Building the Foundation for the Next World Monetary System

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Gold: the Monetary Polaris (2013)

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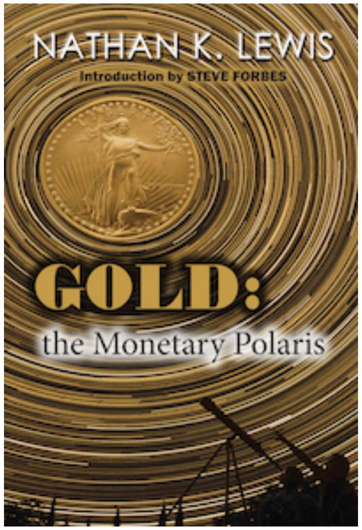
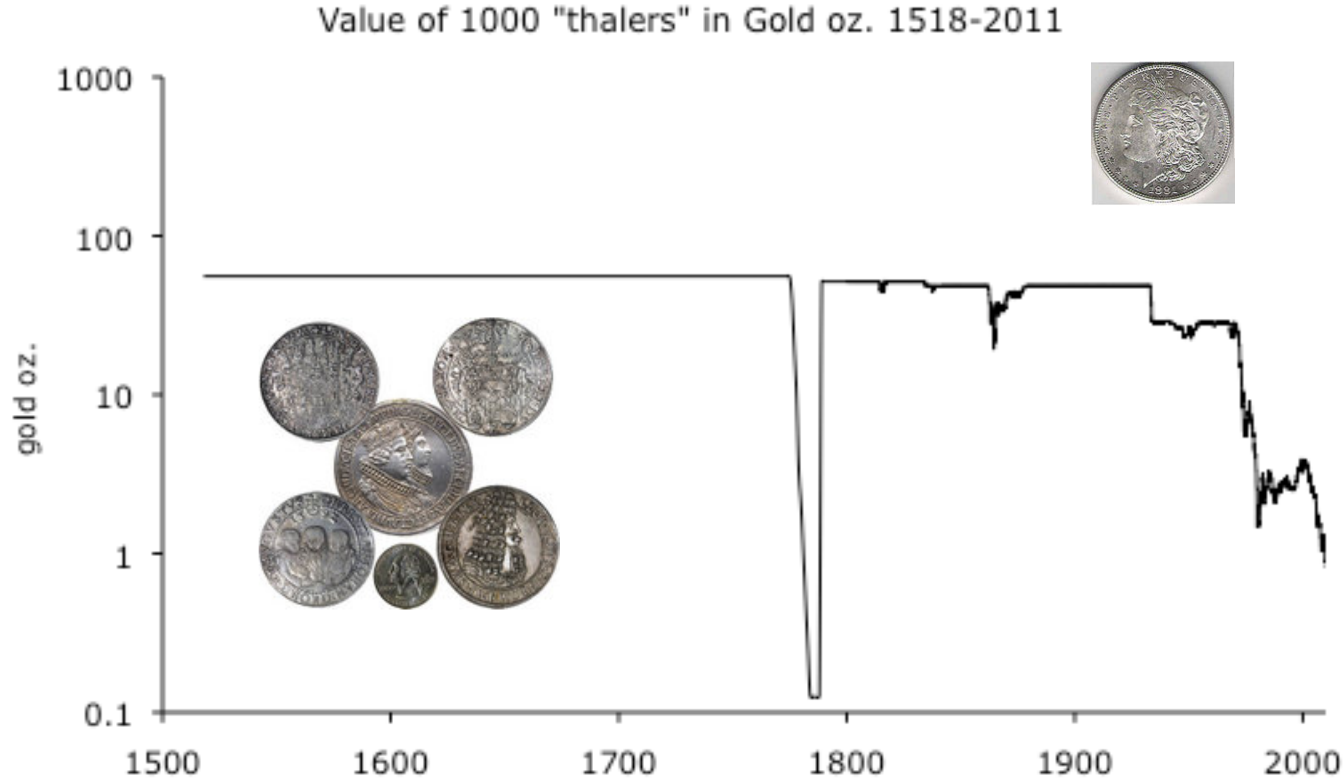


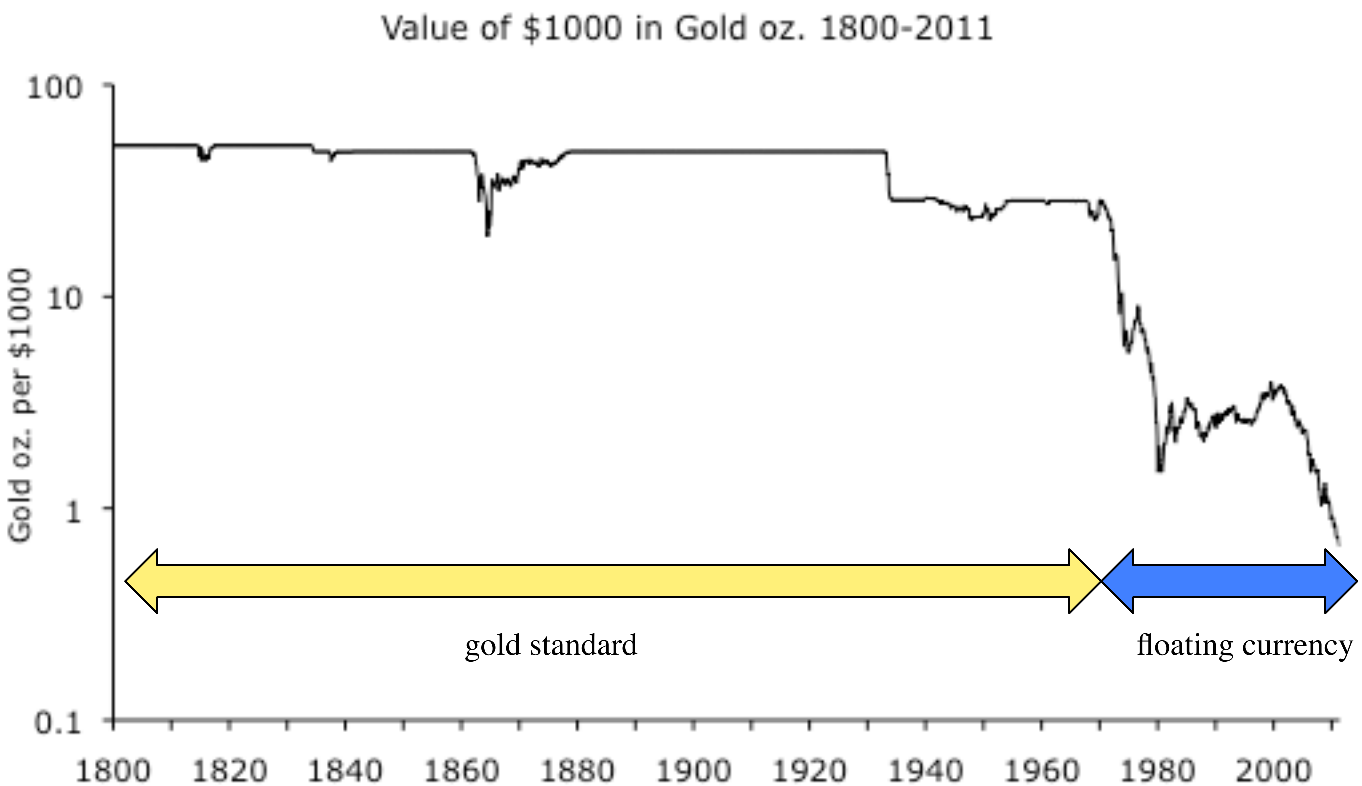
A Brief History of the Dollar/Thaler

The European tradition of the “thaler” goes back 500 years. The Austrian “thaler,” the Spanish “dollar,” and the U.S. dollar were all basically identical silver coins (about 29 grams of silver).
The value of the “dollar/thaler” in 1929 was about the same as in 1518!
During the bimetallic era (pre-1870), gold and silver were basically interchangeable, so this was a “gold standard system.”



U.S. Monetary History in one chart.

From 1789 to 1971, the U.S. used a gold standard system. There was one permanent devaluation in 1933.



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

- In a Classical, "Hard Money" paradigm, the most important aspect of "money" is that its *value is stable.*
- Gold's value is stable.
- Thus gold makes the best monetary standard.
- Currencies whose values are linked to gold are stable in value.

Greek gold coin, 7th century BC

Roman gold coin, 1st century AD

Chinese gold coin, 6th century BC

Gold coin of Kushan empire (Pakistan and northern India), 2nd century AD

Pre-Columbian Inca gold bar (not jewelry!)

In the 1970s, the mining company Anglo-American invited archaeologists to date ancient underground gold mines in the Zambezi River basin. Radiocarbon dating indicated underground mining activity as early as **60,000 BC** – exactly as ancient Sumerian texts (3500-2000 BC) described.

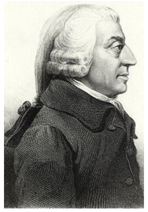
Two Monetary Paradigms

Classical Paradigm
"Hard Money"

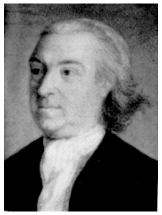
- "Rule of Law"
- Stable currency value is goal.
- Avoid government manipulation.
- Gold link enables stable money.
- Unstable money causes problems
- Leave credit up to the free market.
- Interest rates left to free market.
- Fixed exchange rates are good.
- "You can't devalue yourself to prosperity."

Mercantilist Paradigm
"Soft Money"

- "Rule of Man"
- "Full employment" is goal.
- Constant government "management."
- Gold link prevents management.
- Money manipulation solves problems.
- Manipulate credit for macro effect.
- Interest rates managed.
- Floating currencies allow "adjustment."
- "In the long run, we're all dead."



Adam Smith vs. James Denham Steuart



We are in a Mercantilist paradigm today!

People knew exactly what a gold standard system was for.

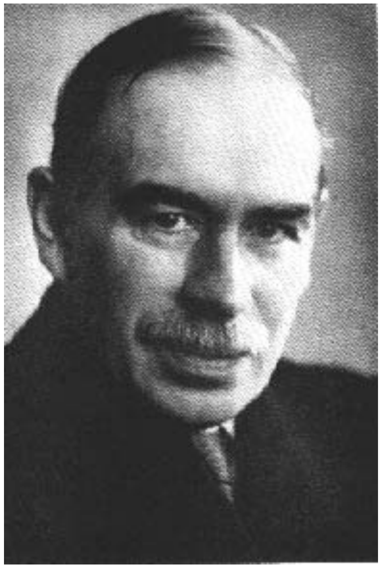
"A currency, to be perfect, should be absolutely invariable in value."

David Ricardo, "Proposals for a Sound and Economical Currency," 1816

Ricardo played a key role in returning Britain to a gold standard system in 1821. At the time he wrote this, the British pound had been a floating currency for 19 years, and many people thought it should stay that way – so they could manage interest rates (no kidding!)

"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



Keynes returned toward his Classical roots at the end of his life, admitting to his friend Friedrich Hayek that he regarded the post-WWII "Keynesians" as rather extreme.

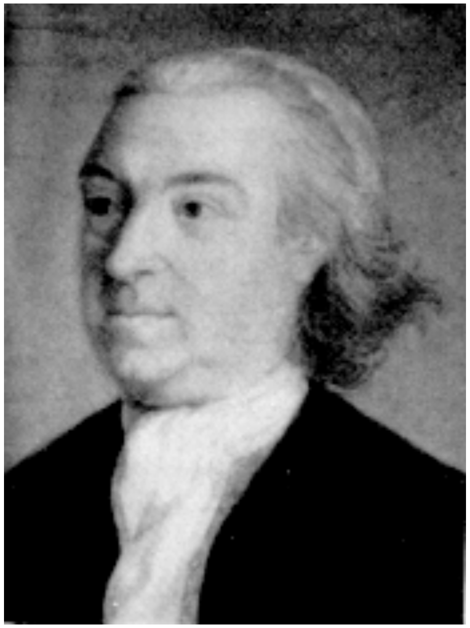
Mercantilism poisoned British thinking for nearly two centuries (1600-1770).

