

Gold and the Gold Standard

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Why have people used gold as money for 5000+ years?

- The most desirable aspect of “money” is that its *value is stable*.
- Gold’s value is stable.
- Thus gold makes the best money.
- Currencies whose values are pegged to gold are stable in value.
- That’s it!

People have understood this for hundreds (thousands!) of years...

“Coinage is imprinted gold or silver, by which the prices of things bought and sold are reckoned ... It is therefore a measure of values. A measure, however, must always preserve a fixed and constant standard. Otherwise, public order is necessarily disturbed, with buyers and sellers being cheated in many ways, just as if the yard, bushel, or pound did not maintain an invariable magnitude”

Nicholas Copernicus, “Treatise on Debasement,” 1517



“The Individualistic Capitalism of to-day, precisely because it entrusts saving to the individual investor and production to the individual employer, presumes a stable measuring-rod of value, and cannot be efficient -- perhaps cannot survive -- without one.”

John Maynard Keynes, “Social Consequences of Changes in the Value of Money,” 1923



“The first chief function of money is to supply commodities with the material for the expression of their values, or to represent their values as magnitudes of the same denomination, qualitatively equal, and qualitatively comparable. It thus serves as a universal measure of value. And only by virtue of this function does gold, the equivalent commodity par excellence, become money.”

Karl Marx, *Capital*, 1867



“The one essential quality that is needed in the article which we use as a basis for exchanging all other articles is fixity of value. The race has instinctively always sought for the one article in the world which most resembles the North Star among the other stars in the heavens, and used it as ‘money’ -- the article that changes least in value as the North Star is the star which changes its position least in the heavens, and what the North Star is among stars the article people elect as ‘money’ is among articles.”

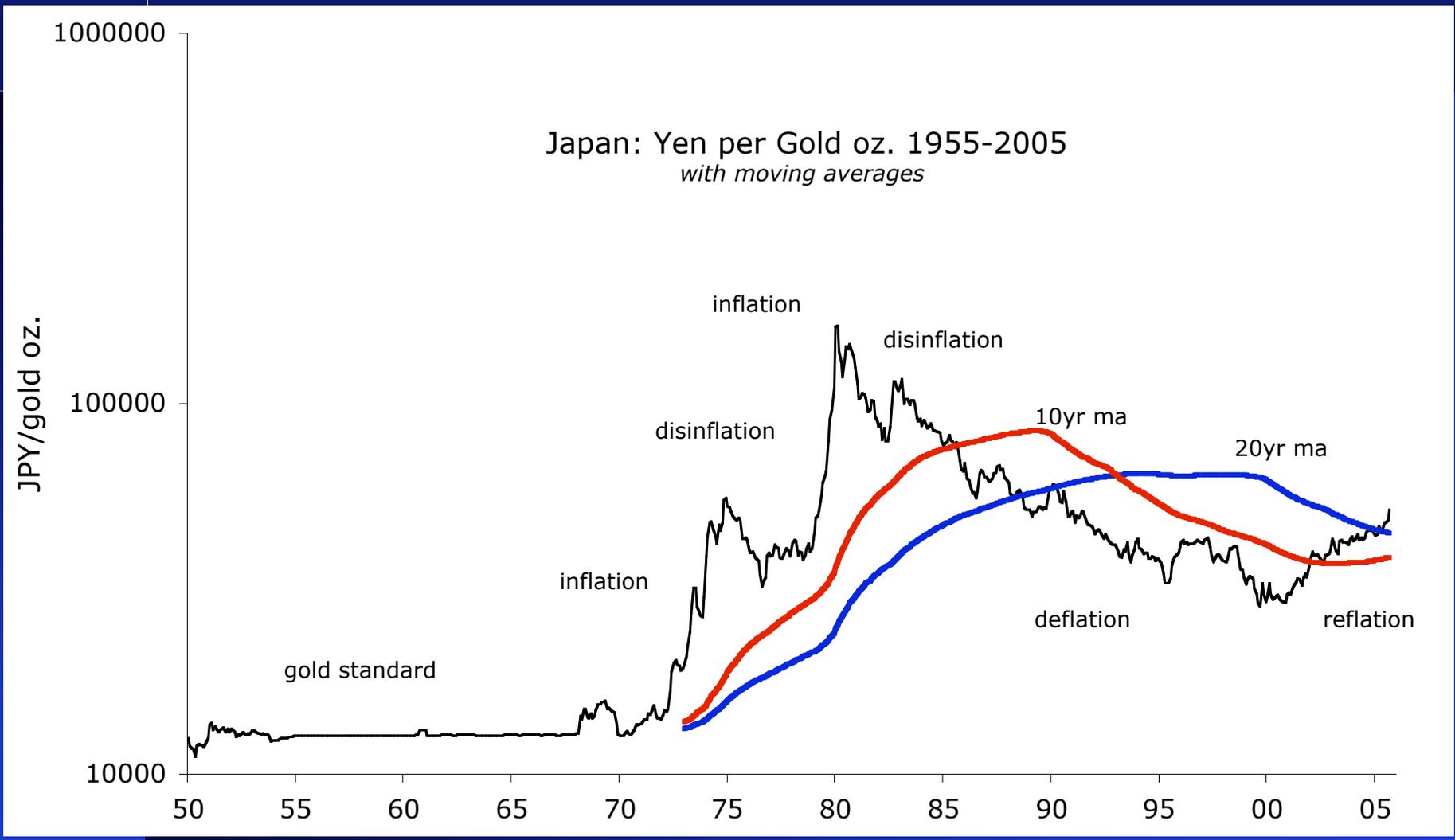
Andrew Carnegie, “The A B C of Money,” 1891

