House Ad Hoc on Gold Bonds

Report
December 2016

Committee Members:
Representative Mark Finchem, Chairman
Representative Diego Espinoza
William Stan Ackroyd
Joe Cobb
Larry Hilton
Peggy Smoot
Dr. Keith Weiner

TABLE OF CONTENTS

Report 2016

A. Background

The House Ad Hoc Committee on Gold Bonds (Committee) was established to study the establishment of gold bonds systems, including programs already established in other states or counties, which provide secure holding for honest money and preferred financing at lower than market interest rates.

B. Summary of Committee Activity

Committee Hearing August 11

Dr. Weiner presented on *How Gold Bonds Can Benefit the State of Arizona*. The Committee discussed the following topics: gold pricing, premiums on gold bonds, mechanisms for severance tax collection, and liabilities of bonds.

A video recording of the committee can found at:
http://azleg.granicus.com/MediaPlayer.php?clip_id=18133

Committee Hearing November 3

Mr. Cobb commented on financial planning and submitted a statement for the record. The Committee discussed bonds, gold pricing, and severance tax. Chairman Finchem distributed proposed legislation for Committee review.

A video recording of the committee can found at:
http://azleg.granicus.com/MediaPlayer.php?clip_id=18183

Committee Hearing December 12

The Committee discussed gold and copper mining within the state. Mr. Hilton reviewed and discussed a revised proposed legislation. The Committee elected to submit statements for the record.

A video recording of the committee can found at:
http://azleg.granicus.com/MediaPlayer.php?clip_id=18221

C. Submitted Statements

The following statement was submitted:

Arizona should issue a gold bond, that is a bond denominated in gold, with interest and principal payable in gold. There is a fiscal benefit to the state, as well as a benefit to pension funds and savers who depend on a real rate of return. The fiscal benefit comes from the opportunity to sell the bond when the market is willing to pay a premium, and sometimes buy it back if the market is willing to sell at a discount. The state also benefits from taking a leadership position, and will attract investment capital from all over the world.

In summary, gold bonds are a tool to help the state get out of debt.

We had discussed the mechanics of collecting the severance tax levied on gold mining in specie, but Arizona does not have significant gold mining activity in the state. We think Arizona would benefit from studying the known ore deposits, and the costs of extraction including how much of that cost is due to Arizona-imposed taxes or regulation. The state might be able to encourage gold mining to start back up, by lessening the burden on miners.

We also discussed the possibility of issuing a gold bond based on production of other commodities. Arizona has significant copper mining. The price of copper is less volatile when measured in gold than when measured in dollars. Therefore, the state is better off to issue gold bonds based on the copper mining severance tax than to issue dollar bonds as currently.

We recommended legislation which authorizes the Treasurer to issue a gold bond. One noteworthy provision is to allow taxpayers to elect the gold basis for tax assessment and payment purposes. This will begin to give the state additional gold revenues.

Arizona House of Representatives

Ad Hoc Committee on Gold Bonds

Summary of Findings & Recommendations

The *Ad Hoc* Committee on Gold Bonds, which conducted several hearings during the summer and fall of 2016, was convened for the express purpose of considering the advisability of the issuance of bonds denominated and payable in gold or silver by the State of Arizona. As a result of its deliberations the Committee made the findings and recommendations outlined below:

OVERVIEW

The Committee determined that Arizona should issue a gold bond, that is a bond denominated in gold or silver (“specie”), with interest and principal payable in specie legal tender—thus realizing a significant fiscal benefit to the state, as well as a benefit to pension funds and savers who depend on a real rate of return. The fiscal benefit comes from the opportunity to sell the bond when the market is willing to pay a premium, and to buy it back if the market is willing to sell at a discount. The state also benefits from taking a leadership position that will attract commercial activity and investment capital from all over the world.

In summary, gold bonds are a tool to help the state reduce its debt burden more rapidly, and at a lower cost, than would otherwise be possible.

The Committee discussed the mechanics of collecting a severance tax levied on precious metal mining as a preferred method for establishing reliable gold revenues for the State. Although Arizona has substantial precious metal reserves, no significant gold mining activity exists at present. Nevertheless, the State would benefit from further studying known ore deposits, and the costs of extraction, including how much of that cost is due to Arizona-imposed taxes or regulation. The state might be able to encourage the renewal of its once vibrant gold mining industry by lessening the regulatory burden on miners.