"If money can be made of paper, … a statesman has it in his power to increase or diminish the extent of credit and paper money in circulation, by various expedients, which greatly influence the rate of interest.

…

From these principles, and others which naturally flow from them, may a statesman steer a very certain course, towards bringing the rate of interest as low as the prosperity of trade requires."

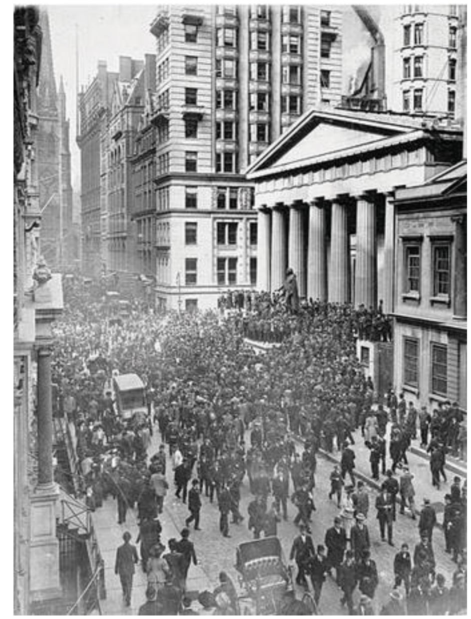
James Denham Steuart, *An Inquiry into the Principles of Political Economy*, **1767.**



Adam Smith brushed this nonsense aside in 1776. Britain became the birthplace of the Industrial Revolution, and the most powerful empire of the nineteenth century.

What a Gold Standard System is NOT

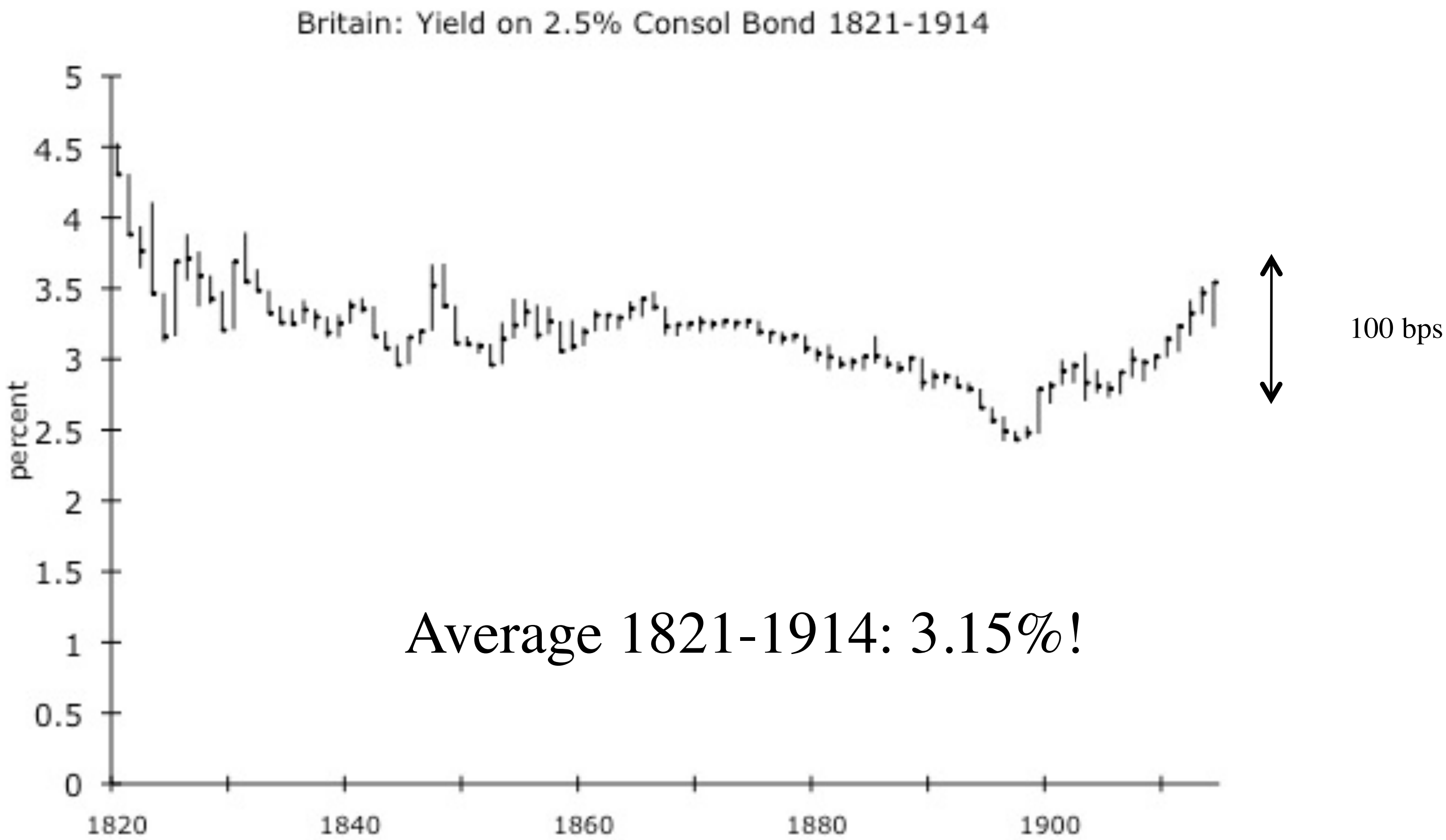
- It does NOT depend on the *quantity* of gold available. (It is a *value* link not a quantity link.)
- does NOT cause an "inflexible" money supply.
- does NOT create "balanced trade."
- does NOT prevent government budget deficits.
- does NOT disallow "fractional reserve banking."
- does NOT disallow "central banking" or a "lender of last resort" (in the 19th-century meanings of the terms).
- If it happened during the gold standard period (U.S.: 1789-1971), then obviously it was possible with a gold standard system.
- A gold standard system produces money that is stable in value. That's it!



Panic of 1873: happened when U.S. dollar was **off the gold standard**.

British Consol yields indicate extraordinary monetary and macroeconomic stability over a century.

No central bank today can touch this performance.



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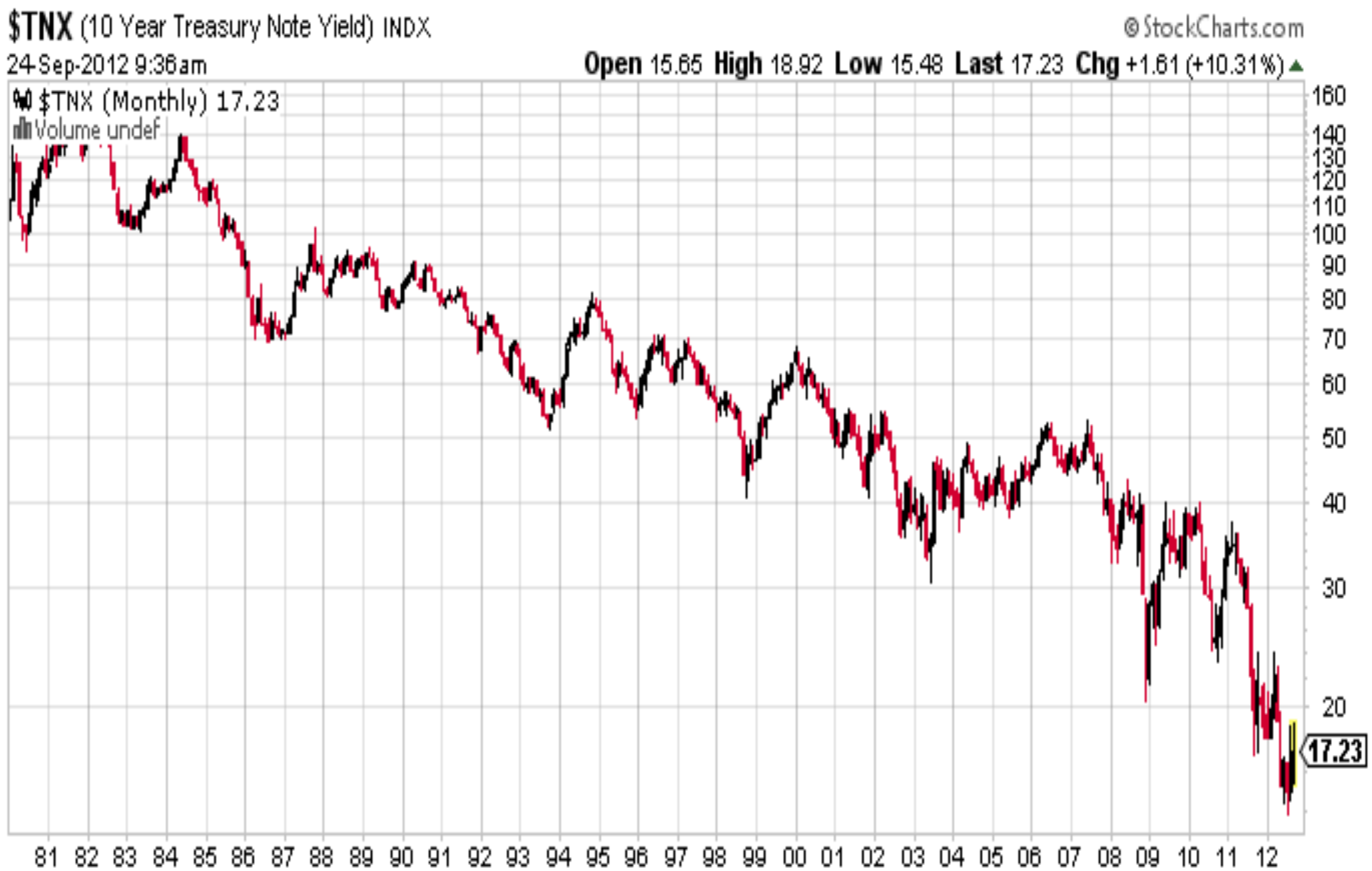
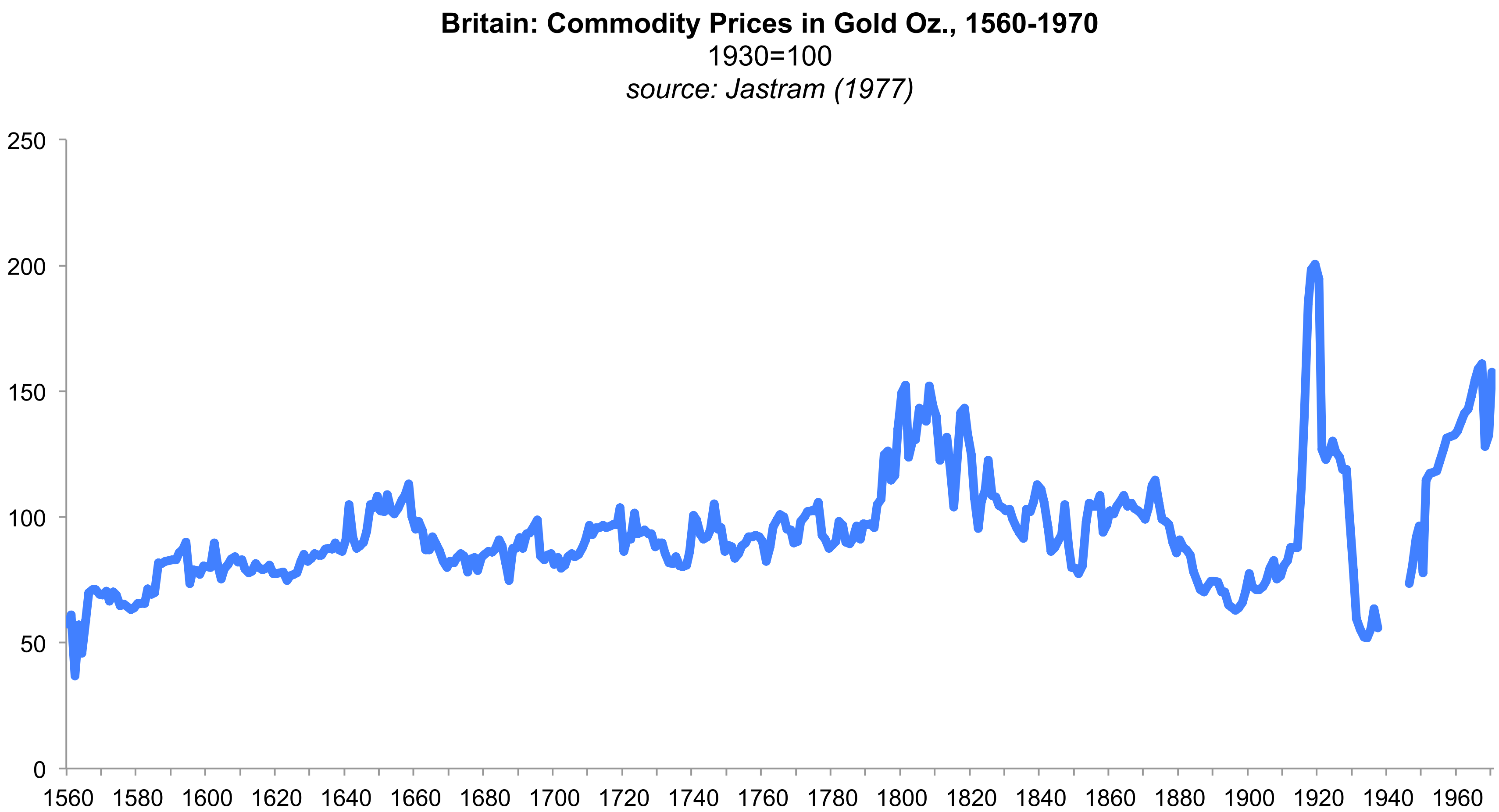
Certainly not the Federal Reserve.