What a Gold Standard is NOT

- does NOT depend on the *quantity* of gold available. (It is a *value* link not a quantity link.)
- does NOT “balance current accounts”.
- does NOT prevent government budget deficits.
- does NOT disallow “fractional reserve banking.”
- does NOT cause panics, crashes, etc. *No economic problem in history was caused by stable money.*
- A gold standard produces money that is stable in value. That’s it!

What happens when money is unstable?

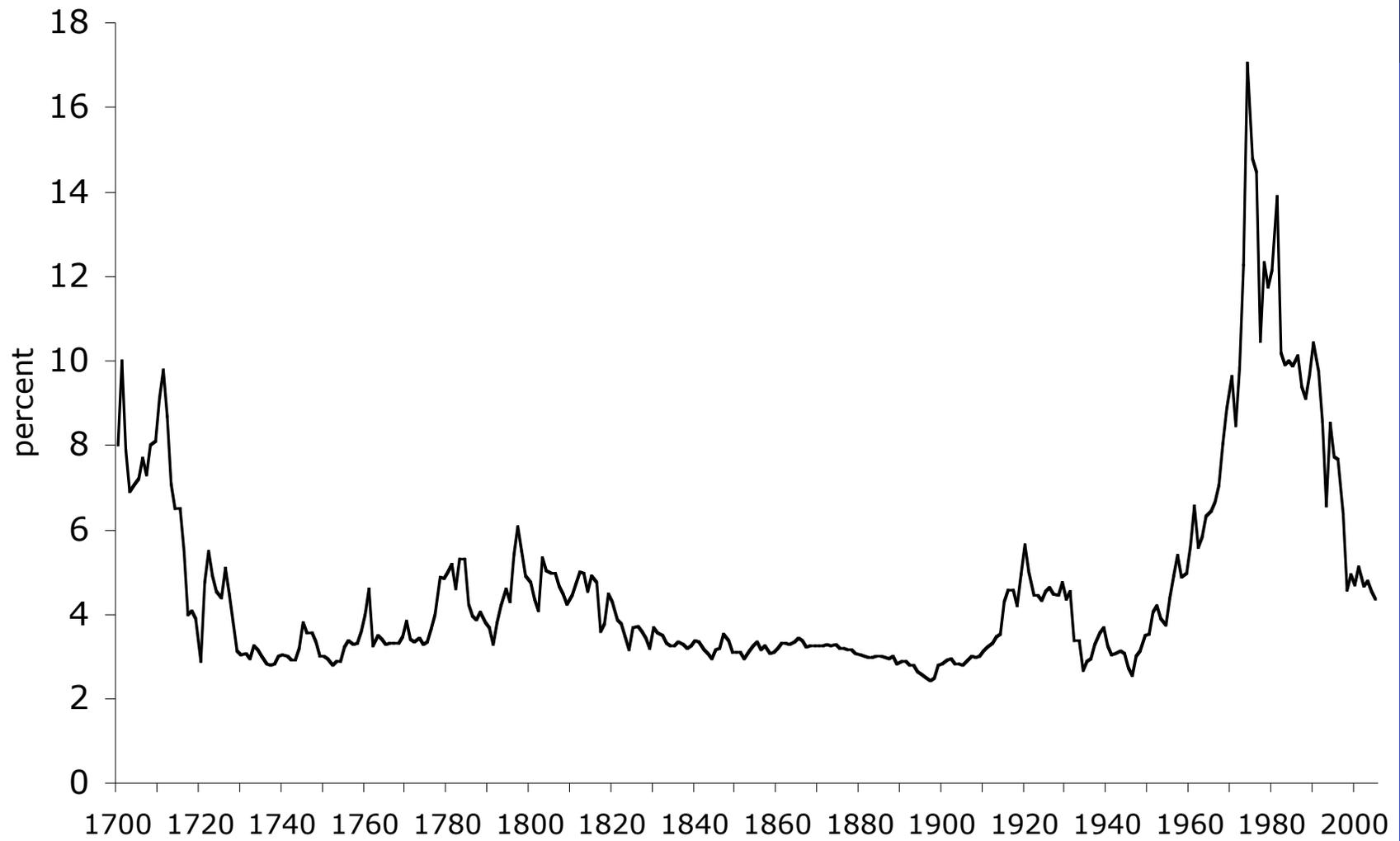
- If money falls in value, you get a “Type A monetary distortion,” (“inflation”).
- If money rises in value, you get a “Type B monetary distortion,” (“deflation”).
- It really is that simple.