The Committee also considered the possibility of issuing a gold bond based on production of other commodities. Arizona enjoys significant copper mining. The price of copper is less volatile when measured in gold than when measured in dollars. Therefore, the state is better off to issue gold bonds based on the copper mining severance tax than to issue paper dollar bonds as currently. Accordingly, the Committee recommends legislation which authorizes the Treasurer to issue a gold bond. One noteworthy provision would be a requirement that taxpayers transacting in gold and silver remit applicable taxes in the same medium. This will begin to give the state additional gold revenues, which in turn would expand its gold bonding capacity.

FINDINGS

1. The United States Constitution provides that Congress shall have power “To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures”, and that no state shall “make any Thing but gold and silver Coin a Tender in Payment of Debts”. Article I: §8 cl. 5; and §10 cl 1.

2. In 1981 Alan Greenspan proposed the issuance of 5-year, 0 coupon, treasury notes payable in gold from U.S. gold reserves as a means of promoting fiscal discipline at the federal level.

3. In 1985, in light of the then recent Gold Commission report, Congress restored gold and silver coin to the status of “legal tender for all debts, public charges, taxes, and dues”, thus ending a twenty-year precious metal mintage moratorium during which only Federal Reserve notes and base metal coinage served as legal tender. 31 USCA § 5103.

4. At that time, in a debt reduction effort, Congress also required that "amounts received from the sale of gold shall be deposited by the Secretary in the general fund of the Treasury and shall be used *for the sole purpose of reducing the national debt*." 31 USCA § 5116(2). Nevertheless, the committee was unable to ascertain any evidence that the Secretary of the Treasury is currently fulfilling this statutory duty.

5. In 2011, Dr. Judy Shelton, a noted economist with expertise in global finance and monetary issues, serving as Co-Director of the Sound Money Project at Atlas Network, reiterated Greenspan’s prior proposal for the issuance of 5-year, 0 coupon, treasury notes suggesting, however, that such notes be payable in gold or paper currency at the holder’s option, thus providing a powerful incentive for the Federal Reserve to maintain an informal gold standard as had been done previously during periods of economic prosperity.

6. In 2012, Dr. Keith Weiner’s paper proposing gold bonds as a means to permanently retire sovereign debt based on gold flows rather than gold reserves was considered for the prestigious Wolfson Award, which is analogous to the Nobel Prize in the field of economics.

7. In 2014, economic historian, Dr. Brian Domitrovic, demonstrated that the United States economy has enjoyed greater, sustained economic growth during periods of formal or informal adherence to a precious metal monetary standard than at any other time.

8. Dr. Weiner demonstrated that the ascendancy of the paper dollar, a debt-based instrument, has depressed interest rates so as to create an economic environment which rewards debtors and punishes savers, including pension funds. Moreover, globally, interests rates are at all time lows, including the emergence of negative rates in a growing number of jurisdictions around the world.

9. Historically, gold and silver money has maintained stable, predictable interest rates when accepted as the prevailing currency, as well as steady purchasing power even when not the predominant medium of exchange.

10. 1n 2008, comparing gold dollars to paper ones, the Fifth Circuit ruled that "as legal tender, a dollar is a dollar, regardless of the physical embodiment of the currency." *Crummey v. Klein Independent School District* (Unpublished Opinion, U.S. Ct. App. for the 5th Circuit, No. 08-20133, 2 October 2008). In so finding, that federal court relied upon the Supreme Court's long-standing holding that "a coin dollar is worth no more for the purposes of tender in payment of an ordinary debt than a note dollar." *Thompson v. Butler*, 95 U.S. 694, 696 (1877).

11. Notwithstanding the legal fiction of dollar parity, the value of gold, silver and paper dollars vary widely in the real world economy, as recognized by the Supreme Court long ago: "The law has not made the note a standard of value any more than coin. It is true that in the market, as an article of merchandise, one is greater than the other; but as money, that is to say, as a medium of exchange, the law knows no difference between them." *Thompson* at 696. In today's monetary environment, the value of the paper dollar in gold dollar terms exhibits significant short-term price fluctuations.

12. The combination of long-term stability in the purchasing power of gold and silver coupled with the short-time exchange rate fluctuations of gold, silver and paper dollars against each other, provides tremendous opportunity for the State of Arizona, or any other sovereign having the power to lay taxes, to significantly reduce its debt load by simply replacing outstanding paper-dollar-denominated bonds with gold and silver ones.

