers, and if the measure have an obvious relation to that end, and is not forbidden by any particular provision of the Constitution, it may safely be deemed to come within the compass of the national authority***."** This conception of ***Implied Powers*** was later to be adopted by John Marshall and incorporated in the Supreme Court's opinion in **McCulloch v. Maryland** (1819) on the constitutionality of the second national bank.



Alexander Hamilton
(1755 - 1804)

Hamilton sought to enhance the revenue and fiscal system of the national government while establishing the creditworthiness of the Federal government that he saw would be "*the powerful cement of our Union.*" Madison and Jefferson were Virginians and saw this plan as creating a strong central government and feared the establishing of precisely what they had fought to defeat. Both Madison and Jefferson had been deeply influenced by Aristotle who wrote about how the agrarian economy of Greece was suppressed by the rise of the new capital markets in Athens. Aristotle had said they were the people who made money from money. This would clearly shift the powerbase within the new government of the United States from the Southern colonies, especially Virginia the strongest economically, to the Northern colonies where the cities of New York, Philadelphia, and Boston had become the new ports and commercial economic centers precisely as Aristotle had written about. Madison had called this a economic model of "*discrimination*".

Madison and Jefferson further saw that Hamilton was rewarding the speculators. Many patriots and soldiers who were owed money, sold their securities to speculators for 25 cents on the dollar, which had been the going rate as late as George Washington's inauguration in March 1789. They saw Hamilton's plan as rewarding the speculators with 100 cents on the dollar while giving the original patriots nothing was unfair. The plan would also penalize states which had paid off most or all of their debt, such as Virginia, and force those states to finance the states who still owed money.

Madison won the day at first as the House voted down Hamilton's assumption plan in April 1790. This very issue of creating the ***Bank of the United States*** caused tensions to rise and unable to resolve this first major crisis, immediately dissention emerged as people began talking about dissolving the new government. This resulted in a further delay in any talk about creating a new national capital city.

Backroom political deals took place then as they do today. Jefferson and Hamilton agreed to withdraw their opposition to Hamilton's plan to assume the state debts in what has become known as the "dinner table compromise," on June 20, 1790. The deal was to build the future capital (Washington, DC) in an area along the Potomac River next to Virginia and Hamilton agreed to eliminate $1.5 million of Virginia's debt under the assumption plan. Jefferson and Madison were interested in moving the capital to the center where they believed an agrarian economy would be on an equal footing with the commerce economy of the north. On July 10, 1790, the House passed the Residence Act. On July 26, 1790, Hamilton's assumption plan finally passed by just four votes. It included his proposals for funding the debt.

Hamilton's ***Bank of the United States*** initial program was an instant success. He was correct that it would established excellent credit for the Federal government. However, it came at a time with the French Revolution and capital was seeking a safe haven to flee. When Jefferson transacted the Louisiana Purchase with France, credit and funding were available to the Federal government simply because of Hamilton's debt assumption plan. It also resulted in the exponential growth of the Treasury Department as taxation became its primary objective.

Today, applying the lessons of this period to Europe, we see a strong parallel regarding the resistance regarding federalism. The first decade of monetary union has been a disaster. The design was purely political in its structure. There was no real planning of how to construct the monetary system of Europe outside of the academic community. This prevented a practical perspective for academics deal in theory with no real experience. We MUST understand that the theories still taught in school are from Keynes and others wrought during a fixed exchange rate system When the Floating Exchange Rate System began on August 15th, 1971, no one sat down and designed anything. The world currencies began to float on a temporary basis when Nixon closed the gold window. All the theories are still from a closed fixed exchange rate system where capital only moved internationally purely for economic gain, never out of fear that the currency would decline, which was impossible without negotiation.

The unsophisticated in global economics bought the idea that they were creating a **Single Currency**. This hogwash helped to sell the Euro to the public claiming the costs of converting currency and the currency risk inherent in European trade would all be magically swept away with this new Euro. In reality, what they did not understand is this concept of **International Value** that creates a **Virtual Currency** they could not prevent. Any professional trader knows instinctively how to use markets to synthetically achieve goals. Just because you eliminated the currency did not mean you created a ***Single Currency***. Currency rises and falls like a stock based upon confidence in the country instead of confidence in a company. The motivation remains the same.