100 bps

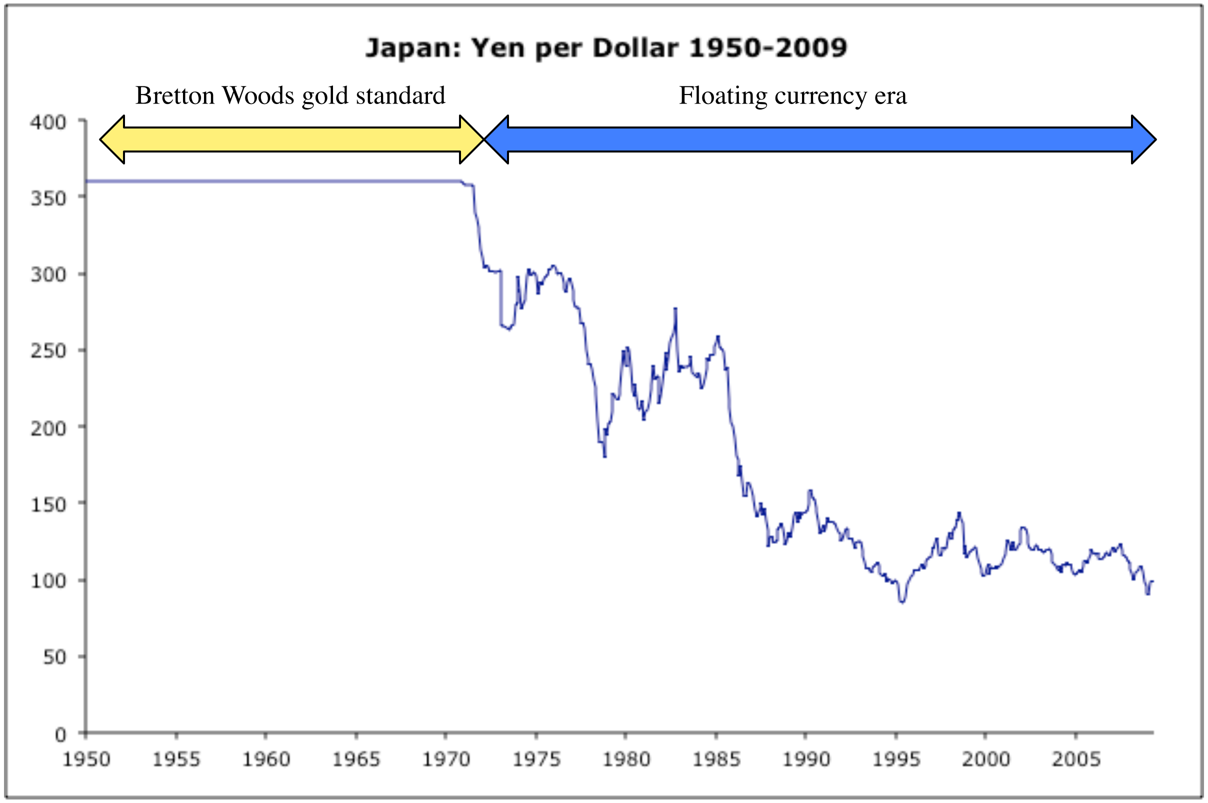
Gold vs. commodity basket over 400 years.

Some commodity price variation is to be expected. This is what it should look like if gold is stable in value.

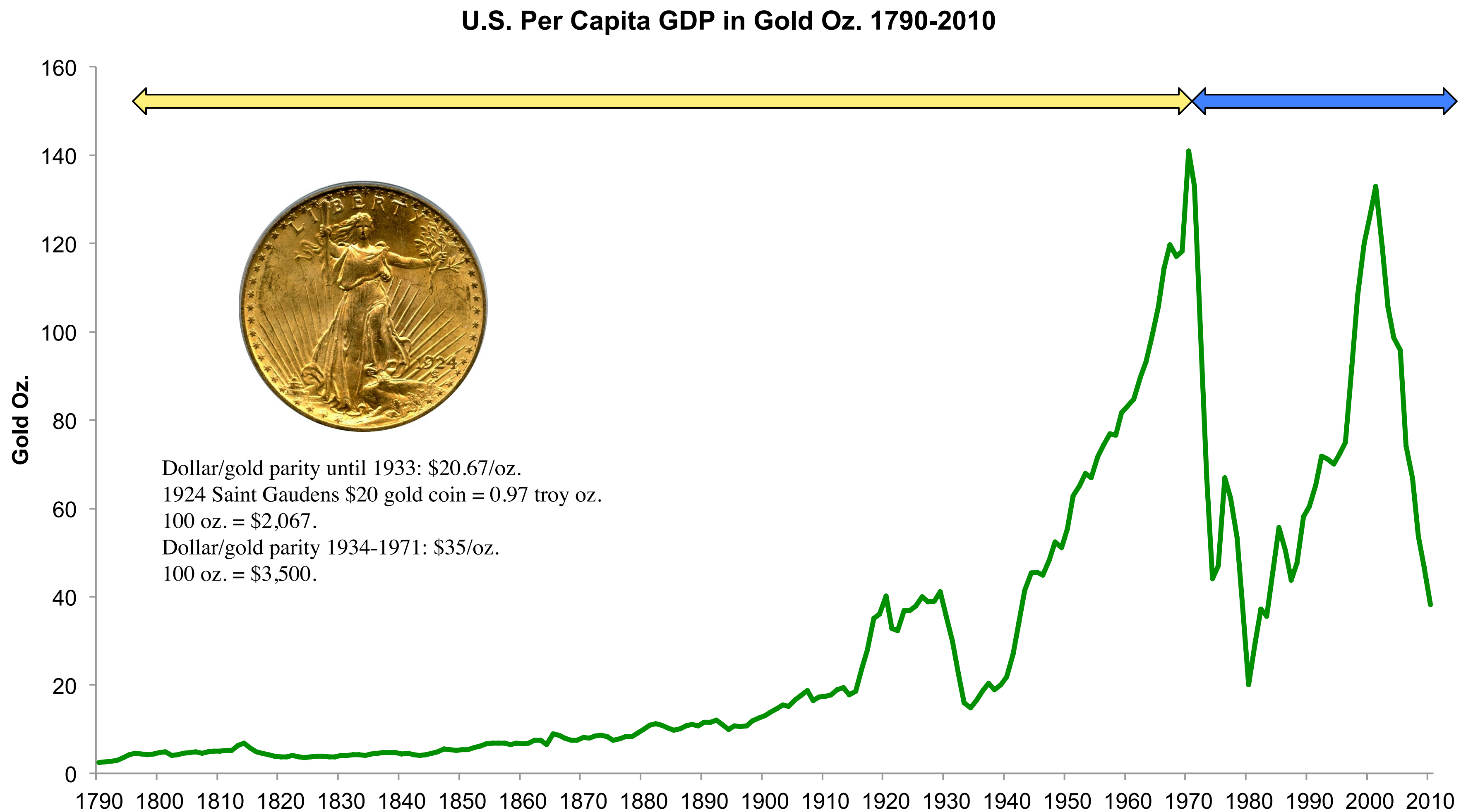


The Gold Standard era was also a time of fixed exchange rates.

