

Hillsdale College Free Market Forum

Nathan Lewis

October 13, 2023

Nathan Lewis

Five books about monetary and economic topics, including the “gold standard trilogy.”

Gold: The Once and Future Money (2007)

Gold: The Monetary Polaris (2013)

Gold: The Final Standard (2017)

The Magic Formula (2019)

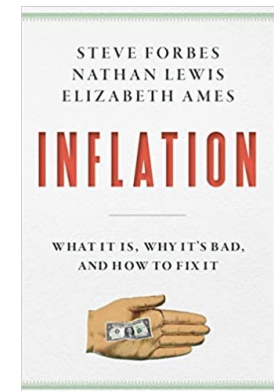
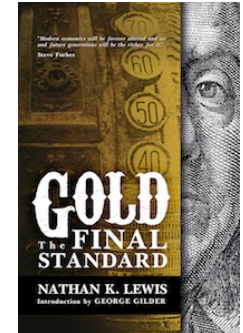
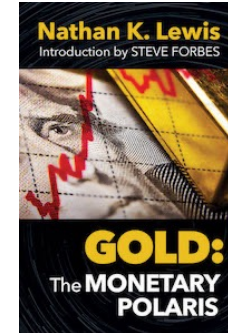
Inflation (2022), with Steve Forbes and Elizabeth Ames

Discovery Institute Fellow

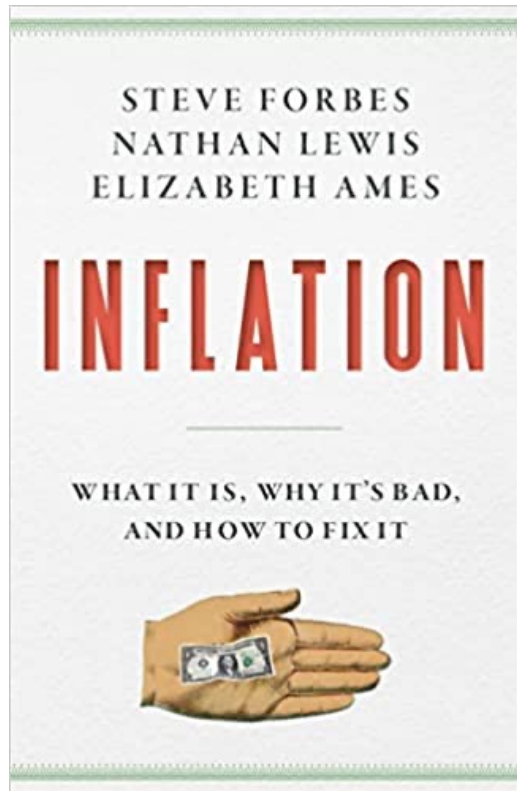
15+ years of institutional research and asset management experience.

Newworldeconomics.com

The Polaris Letter (polarisletter.substack.com)



Inflation: What It Is, Why It's Bad, and How to Fix It (2022)



Monetary and Non-Monetary Processes (Keynes vs. Friedman)



Postwar Keynesianism:

Keynesian economics are the various macroeconomic theories and models of how aggregate demand (total spending in the economy) strongly influences economic output and inflation. (Wikipedia)

=Supply and Demand of Goods and Services



Monetarism:

“Inflation is always and everywhere a monetary phenomenon, in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output.”
(Milton Friedman)

=Quantity of Currency

We've Always Known This.



David Ricardo (1817)

It has been my endeavor carefully to distinguish between a low value of money and a high value of corn, or any other commodity with which money may be compared. ... The effects resulting from a high price of corn when produced by a rise in the value of corn, and when caused by a fall in the value of money, are totally different.



Ludwig von Mises (1949)

Changes in the purchasing power of money ... can originate either from the side of money or from the side of the vendible goods and commodities. ... either in the demand for and supply of money or in the demand for and supply of the other goods and services.

We Got Both.

Supply/Demand for Goods and Services:

Rising energy prices (natural gas in Europe!)

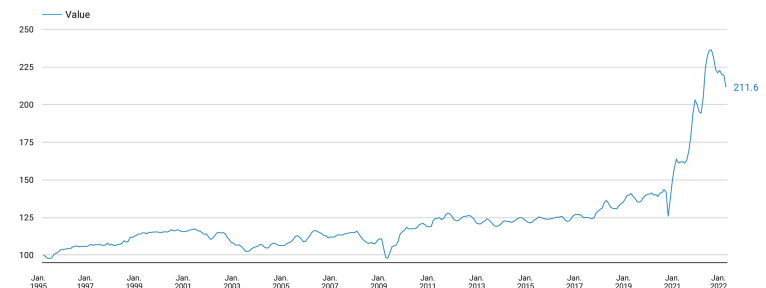
Chip shortage → Rising car prices

Tight labor market → Higher wages

Lack of housing development in popular cities, plus Red State migration → Higher house prices, rents