Consequently, the Euro is being torn apart because the politicians wanted to be just a little bit pregnant. They believed they could create a ***Single Currency***, yet allow each country to retain its own debt. That was the mistake. As long as you could isolate anything on a nation by nation basis, you could trade that instrument account to the rise and fall of confidence in that nation. Hence, the bonds, issued in Euro, became the same as if there were still individual currencies. This is what is tearing Europe apart because politicians and academics, with absolutely no practice understanding of this new floating monetary system, failed miserably to create a ***Single Currency*** and a monetary union once they stopped shy of consolidating the national debts of each nation. The bonds simply became a derivative ***Virtual Currency.***

The ***European Redemption Pact*** proposal is claimed to return Europe to the Maastricht discipline where each state is responsible for its own debts. It is the exact opposite of fiscal union. Officials at Germany's top court say it appears compatible with the country's constitution -- unlike Eurobonds. There would be a fixed limit to costs and the fund would not endanger the tax and spending sovereignty of the Bundestag.

Nonetheless, the debt would be covered by joint bonds, paid for from a designated tax. Each country would be responsible for its own share of debt in the fund. This is proposed for example to be Italy €960bn, Germany €580bn, and France €500bn.

The stumbling block, however, has always been this notion that somehow by issuing a Eurobond, this will make Germany responsible for the debts of other nations. Let's set the record straight! This is nonsense! Why? Because government has no plan of ever pay off any debt. Nobody does! They borrow more every year just to pay interest on the debt for the previous year. The idea that Germany would be responsible for paying off the debt of another country is absurd. The German finance minister Wolfgang Schäuble told Stern Magazine just recently: ***"This fund is not feasible because it breaches with the European treaties and the `no bail-out' clause, which says countries cannot be responsible for the liabilities of another country. Without a joint fiscal policy you can't have shared liabilities"***.

This is no resulting in Italy and other states would have to pledge gold and other forms of collateral equal to 20pc of their debt in the fund created by the ***European Redemption Pact***. In theory only, the assets could be taken from the country's currency and gold reserves. The collateral nominated would only be used in the event that a country does not meet its payment obligations. Berlin would have a veto lock, able to ensure discipline in a way that it cannot do with the ***European Central Bank*** where it has just two votes.

The ***European Redemption Pact*** would be a €2.3 trillion stabilization fund that would entail sacrifices for Germany. The country would no longer enjoy safe-haven borrowing status whereby its interest rates of about 1.48% on the 10-year Bunds would most likely rise by 0.5 to 1% on its total national debt. Nonetheless, the authors of the plan insist that any such costs will be outweighed by massive relief as Europe finally breaks the logjam of the last two years and offers southern Europe a chance to claw its way out of perpetual depression. This is a rosy picture because they are ignoring the fact that we are looking at a Sovereign Debt Crisis that is monumental on a global scale. Hence, this is not an isolated problem. This is a systemic trend.

The ***European Redemption Pact***, some call the German takeover, offers a form of "Eurobonds Lite" that can be squared with the German constitution and breaks the political logjam. It is not a soft option for Italy, Spain, Portugal, and other states in trouble. The plan is drafted by the German Council of Economic Experts and inspired by Alexander Hamilton's ***Sinking Fund*** in the United States put in place in 1790 to compel the union of the colonies and strengthen the new federal government. Virginia was perhaps in the role of Germany at that time. The proposal to compel Southern Europe to pledge their gold reserves may now actually enflame opinion in Italy and Portugal that this entire idea of a unified Europe is way over the top. Both states have kept their bullion, resisting the rush to sell by Britain and others. Italy has 2,451 tons of gold, valued at €98bn as of March 2012. Of course, despite being authored by the ***Five Wise Men*** of Germany, Chancellor Merkel shot down the proposals last November as *"completely* *impossible"*, but Europe's debt crisis has since continued to balloon and now even her Christian Democrat party has since suffered crushing defeats in regional elections forcing her to start to listen.

However, the whole scheme is deeply flawed. They are overlooking a vital fact. Hamilton's Sinking Fund actually paid off the debt by 1813. The United States stopped issuing paper currency as had been the case with the previous government. This was a massive deflationary prospect. The contraction in money supply was massive. Hamilton's idea restored the confidence and those that took advantage exchanged the worthless continental currency at 100:1, at least got something. There is no plan to even stop the borrowing year after year, and there no plan on paying off the debt. To really have done what Hamilton did would have consolidated all the debts, on a scale in proportion to debt to GDP ratios, and then they should have devalued the debt and say look, one Euro was now worth one Ecu (the artificial currency created from the consolidation of devalued debt).