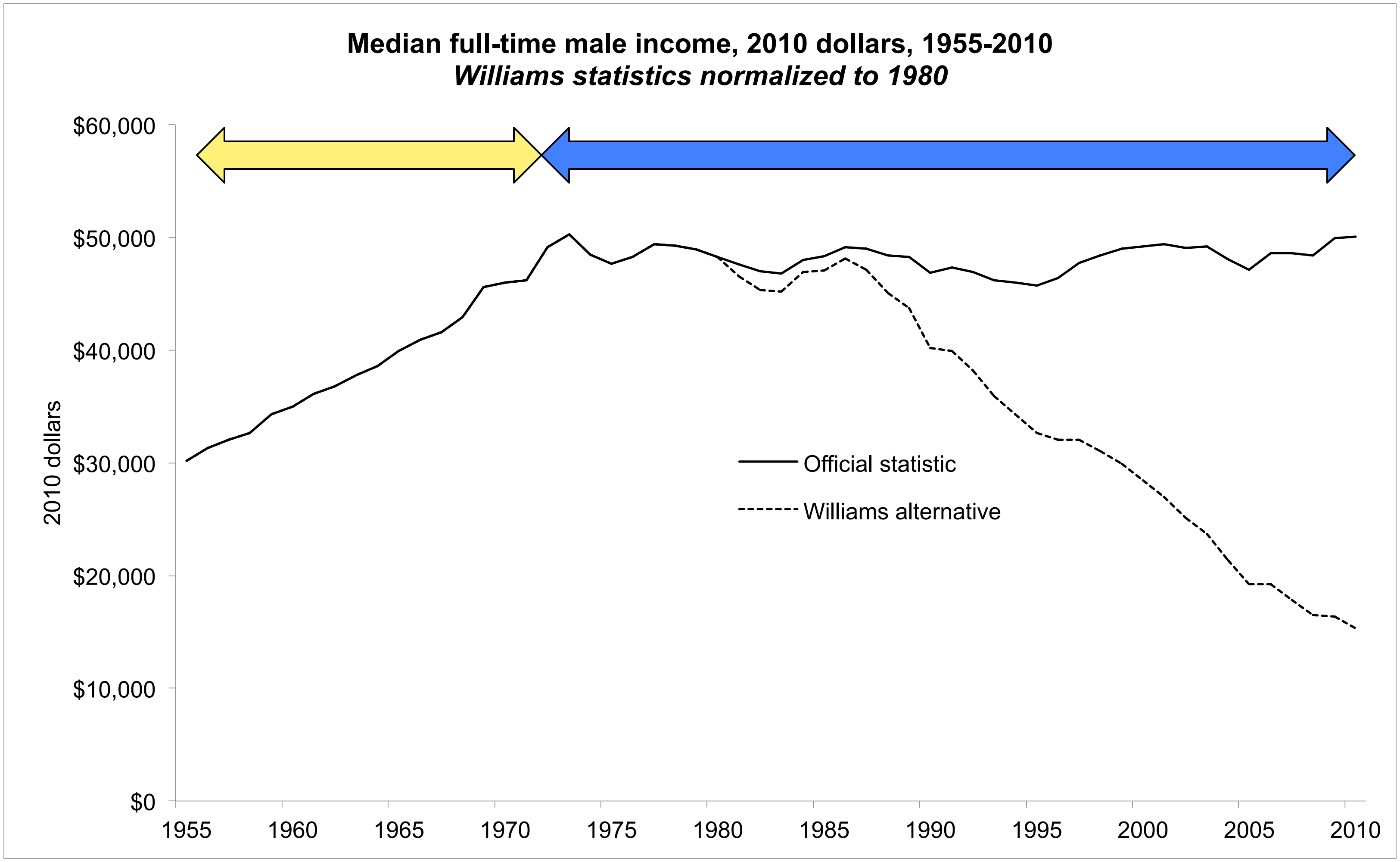
Floating rates are not a phenomena of the "free market." They are a phenomena of bureaucrat-managed funny money!



Despite major setbacks, Americans got wealthier with Classical Money.
Since 1971, they've stagnated at best.



Even the U.S. government, devoted to happytalk, admits that the median male income has stagnated for forty years. If you back out the "revisions" to the CPI since 1980, it looks a lot worse.



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.

July 2009: At a G8 meeting in Italy, Russian President Dmitry Medvedev presented this 1/2 oz. gold bullion coin, calling it an example of a "united future world currency."

How Does a Gold Standard System Work?

Although there are many variations, at a basic level, all functional systems are similar to currency boards already in use today. It's like "a currency board linked to gold."

Economist Steve Hanke, who has established currency boards in Estonia, Argentina, Bosnia, Lithuania and Bulgaria, now suggests a "gold-based currency board."
(GlobeAsia, May 2012)

Perspective

A gold-based currency board, please

Until early in the 20th century, gold played a central role in the world of money. Gold had an incredible run – almost three thousand years. And why not? After all, Professor Roy Jastram convincingly documents in The Golden Constant just how gold maintains its purchasing power over long periods of time.

But, since President Richard Nixon closed the gold window in August 1971, gold has not played a formal role in the international monetary regime. Today, the "regime" is characterized by many as a chaotic non-system.

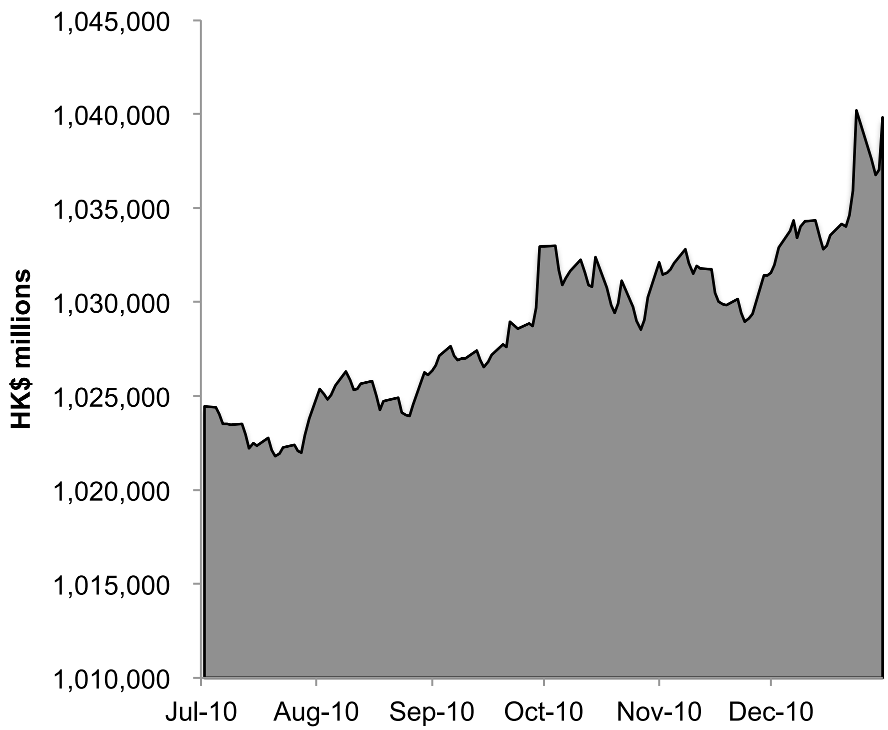
In the past decade, gold prices have surged and there have been noises in some quarters that gold's formal role should be re-established in the

interest-earning securities and other assets payable in the reserve currency. Its reserves equal 100 percent or slightly more of its notes and coins in circulation, as set by law.

An orthodox currency board has no active role in determining the monetary base. A fixed exchange rate with the reserve currency and the requirement that the currency board hold foreign reserves equal to 100 percent of the monetary base prevents it from increasing or decreasing the monetary base at its own discretion. Nor

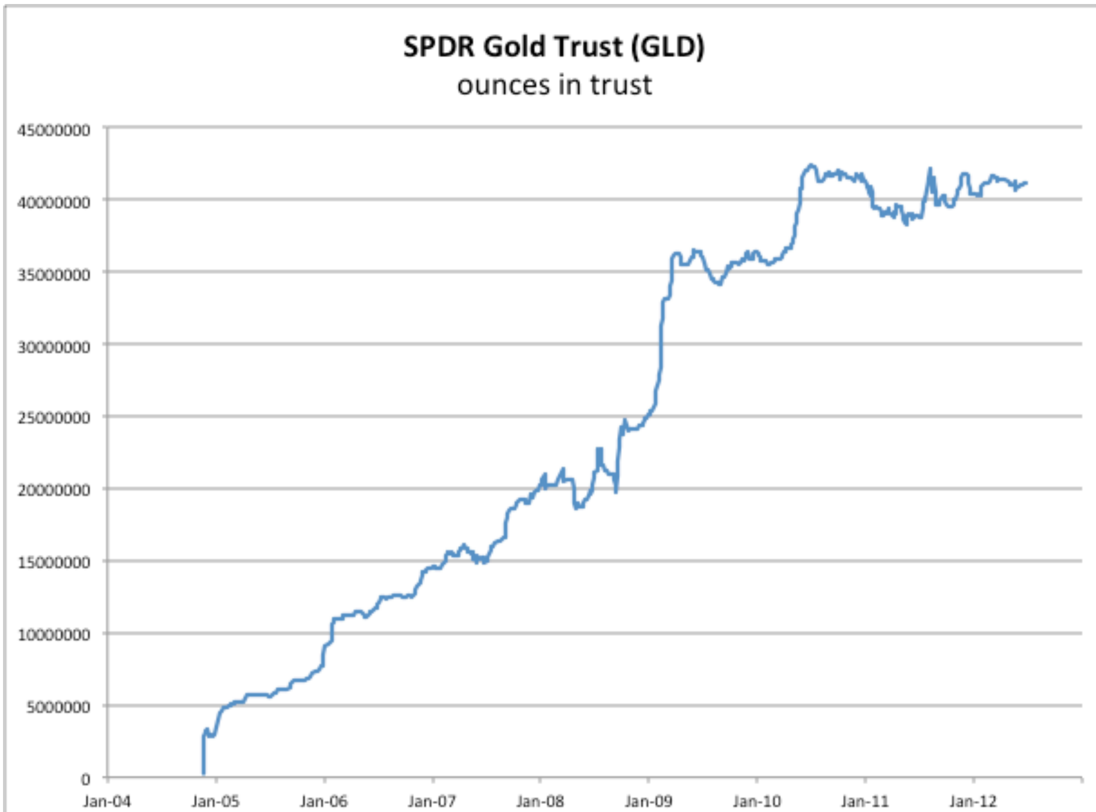
How do currency boards work today?

The currency issuer offers to buy or sell HK$/US$ at a fixed parity rate, in unlimited quantity. This mechanism produces daily variation in total HK$ base money. Total base money is a residual of this process.



How about the "GLD Standard"?

The same basic process is at the heart of gold bullion ETFs popular today.
What determines the number of GLD shares outstanding?
The GLD trust offers to buy or sell shares in unlimited quantity, at or near the parity price. This produces daily variation in the number of shares outstanding.

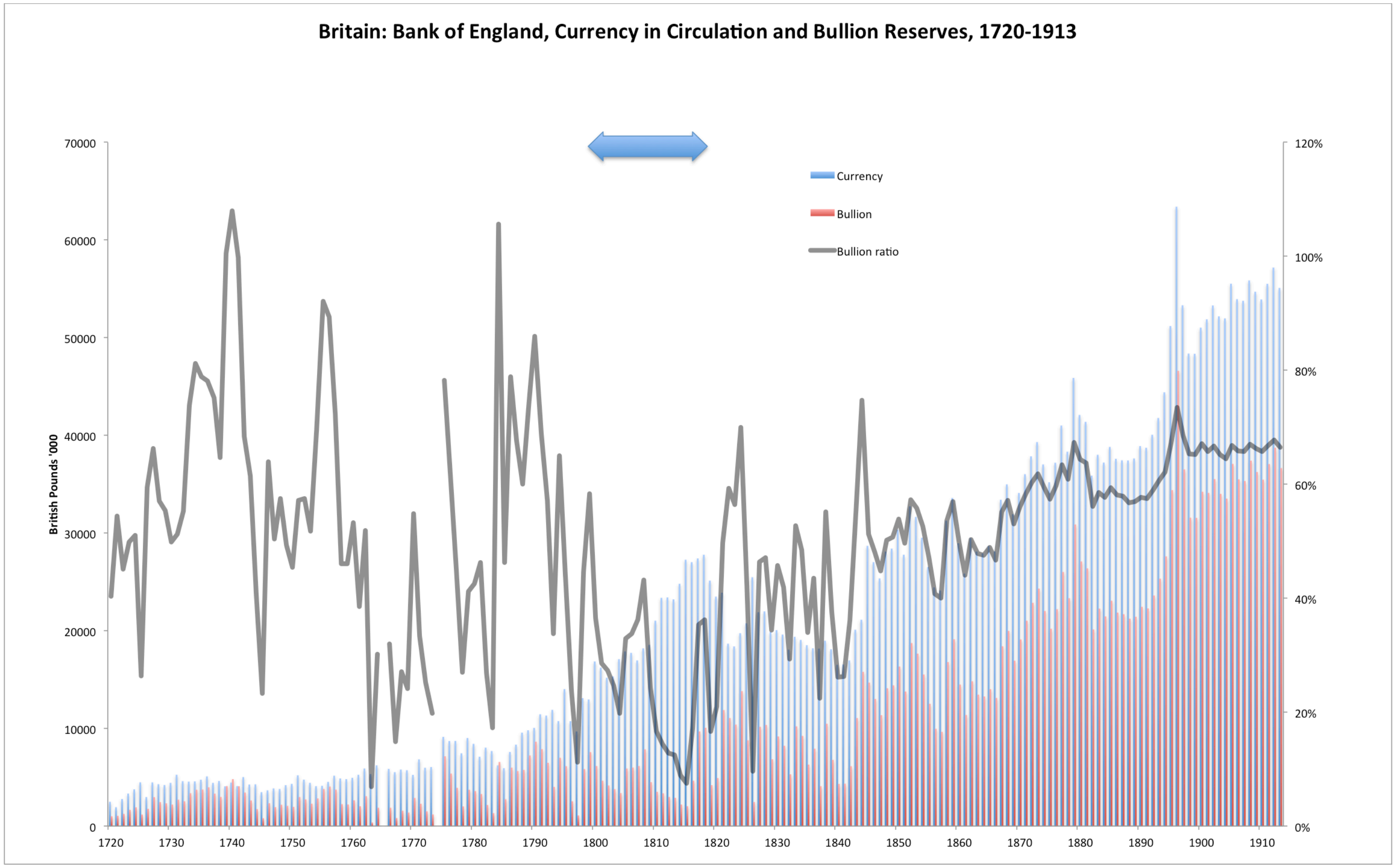


It has nothing to do with gold mining, gold imports or exports, the "balance of payments," interest rates, fiscal policy, unemployment, GDP statistics, or a dozen other things you could name.