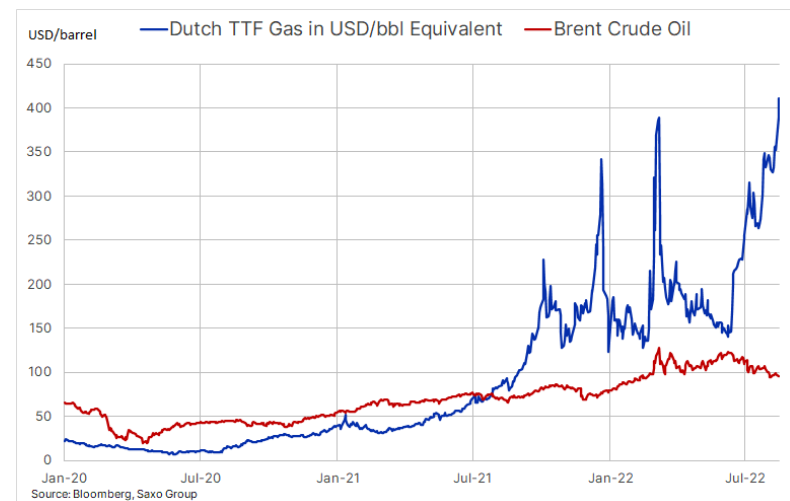
Economic recovery powered by 15%-of-GDP
Federal Deficit in 2020-21 (more spending!)

MANHEIM USED VEHICLE VALUE INDEX
Mid-August 2022



COX
AUTOMOTIVE[™] Manheim

Was this caused by the Federal Reserve?



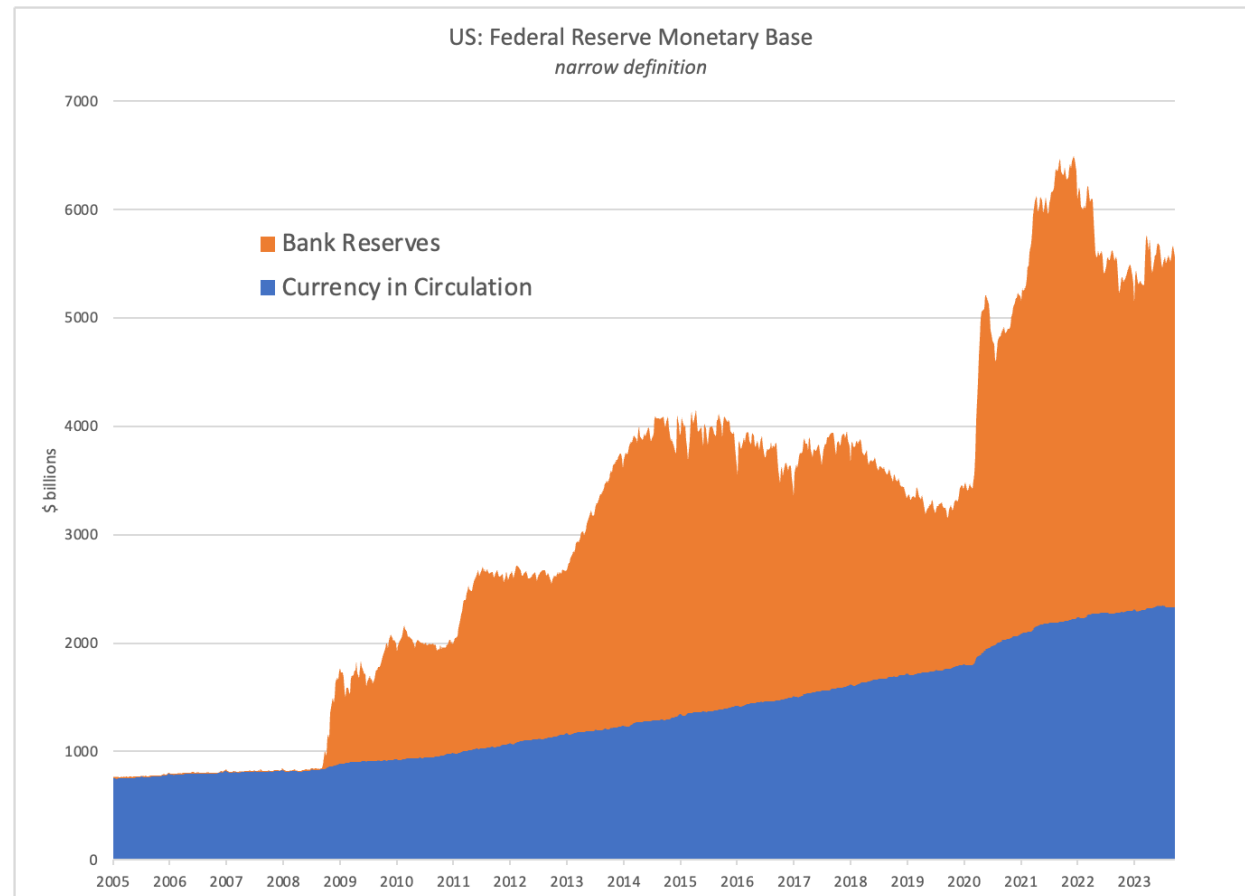
Did the ECB do this?

Central Banks were wildly expansionary.

Money Supply:

The Federal Reserve increased the Monetary Base (currency in circulation + bank reserves) by about \$3.0 trillion, or 86%. But, it later removed about \$1.0 trillion of this.