The disaster that has been created is they took the debts of Sothern Europe, raised them in real tangible value by revaluing them in Euro with debt devaluation and restructuring. This has increased the burden on Southern Europe whereas their currencies would have depreciated naturally with their debts. This is what both the academics and politicians failed to understand.

The Social Democrat opposition in Germany supports the idea of the ***European Redemption Pact***. The Greens say they will block ratification of the EU Fiscal Compact in the German Bundesrat (Upper House) unless Mrs. Merkel personally relents. Hence, they actually think that the ***European Redemption Pact*** cleverly combines the advantages of lower interest rates through joint European borrowing with a reduction of debt. They fail to understand what will happen by the policy of – business as usual. They think interest rates will be lowered and any joint liability would be limited in both time and scale.

The detail of this ***European Redemption Pact*** actually splits the public debts of EMU states. Anything up to the Maastricht limit of 60pc of GDP would remain sovereign. Anything over 60% would be then transferred gradually into the ***European Redemption Fund***. This would be covered by joint bonds. Italy would switch €958bn, Germany €578bn, France €498bn, and so forth. The total was €2.326 trillion as of November but is rising very rapidly as Europe's slump continues to increase debt and lower revenues creating a very interesting debt-dynamic. The ***Sinking Fund*** would slowly retire debt over twenty years, using designated tithes akin to Germany's ***"Solidarity Surcharge"***. This is the plan, but it does not account for new spending and presumes the lowest possible safe-haven level of interest rates.
It is assumed that, Germany would share its credit card to slash debt costs for Italy, Spain and others. However, this again is ignoring the debt-dynamics. This actually presents still this idea of creating a single currency the means you can remain independent states with your own obligations but jointly

support a currency. Interesting to say the least and it would work is there was no debt. While Eurobonds are a federalizing catalyst as Hamilton intended, the idea of creating a ***Sinking Fund*** would be temporary and self-extinguishing. The fund then is merely a resurrection of the old discipline intended by the Maastricht Treaty with sovereign control over individual budgets. This ingenious design they believe will maneuver around the German constitutional court that ruled in September that the budgetary powers of the Bundestag cannot be alienated to any EU body under the Basic Law. The German court simply warned that open-ended liabilities are unconstitutional. The Bundestag may not establish ***"permanent mechanisms which result in an assumption of liability for other states' voluntary decisions, especially if they have consequences whose impact is difficult to calculate,"*** and if the fund is self-extinguishing, the monetary system is now dictated by the words of judges – not economics.

Ultimately, this pretend Sinking Fund cannot tackle the root cause of the Eurozone crisis and masks those problems. It may fail to even cap debt costs as capital is chased away by the aggressive tax collection and hunting of citizens. The brain-dead advisors fail to take into account what will happen when you chase the rich for excessive taxes. They leave! The amount of capital flight from Spain in the first 6 months of 2012 has been about 50% of GDP. When you chase people out, as Spain did to pay its bankers before using the Spanish Inquisition, the chased the Jewish community from Spain and they fled to Holland. It was then Holland that became the financial center of Europe with even the first exchange that was used as the model by the British. This is history repeating all over again. Chase the rich, and you destroy your economy. Spain became a serial sovereign debt defaulter beginning in 1557 followed by 1570, 1575, 1596, 1607, and 1647 ending in a 3rd world status. This Marxist idea of taking from the rich has never worked once in history yet many have tried. Spain succeeded in taking itself from the richest nation of Europe with all the gold and silver from America, to dead broke and a third world country because of its thirst for the blood of the rich.

The ***European Redemption Pact*** does not alter the intra-EMU currency misalignment between North and South, or help the Latin states close the chasm in labor competitiveness by increasing their skill set.
The South would still face the long grind of "***internal devaluation***" with respect to or wage deflation that plagues the region with unemployment among the young in Spain reaching 50%+. This is tearing societies apart and is destroying the future. No one is addressing the structural problem masked over by the Euro argument for a Single Currency. The Redemption Pact is hailed as a first step back from Purgatory. However, the devil is still in the details and they overpower the nonsense. Europe is in crisis and it will drag everyone else down with it. We need monetary reform and debt restructuring on a grand scale. The design of this by no means the same model as Hamilton used in 1790.