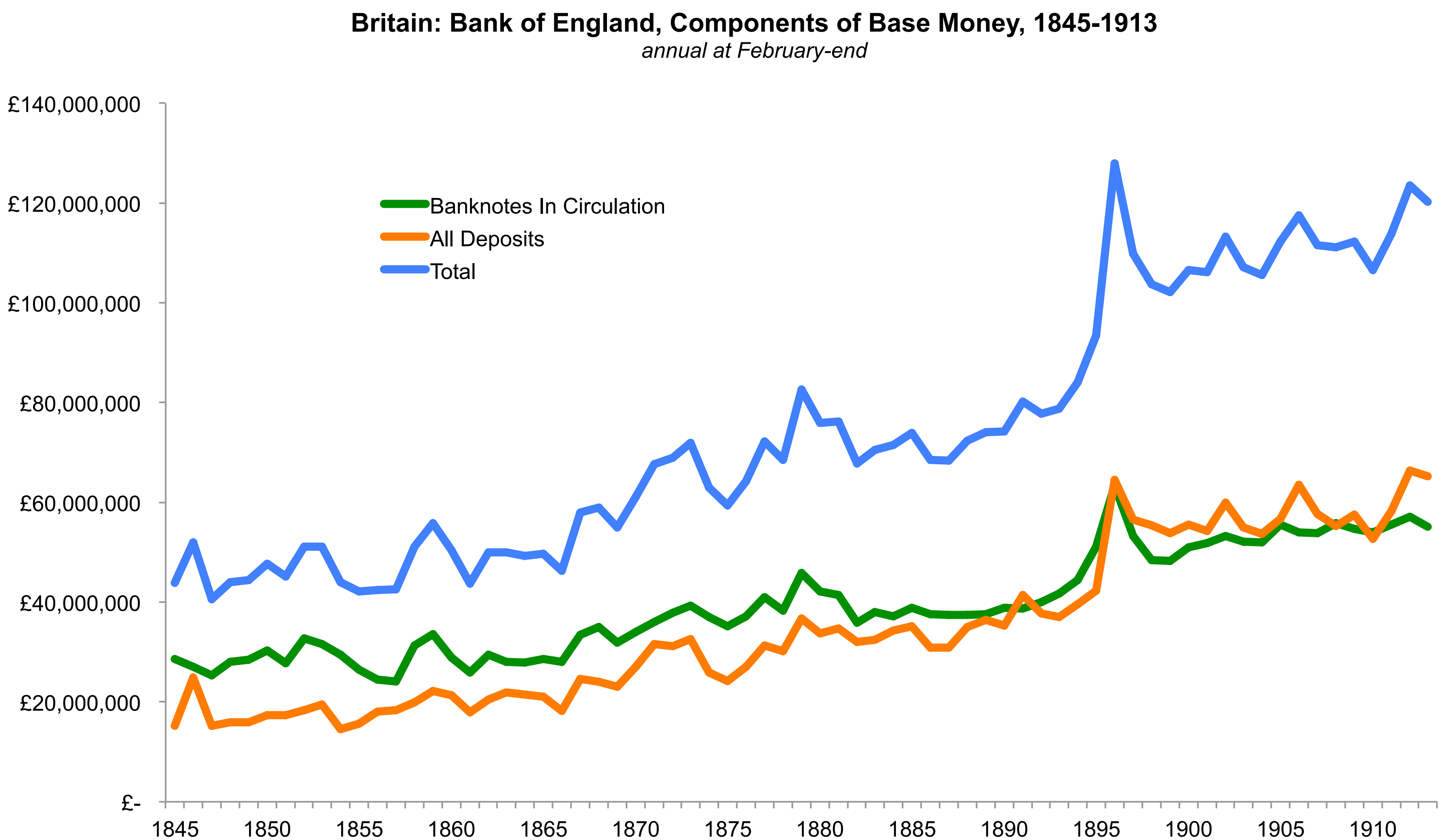
These ETF products can expand to any size, or contract as appropriate.

The same is true of a gold standard system.

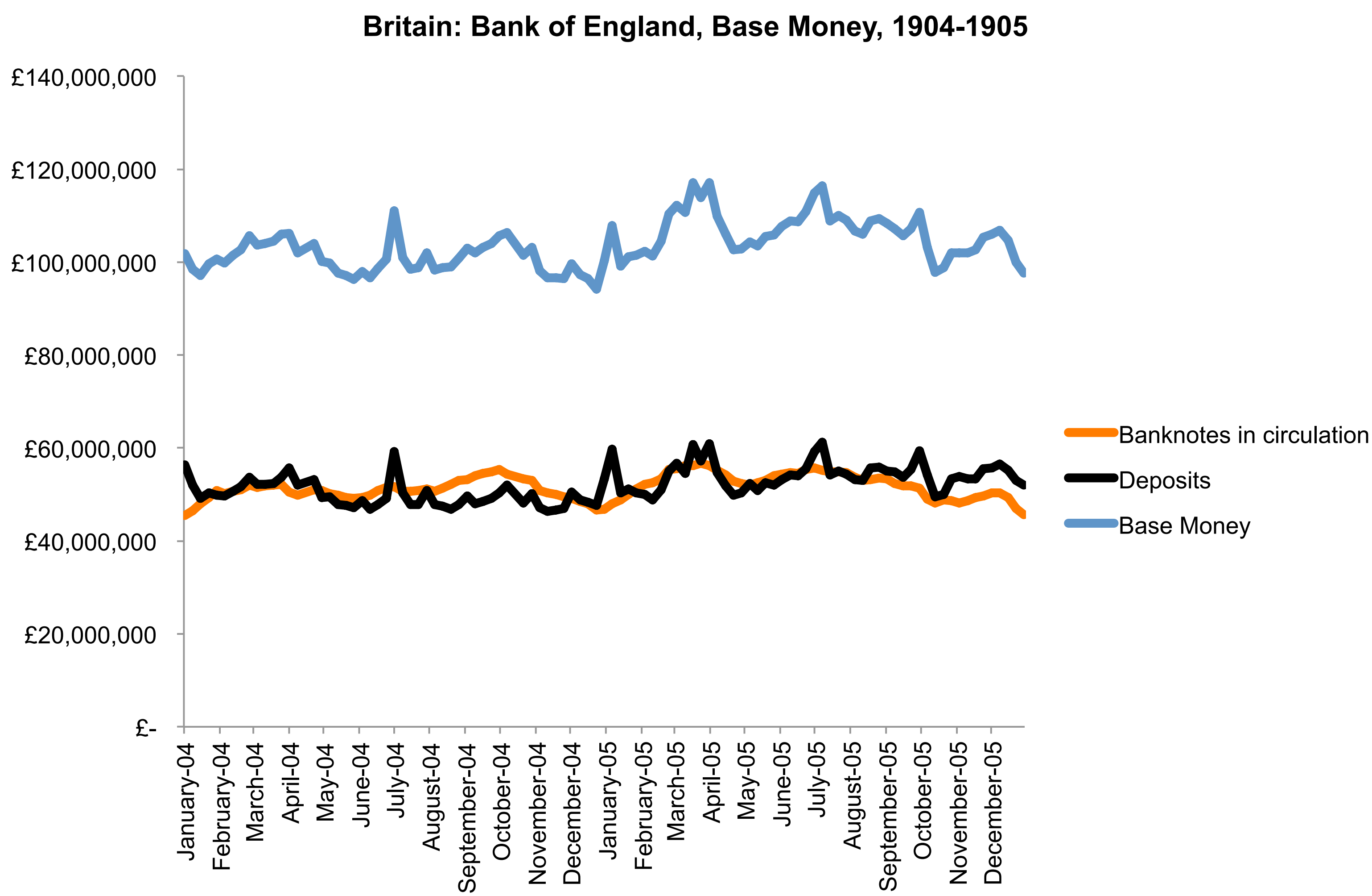
The Bank of England never had a "100% reserve."



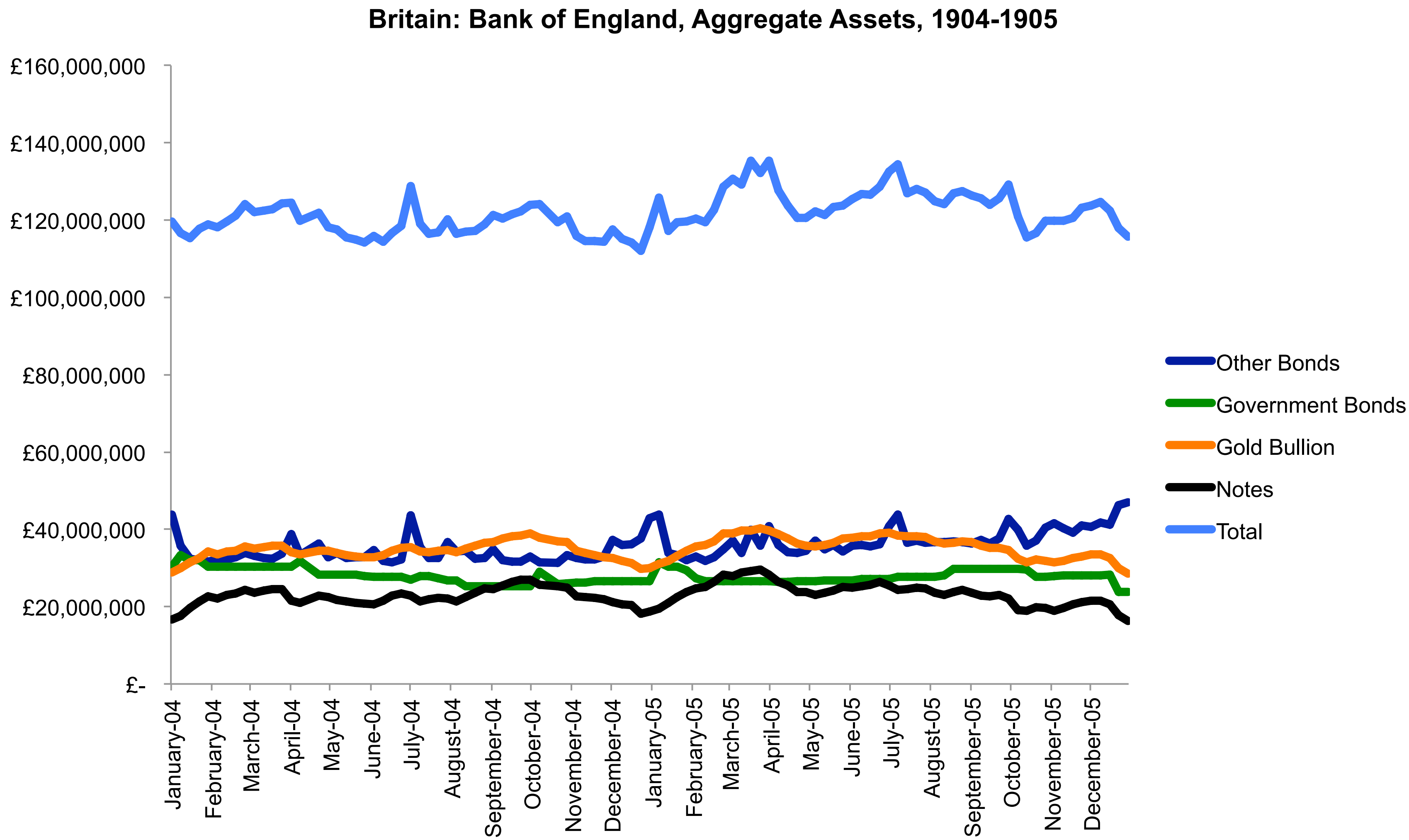
The 1845-1913 period was the heart of the "Classical pre-1914 gold standard system"