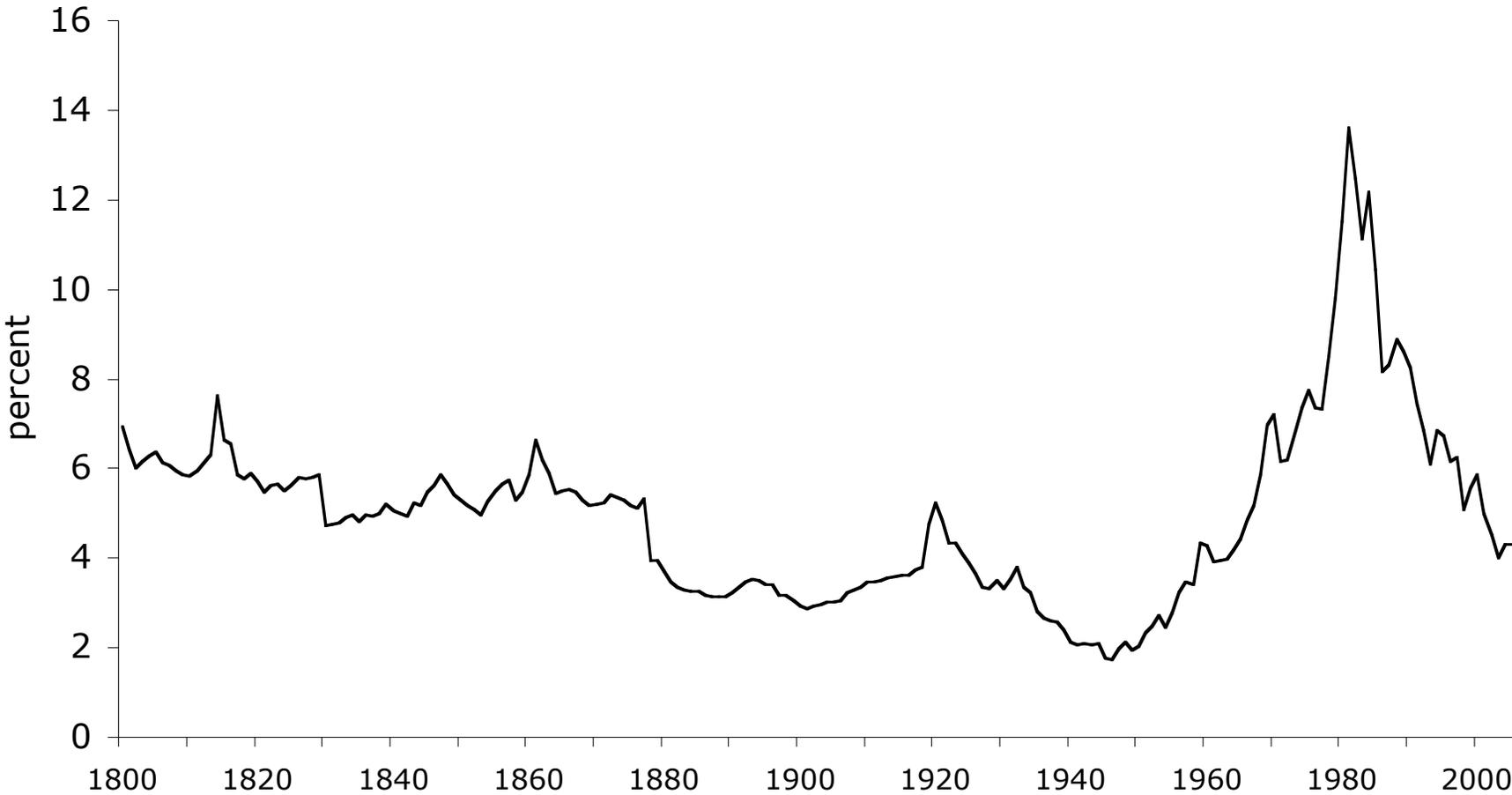
OK, “Show me the money”!

- Britain had a low quality currency (think Mexican peso) until 1698. Then, the pound was pegged to gold (and silver). The pound maintained this peg to gold for 233 years (with some lapses), until 1931.
- The United States Constitution of 1789 mandated a gold/silver standard. This was maintained (with lapses) for 182 years, until 1971.
- What were the results?