13. Employing retrospective price data for the period of 1971 through 2016, Dr. Weiner demonstrated that, following simple heuristics for the issuance and redemption of gold bonds, any state having demonstrable gold flows in the form of tax receipts would have realized up to a 50% reduction in the burden of sovereign debt allocated to gold bonds during that period.

14. Dr. Weiner's analysis further showed that a fiscal benefit to the state accrues regardless of market conditions. In a rising gold market, bonds could be sold at a premium, thus retiring increasing amounts of paper-dollar-denominated debt per gold bond issued. In falling markets, the state could realize significant capital gains on outstanding gold bond obligations by either buying gold or redeeming its own bonds at a discount.

15. The market for gold and gold related products is global, highly liquid and robust. Further, today many gold investments feature significant carrying costs in the form of vaulting fees and insurance premiums. Not only would gold bonds eliminate such overhead, but would actually provide a return beyond mere price action in the gold to paper dollar exchange rates.

16. First mover advantages would likely accrue to the first jurisdiction to introduce gold bonds, including the ability to attract capital from around the world and to establish itself as a hub of precious metal industry and activity.

17. In addition, the United States mint is required to produce enough precious metal coin to “meet public demand” and to do so from the “natural deposits of the United States.” 31 USC §§ 5112(e), (i)(1); 31 USC § 5116 (a)(3). Because states such as Arizona have significant precious metal reserves, they can benefit from the rising demand gold bonds would create.

18. Since federal law has made gold and silver coin a legal tender for payment of taxes, under the supremacy clause of the United States Constitution, governmental entities are required to accept tax payments tendered in such currency. *See* Article VI cl. 2. Maintaining a gold/silver bond program would provide a flexible mechanism for matching specie tax receipts to expenses with a net economic benefit to the State.

19. There is, however, Supreme Court authority suggesting that a state may expressly provide that certain tax payments be made in a particular form of currency. *Lane County v. Oregon*, 74 U.S. 71 (Supreme Ct. 1868). Consequently, the State could, for example, assess severance taxes on gold and silver production in kind.

20. Although Arizona does have significant gold and silver reserves, at present exploitation of those resources is quite limited. Nevertheless, the State’s significant copper production correlates to the gold price much better than paper currency, as do many other commodities. Accordingly, the State could initiate a gold bond program keyed to taxation of such commodity production.

21. Finally, paying off debts denominated in paper currency merely transfers indebtednesss from one party to another. Whereas retiring debt through gold payments permanently extinguishes it, creating a net benefit to society as a whole.

RECOMMENDATIONS

1. Delineate between various forms of U.S. currency, by adopting appropriate definitions such as:

• “Specie” means coin or bullion having gold or silver content, except a numismatic coin with a fair market value that is at least fifty percent greater than the value of the metal it contains.

• “Legal tender” means a medium of exchange authorized for the payment of debts, public charges, taxes, and dues within the United States of America.

2. Employ measures to encourage the commercial development of the State’s precious metal resources;

3. Collect severance taxes from miners and refiners of gold and silver in specie legal tender;

4. Collect other taxes in proportion to the type of legal tender used in the underlying taxable transaction.

5. Determine the State’s reasonably projected specie legal tender bonding capacity based on tax collections in the same, as well as tax collections based on the production of commodities which exhibit a high correlation to fluctuations in the price of gold.

6. Based on the State’s bonding capacity, offer bonds denominated in a particular type of specie legal tender with interest and principal payable in the same.

7. Design such bond programs to make efficient use of the State's specie legal tender bonding capacity:

• Issue bonds in relatively small lots when compared to the State's specie legal tender bonding capacity;

• Issue new lots at a premium into a rising market;

• Either acquire specie legal tender or redeem outstanding bonds denominated in the same at a discount in a falling market; and

• Use gold and silver bond receipts to extinguish permanently a commensurate amount of existing paper-dollar-denominated sovereign debt.

RESPECTFULLY SUBMITTED,
By: ____
Representative Mark Finchem,
Chairman of the Ad Hoc Committee on Gold Bonds

<u>Respectfully submitted by:</u>
Paul Benny
Legislative Research Analyst, Banking and Financial Services and Insurance Committees

Appendix A:

August 11, 2016

Minutes

Appendix B:

November 3, 2016

Minutes

Appendix C:

December 12, 2016

Minutes

Appendix D:

Additional Information

All documents have been placed on file with the Chief Clerk's Office

Gold Bonds: Arizona's Path to Fiscal Fitness