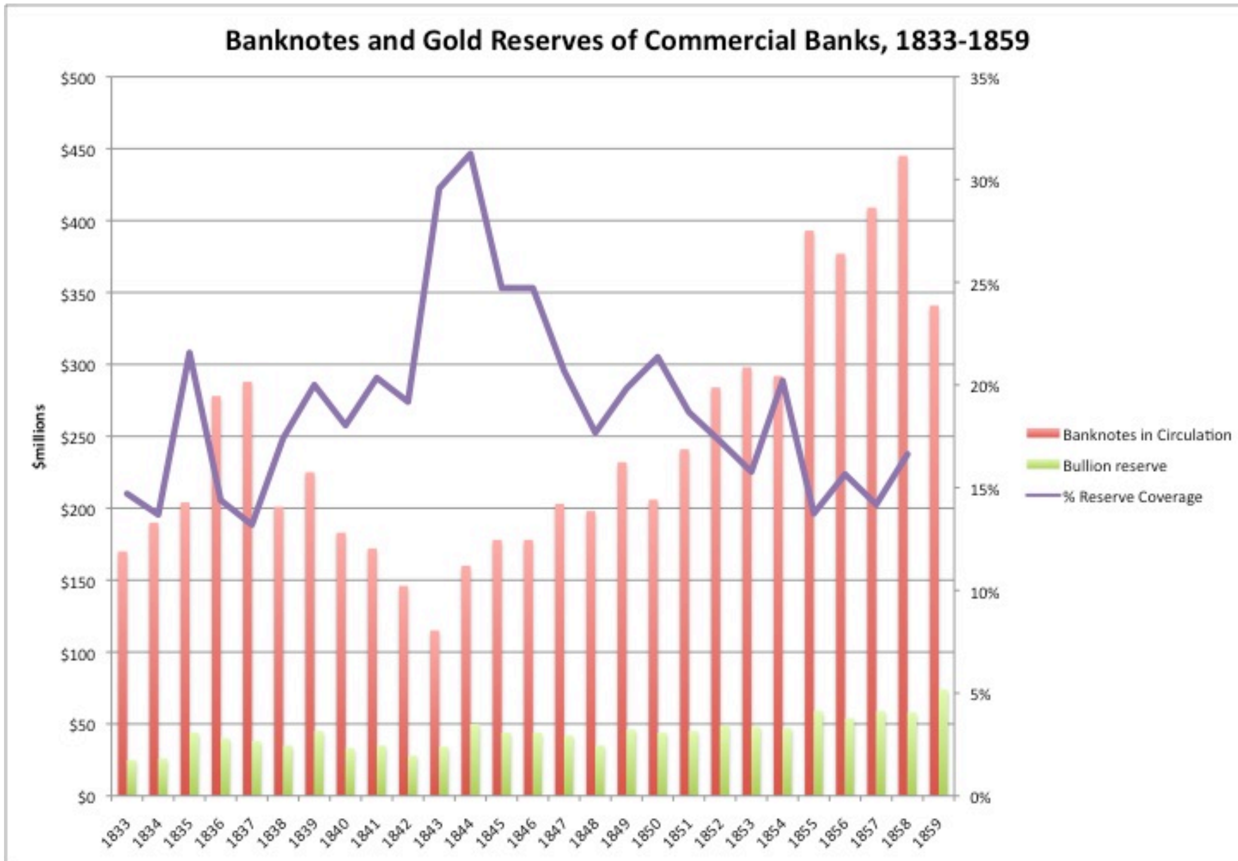
Want to know how the Bank of England operated on a week-to-week basis? Just look!



Open-market operations (market transactions in bonds) were a central part of the BoE's activity.



The pre-1860 "free banking" U.S. currency system never had a "100% reserve" system. Bullion reserve coverage averaged around 20-40%.



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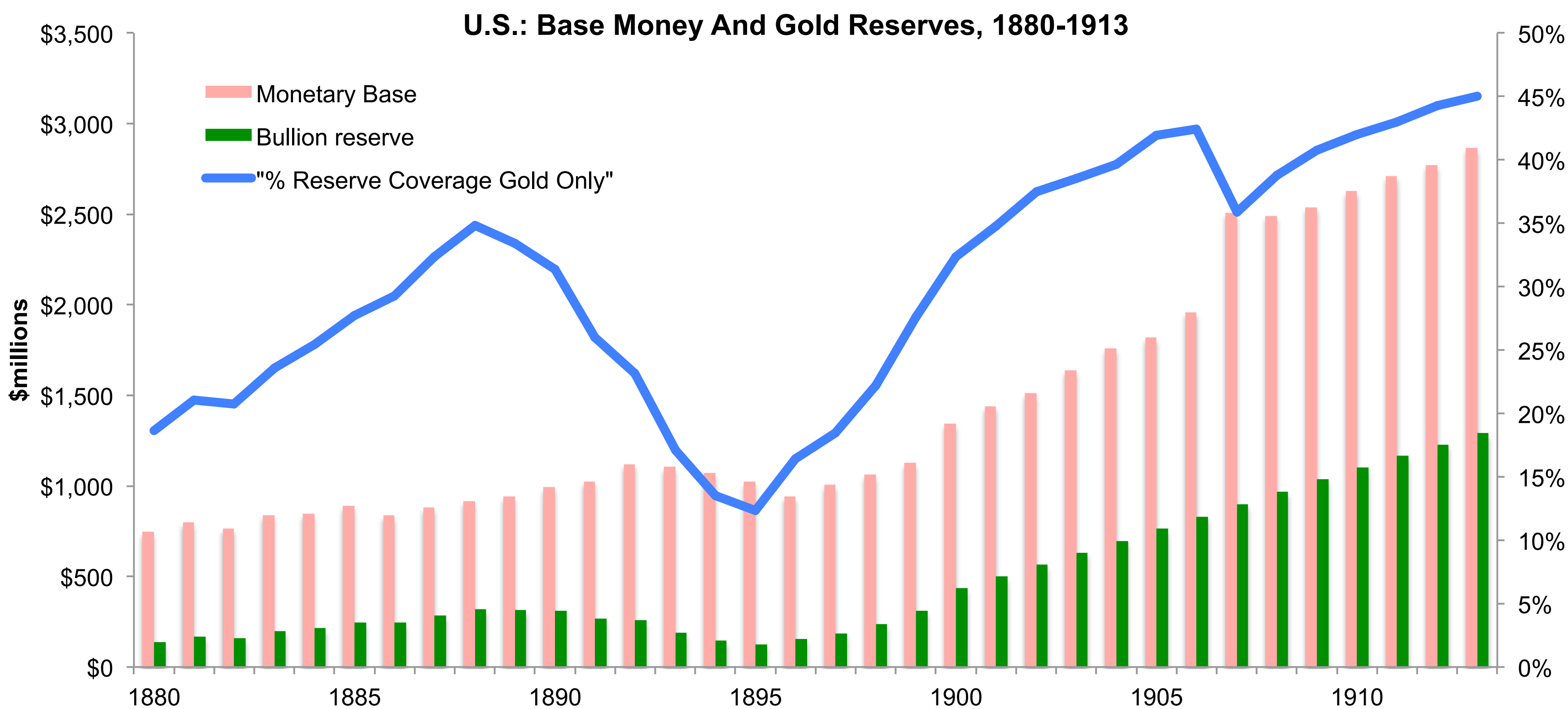
From 1775 to 1900 (125 years), the U.S. base money supply increased by an estimated **163x**. ($12 million to $1,954 million.)
However, the amount of gold in the world increased by about **3.4x** during that time period.
The "money supply" with a gold standard system is **NOT** linked to mining!