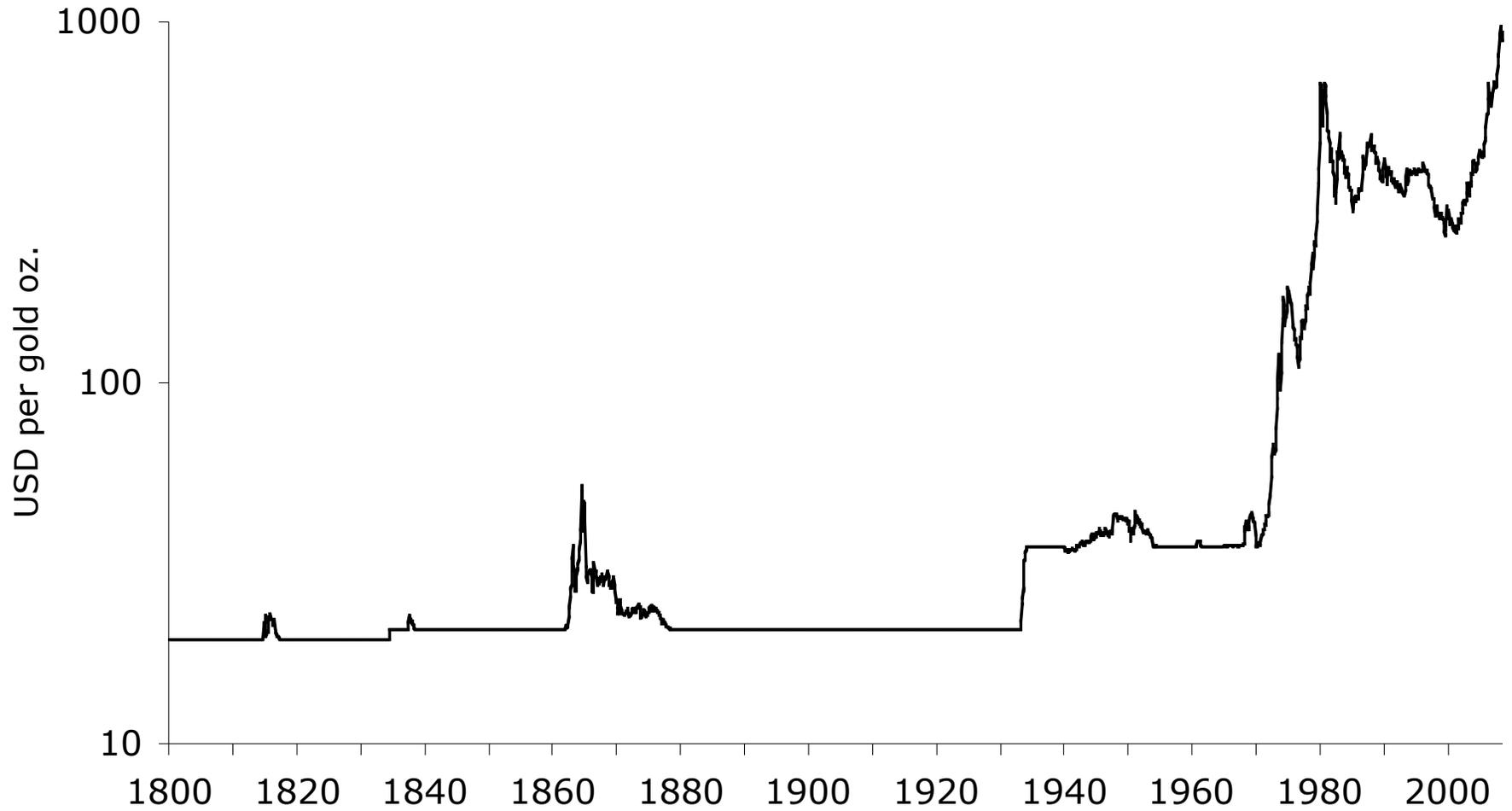
Britain: Yield on 2.5% Consol Bond 1700-2005