Other major central banks acted similarly.



Focus on the Value of the Currency, not the Quantity

- Coins have been debased (gold and silver content reduced, thus reducing their market value) since the 7th century BC.
- Henry VIII of England reduced the silver content of the English penny by 83% in 1542-1547.
- Today, it's all virtual: We have floating fiat currencies whose values go up and down.
- Sometimes they go down -- a lot!
- When a currency's value declines, markets adjust and it eventually takes more money to buy things.



Bitcoin's quantity is fixed, but the value is wildly variable.

Bitcoin doesn't work well as a basis for money.



One of Henry VIII's debased pennies.

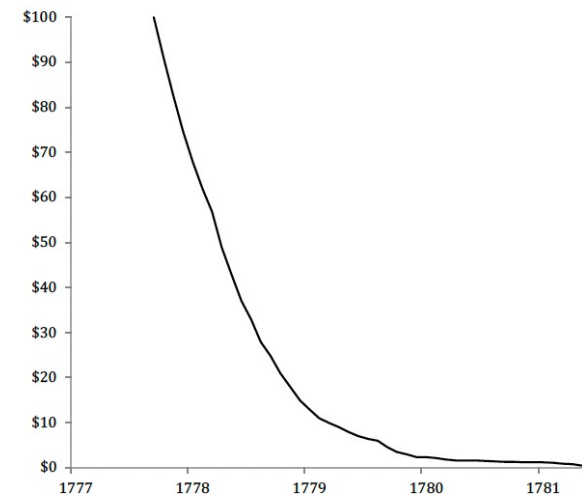
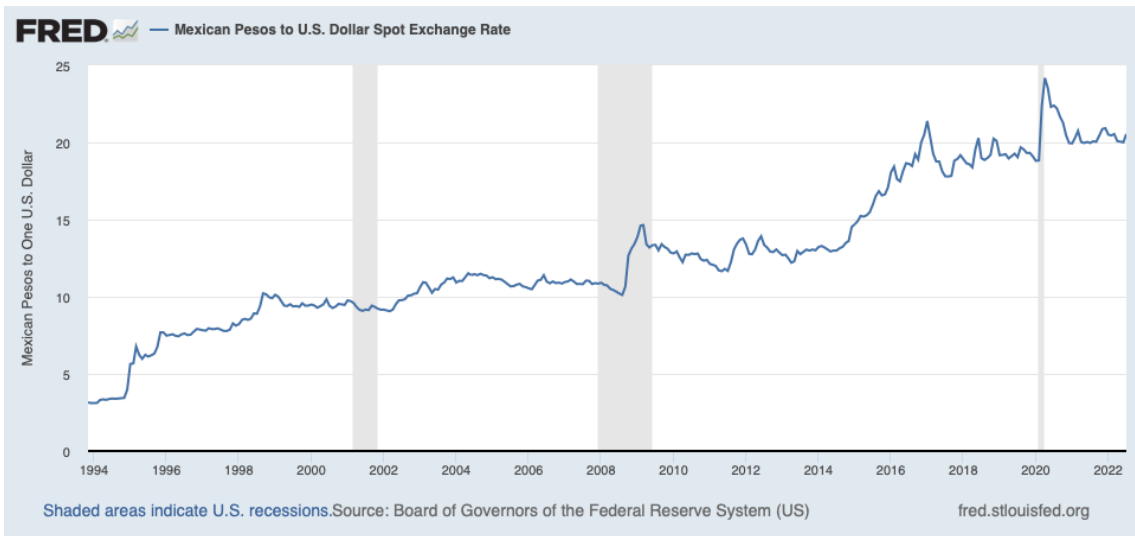


Figure 13.1: U.S.: Value of 100 Continental Dollars Vs. Bullion Coin, 1777-1781¹

In the 1780s, Congress issued a "continental dollar" that was hyperinflated into oblivion.

It's obvious when it happens to *someone else*.



It takes more Mexican pesos to buy a dollar.