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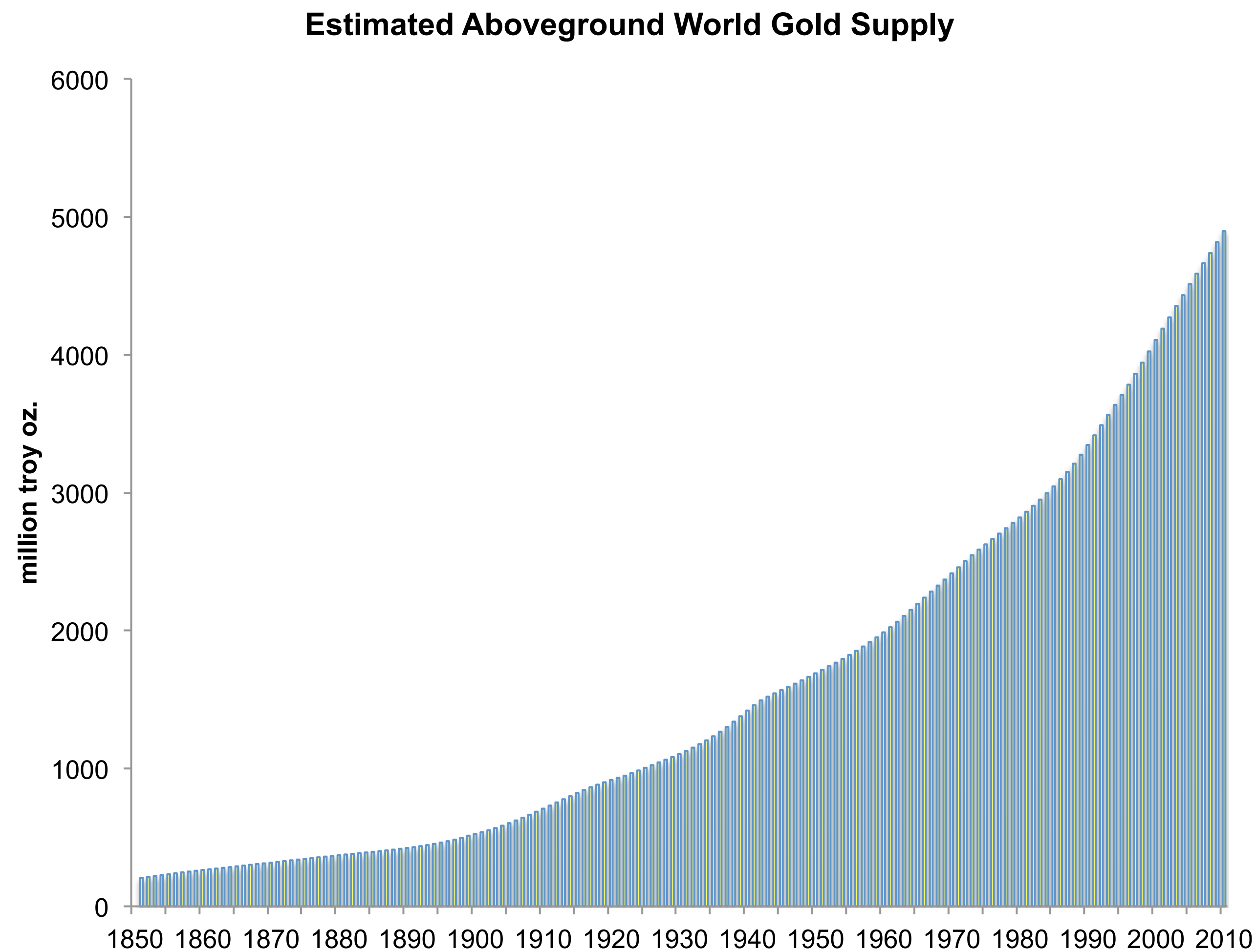
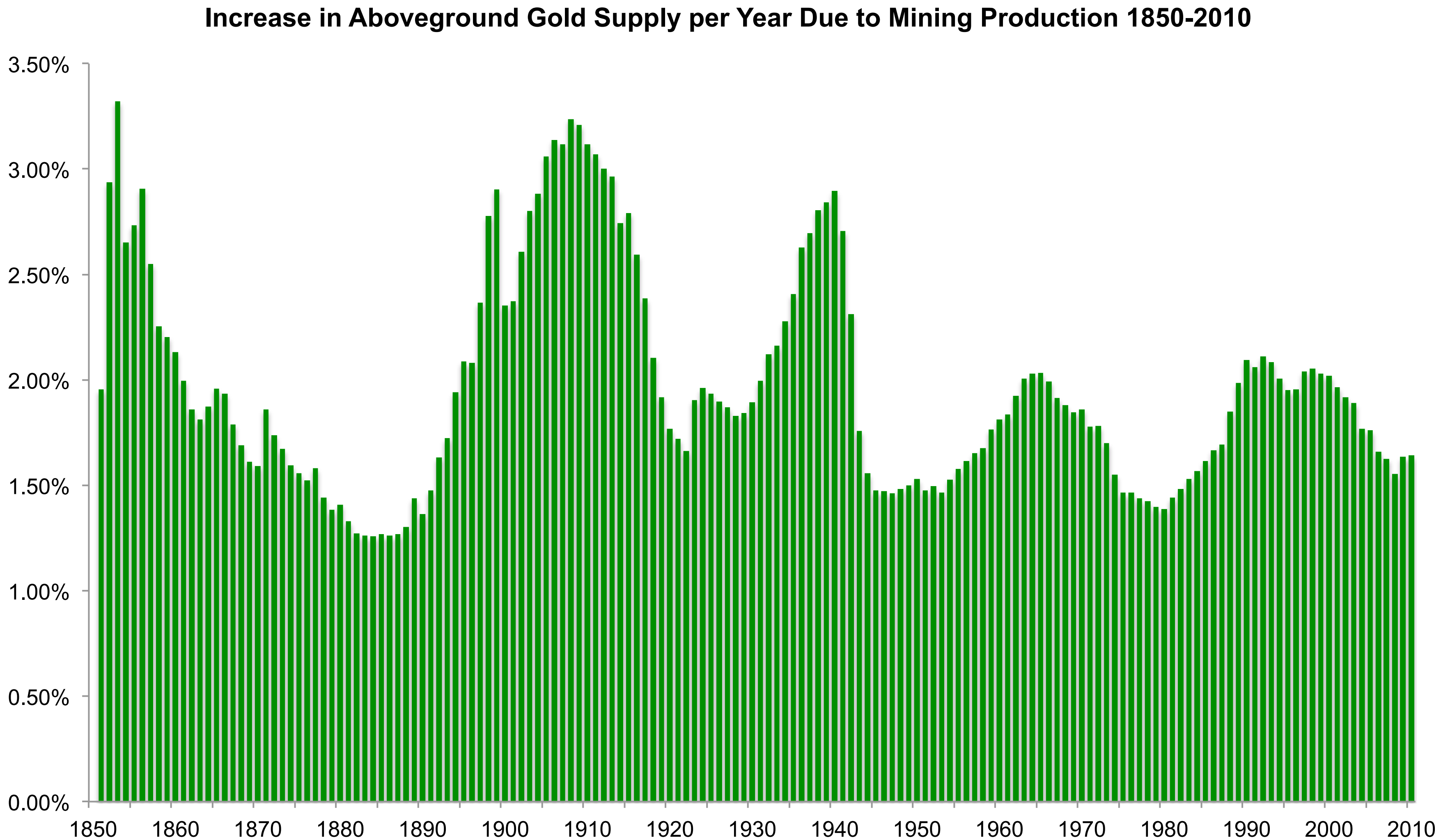
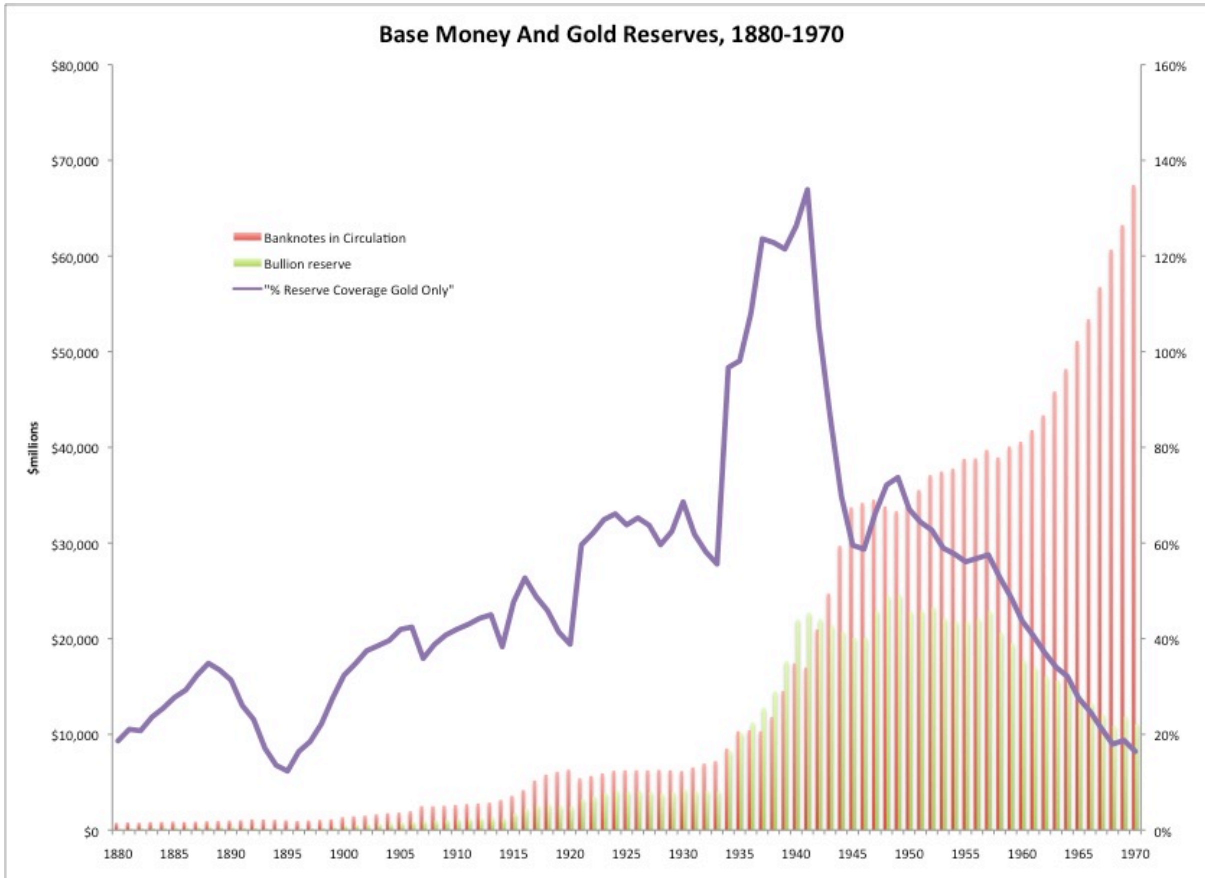
The amount of gold in the world ("aboveground gold") grows slowly, about 2% per year.



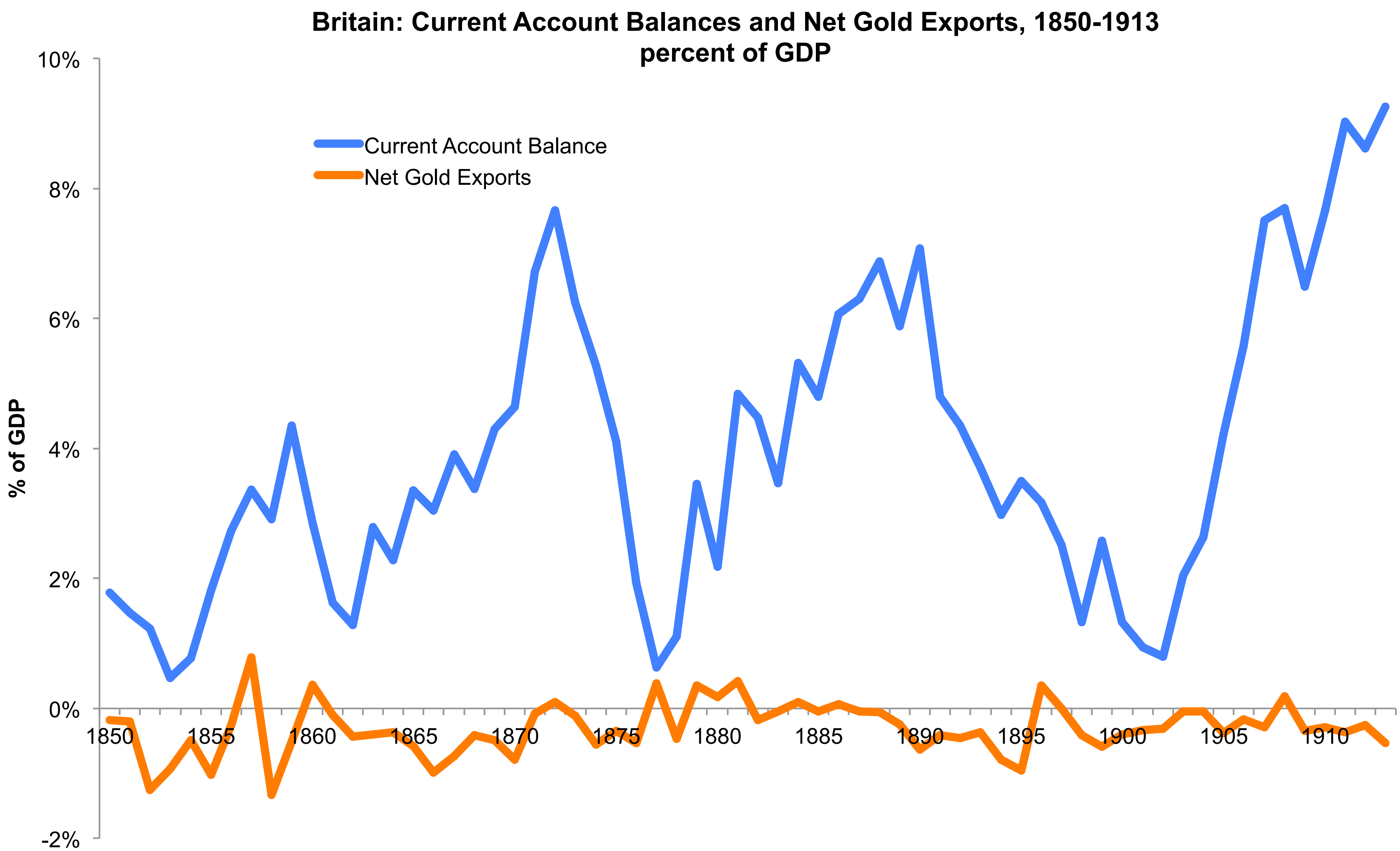
Even in “gold rush” eras, production didn’t increase that much.