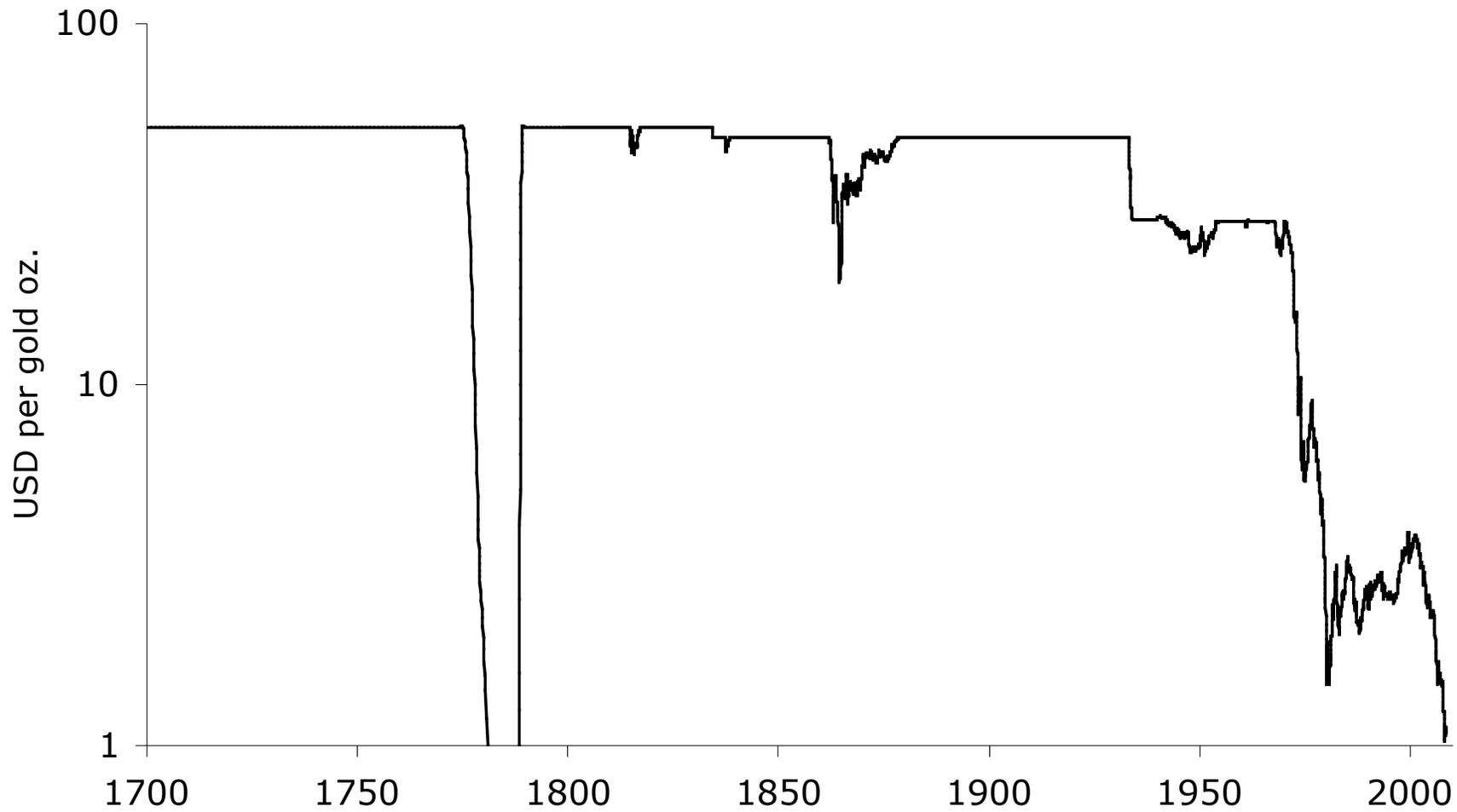
US: Annual Average Yield on 10yr Treasury Bond 1800-2005