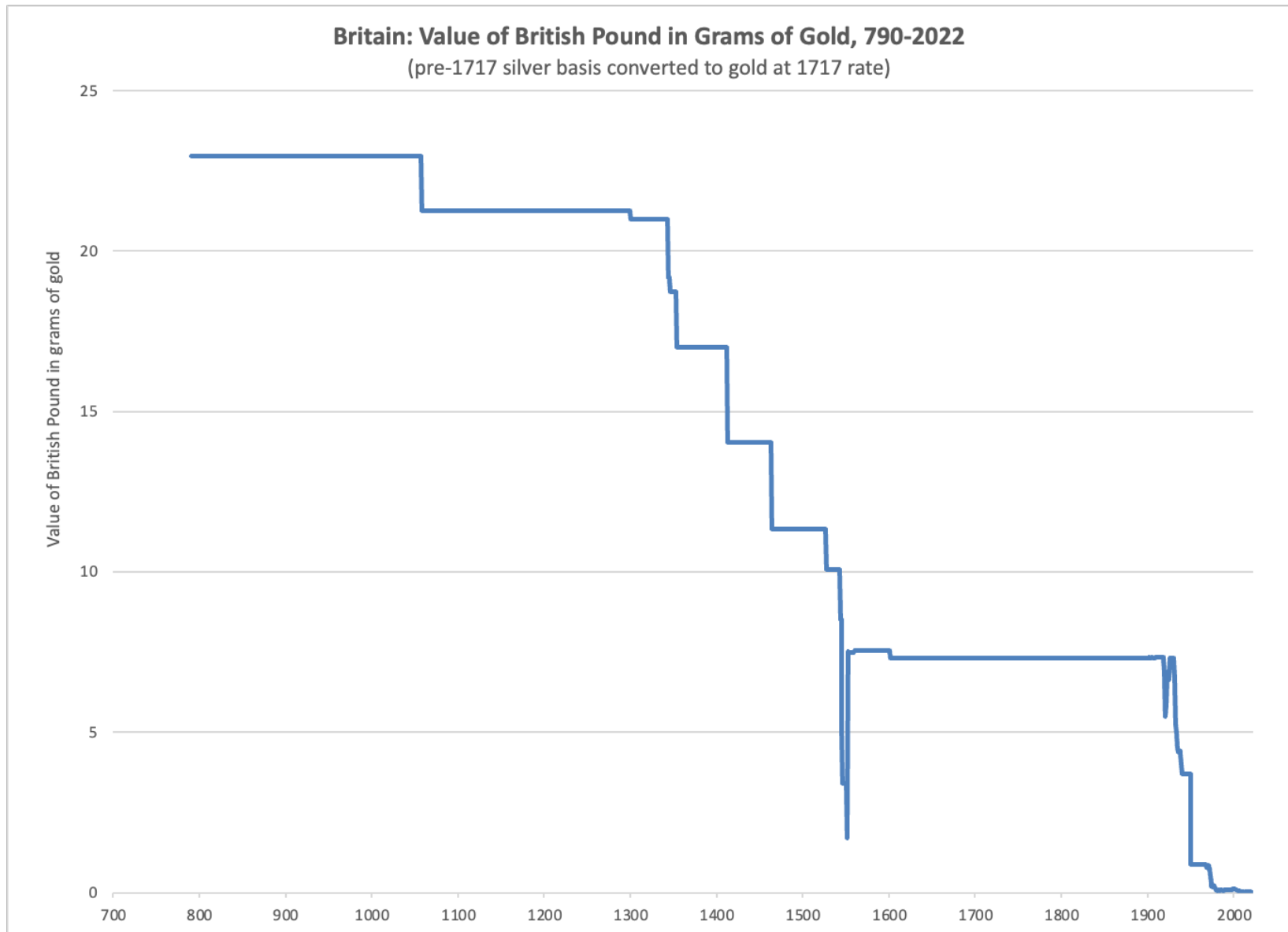
It takes more pesos to buy everything else too.



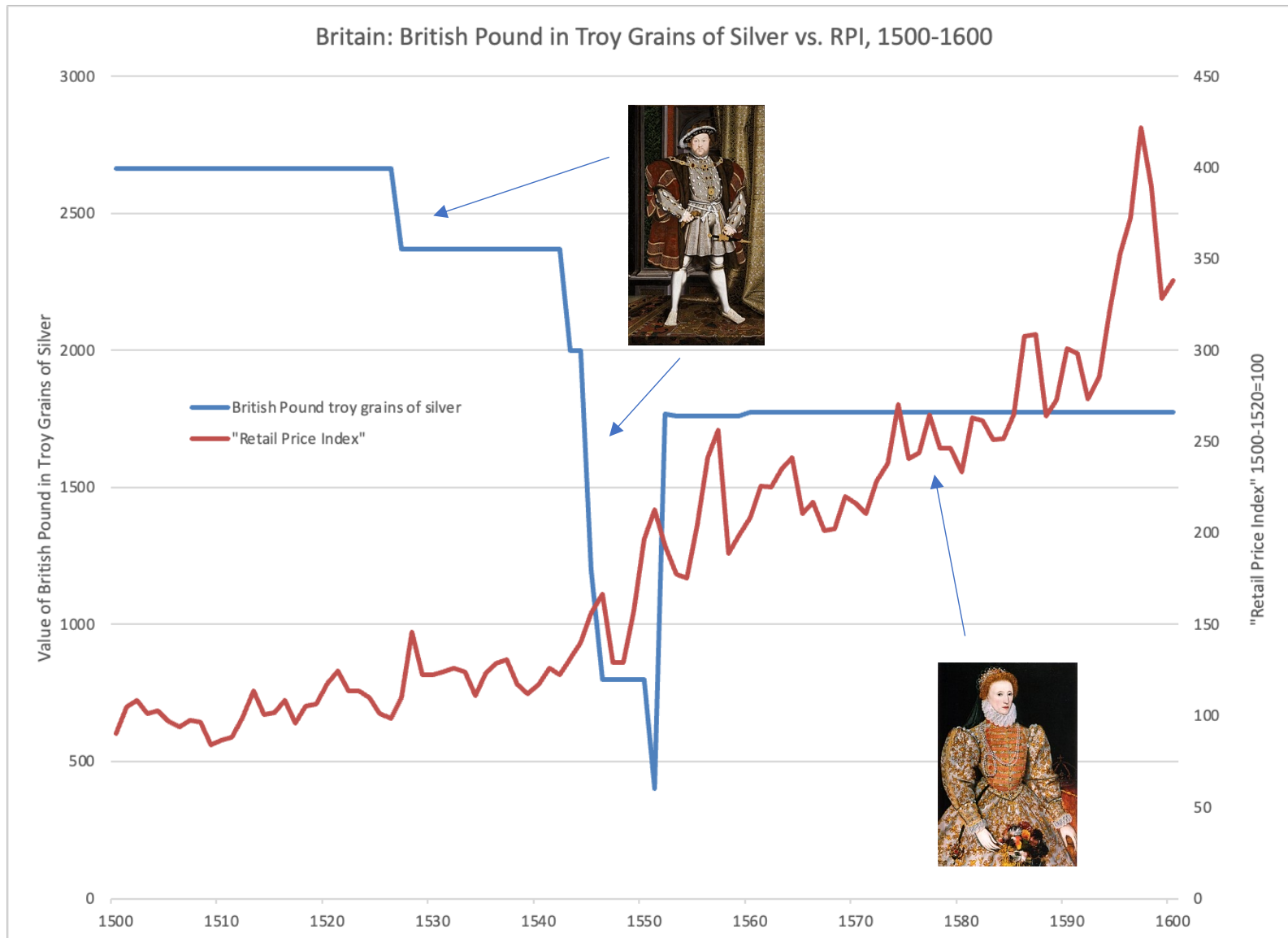
Was there a “more rapid increase in the quantity of money than in output”?