The U.S. only had "100%+ reserves" for a brief time around World War II.
During this 90 year period (1880-1970), the monetary base increased by 90x (53x in gold terms).
(Aboveground gold increased 6.5x during this period.)



"Gold flows" had nothing to do with the "Balance of Payments."



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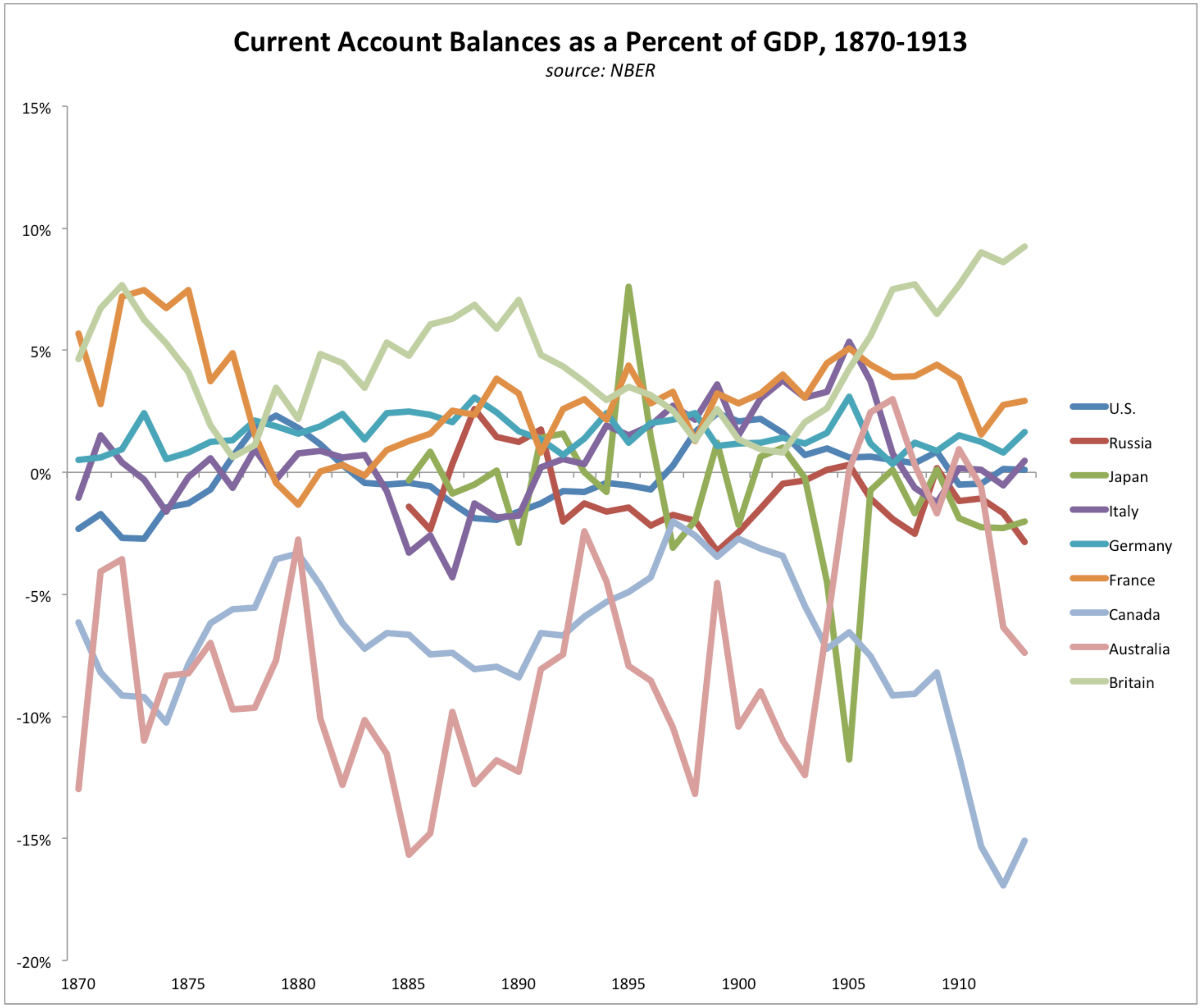
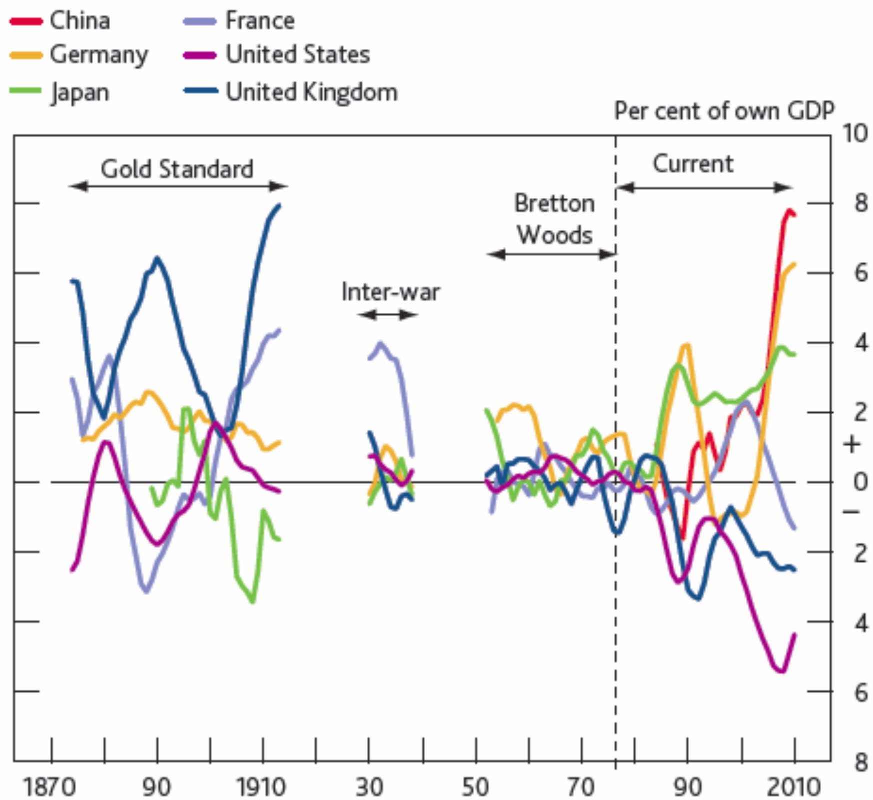
"Balance of Payments imbalances" (=international capital flows) were the norm.



The pre-1914 Gold Standard era was a time of globalization unmatched until the 1990s!

Chart 1 Current account balances(a)

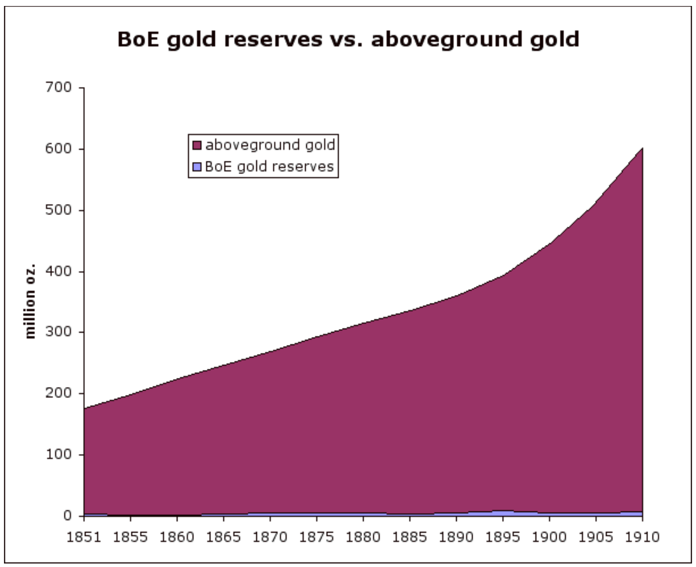


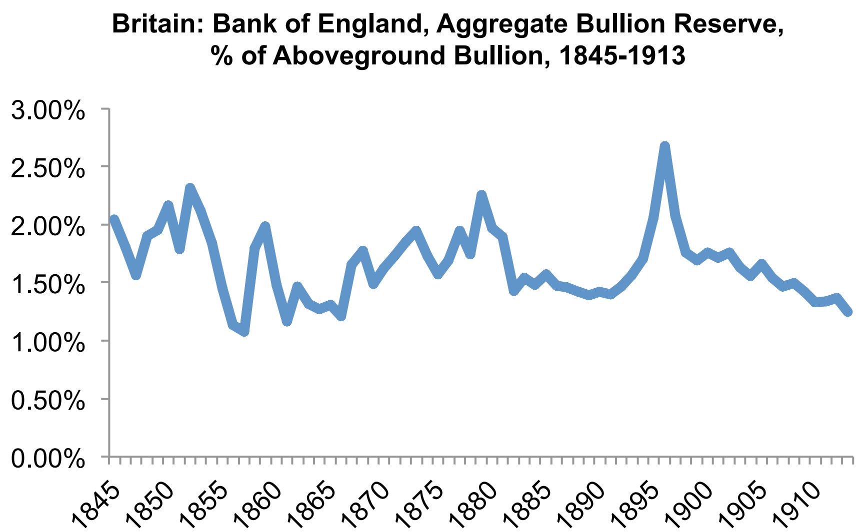
Sources: Global Financial Data, IMF *World Economic Outlook* (September 2011), Taylor (2002) and Bank calculations.

(a) Five-year moving average.

“We don’t have enough gold” complaints are nonsense.

- By 1845, the pound was the premier international currency and London was the world’s financial center.
- Many other governments effectively pegged their currency to the pound (and thus to gold) -- much like Bretton Woods.
- The BoE held little gold (7m oz. in 1910).
- It didn’t matter!
- We have 7x more aboveground gold today than in 1910. (708m oz. vs. 5,000m oz.)





How Might We Create a World Gold Standard System?

- **FIRST: you must embrace the Classical ideal of money** – as stable in value as possible, precise in definition, free of human intervention.
- **Most countries have already done so!** They have a loose or tight link to the dollar or euro, and have mostly or wholly abandoned "domestic monetary policy" (Mercantilism).
- A gold standard system is simply a superior, proven method of achieving this Classical ideal.
- International agreements are not necessary. Countries can act independently.
- Large gold reserves are not necessary.
- Leadership likely to come from China/Russia/Germany NOT the U.S.
- First examples might be small countries like Panama, Gulf States, African countries.
- **A "parallel gold-based currency"** allows the easiest transition from today's dollar-centric world.
- Bitcoin-like gold-based alternatives would be a good step, but require government sanction and likely to lack scale.
- "Free banking" approaches can certainly work, as in Hong Kong today.
- Each country is likely to choose its own unique path – as they did in the 19th century.

It's easy …
when you know how!

Thank You

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Gold: the Once and Future Money (2007)

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