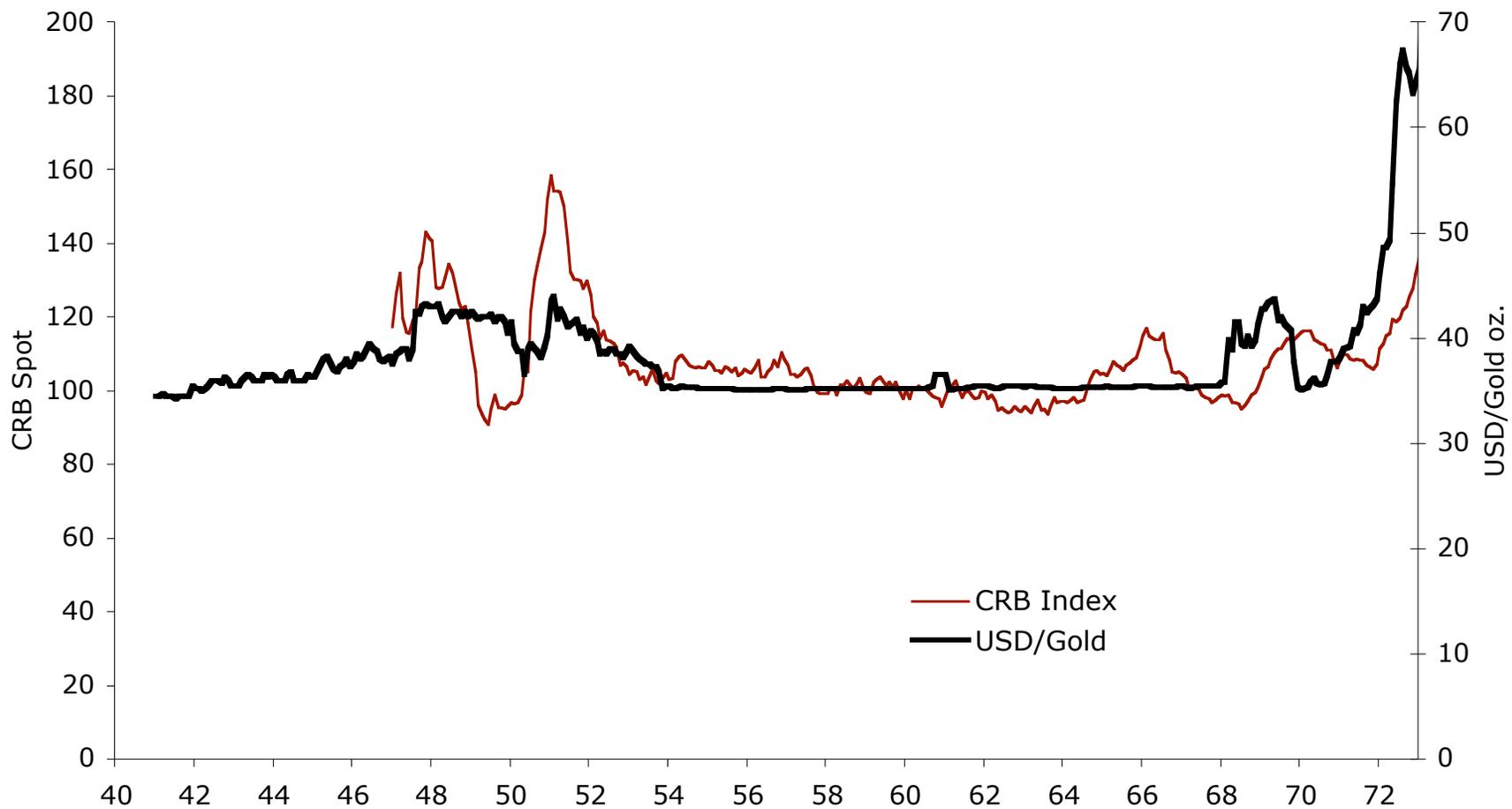
US: Dollars per Gold oz. 1800-2008



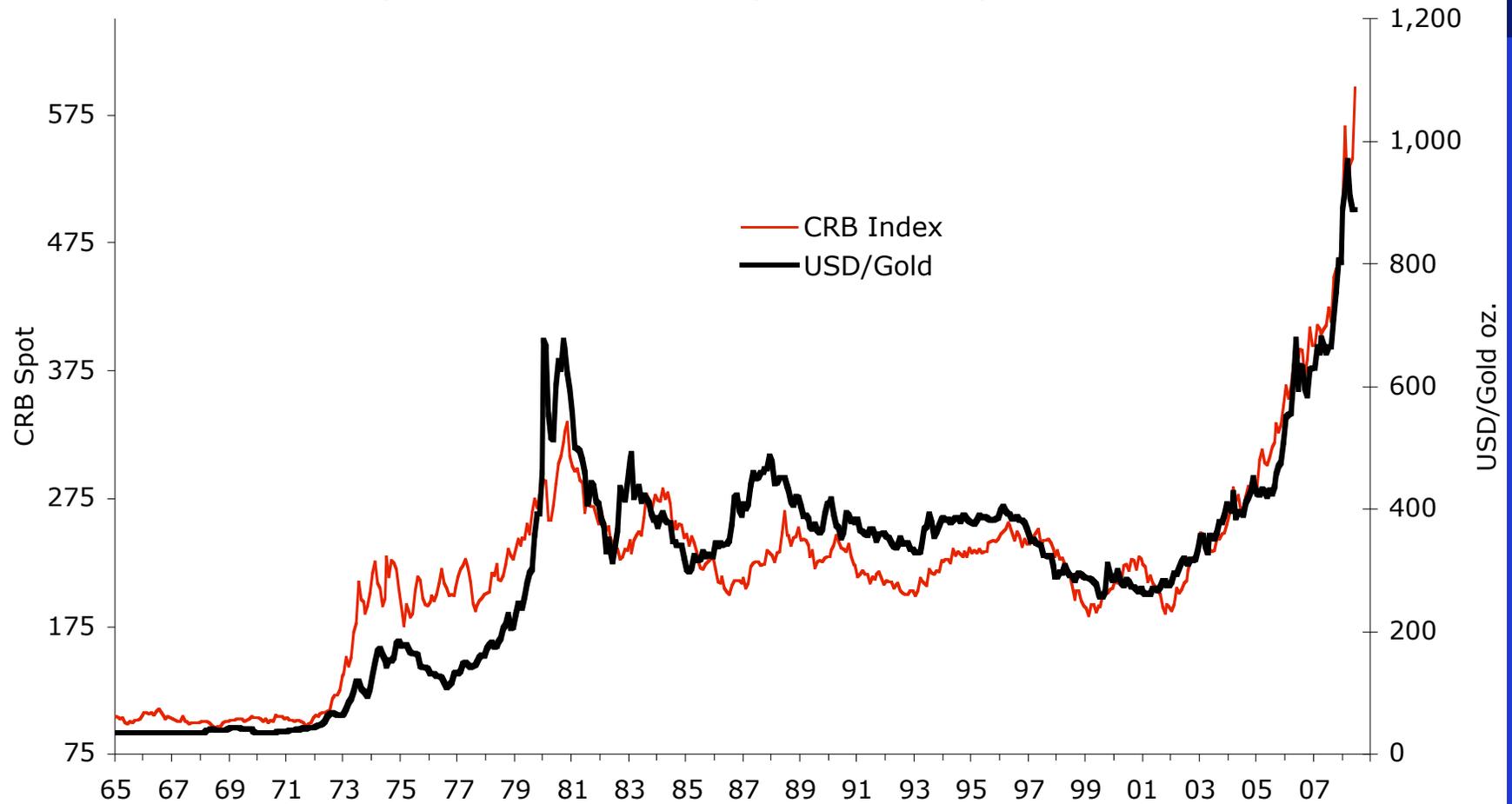
Value of \$1000 in Gold oz. 1700-2008



US: Dollars per Gold oz. and CRB Spot Commodity Index 1940-1972



US: Dollars per Gold oz. and CRB Spot Commodity Index 1965-2008



Time to end the floating currency experiment?

“The most important thing about money is to maintain its stability ...

You have to choose between trusting the natural stability of gold and the honesty and intelligence of members of the government. With due respect for these gentlemen, I advise you, as long as the capitalist system lasts, to vote for gold.”

-- George Bernard Shaw, *The Intelligent Woman's Guide to Socialism and Capitalism*, 1928.

Gold as a portfolio asset

“Gold is money. That’s it.” -- J.P. Morgan

- It is stable in value.
- It is a universal form of “cash.”
- You don’t really “make money” with gold. But, you don’t lose it (via inflation) either.
- That’s it!

Thank You

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