Maybe ... maybe not ... who cares.

We've been doing this a looooooong time.



Prices in Britain rose to adjust to the debasement of the coinage.



The British Pound was one of the more reliable currencies of Europe 1500-1900.

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Markets and Governments in the History of Money

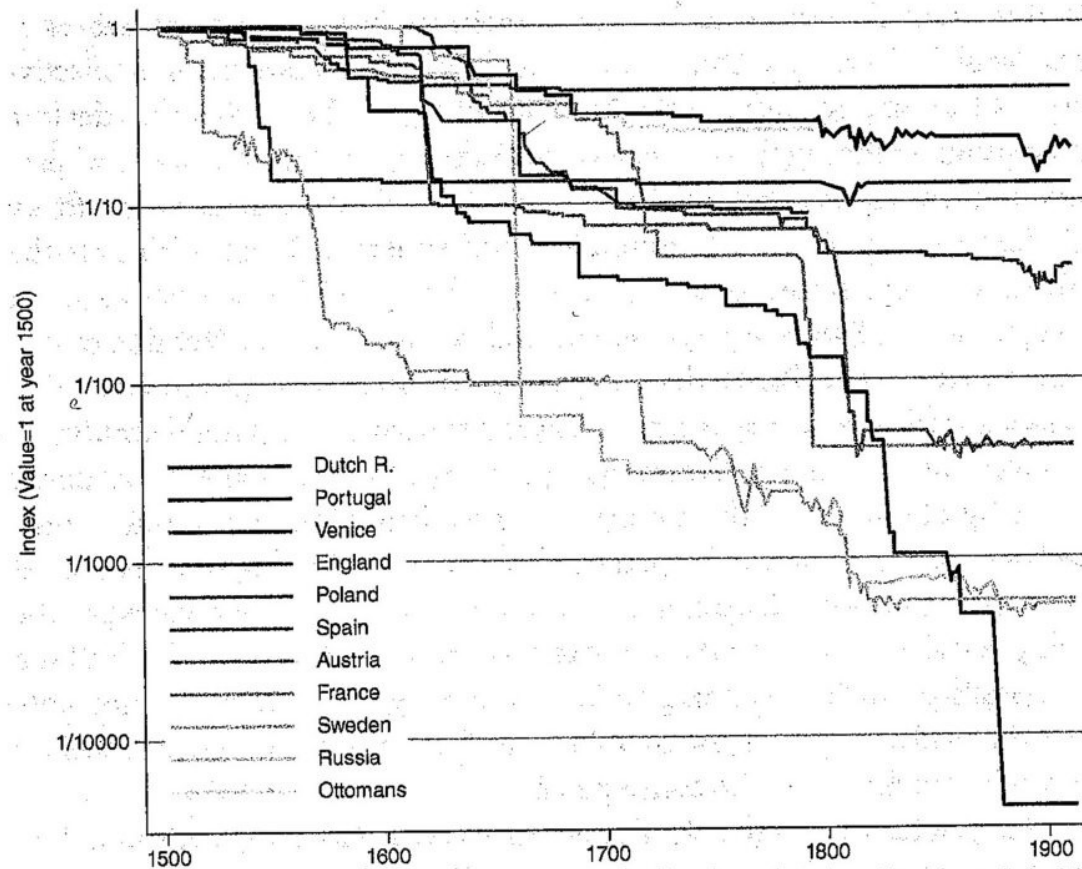
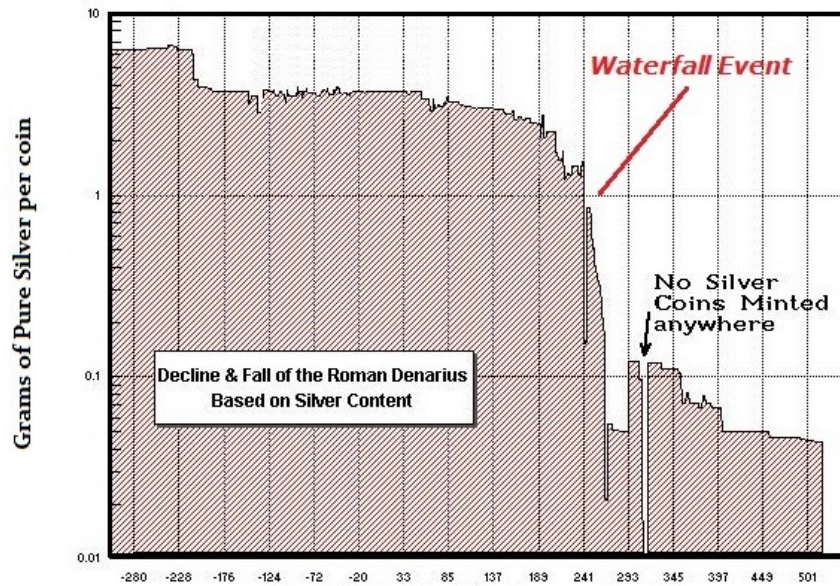


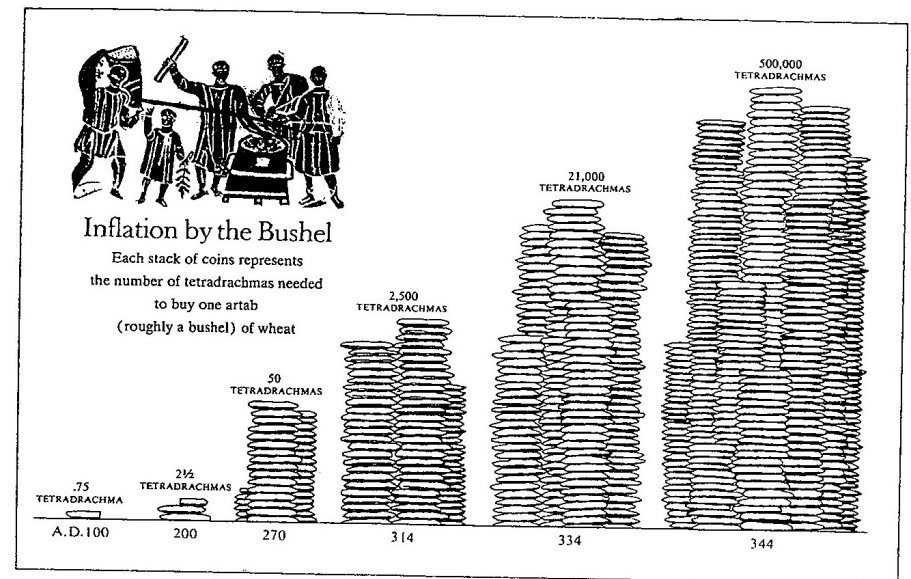
FIGURE I.1 Index of the value of monetary unit, 1500-1914 (in silver/gold). Source: Karaman et al. (2018).

The Roman Empire collapsed in part due to chronic currency debasement.

Collapse of the Roman Silver Monetary System Silver Denarius Basis - 280 BC - 518 AD



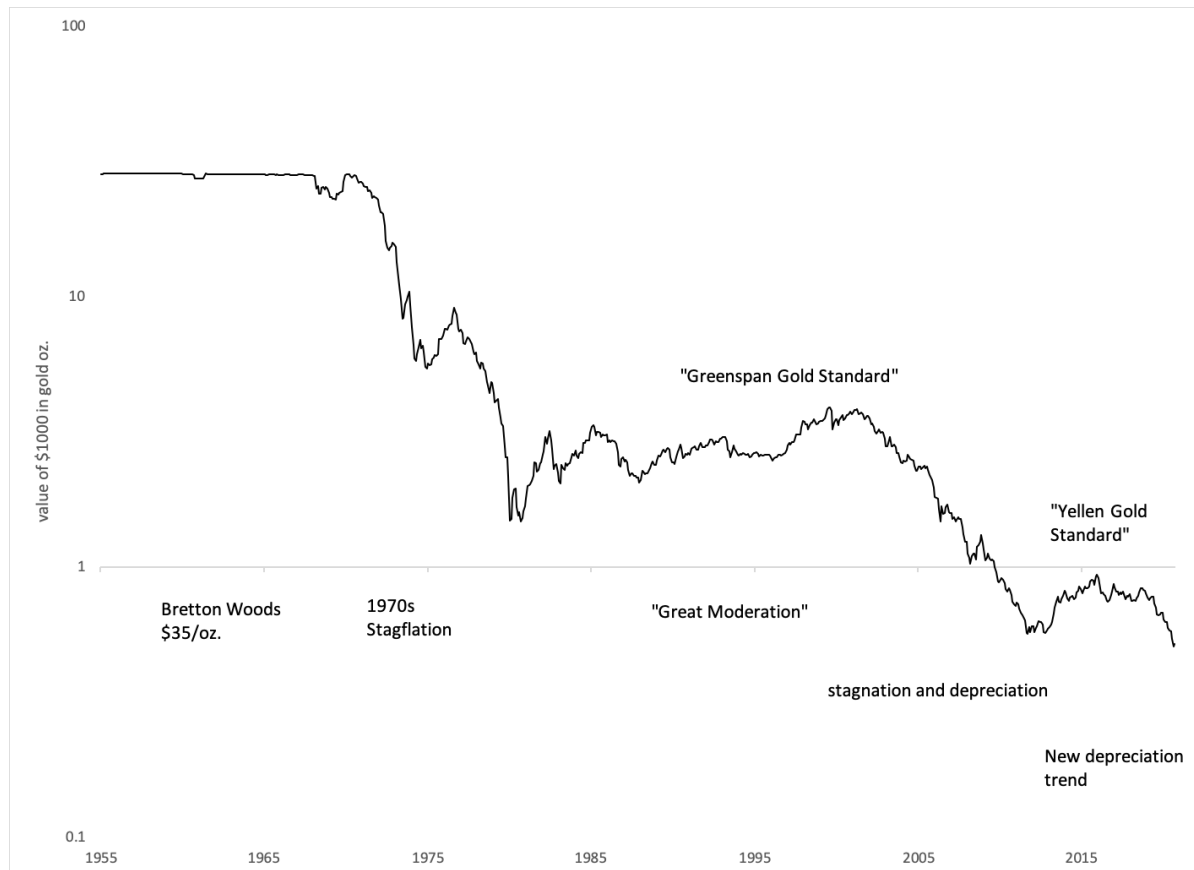
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Inflation by the Bushel.

The 1970s: Value, not Quantity (Classical not Monetarist)

The inflation of the 1970s is easy to understand as a decline in currency value of about 10:1. (\$35/oz. of gold to \$350/oz.)



Inflation is a persistent fall in the value of a monetary standard ...

Contemporary understanding of the inflation issue is hardly better than it was several centuries ago, despite the sophistication of very large economic models involving great mathematical and statistical sophistication but very primitive economic understanding.

Robert Mundell, 1975

In the 1970s, the Monetarists Were Wrong All Day Long.

Monetary quantity statistics (M2, base money) don't show much. You can't understand conditions, or make policy, based on them alone.

Annualized growth rate of M2:

1960s: 7.0%

1970s: 9.6%

1980s: 7.9%

1990s: 2.5%

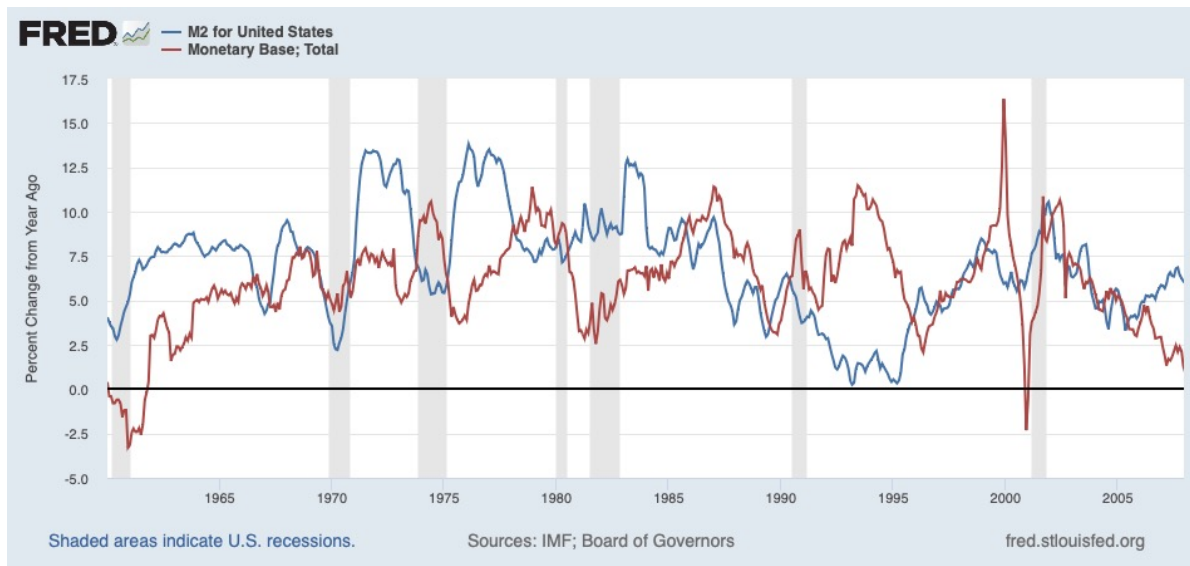
Annualized growth rate of MB:

1960s: 4.1%

1970s: 7.4%

1980s: 6.5%

1990s: 7.6%

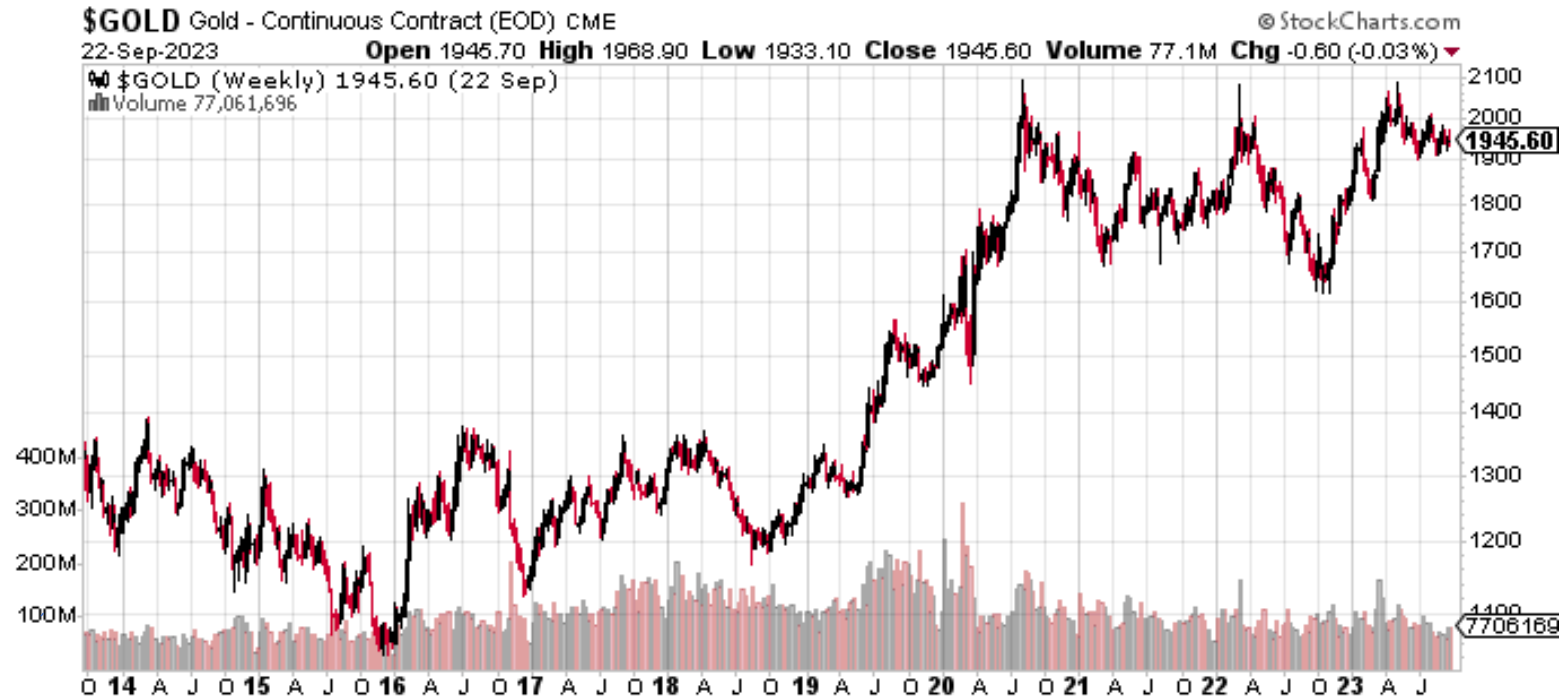


The Monetary Base is the only quantity the Federal Reserve actually controls.

Where's the "inflation" of the 1970s?

(Very little "money printing" took place during the 1970s.)

The USD recently took another step lower in value (vs. gold).



It takes about 50% more dollars to buy an ounce of gold. (\$1200/oz. to \$1800/oz.)

If gold is stable in value, this suggests that, over time, it will eventually take about 50% more dollars to buy everything else too (“all things being equal”).

Since 1900 ...

- The U.S. dollar's value vs. gold declined by 90:1.
- The British pound's value vs. gold declined by 324:1.
- The Italian lira's value vs. gold declined by 28,000:1.
- Russia had hyperinflation in 1917-1921, and 1990-1995.
- China had hyperinflation in 1910-1912 and 1945-1950.
- Germany had hyperinflation in 1919-1923 and 1945-1949.
- Japan had hyperinflation in 1945-1949.
- All of Latin America had hyperinflation in the 1980s.
- All of Eastern Europe had hyperinflation in the 1920s and 1990s.
- It happens all the time.

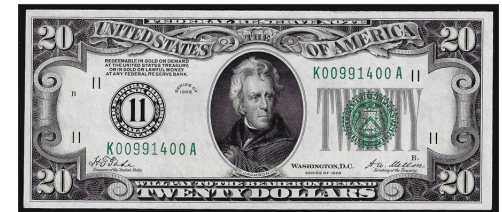
1928



1x

U.S. \$20 Saint-Gaudens coin from 1928, containing 0.97 troy oz. of gold.

=



1x

U.S. \$20 Federal Reserve Note from 1928.

2022



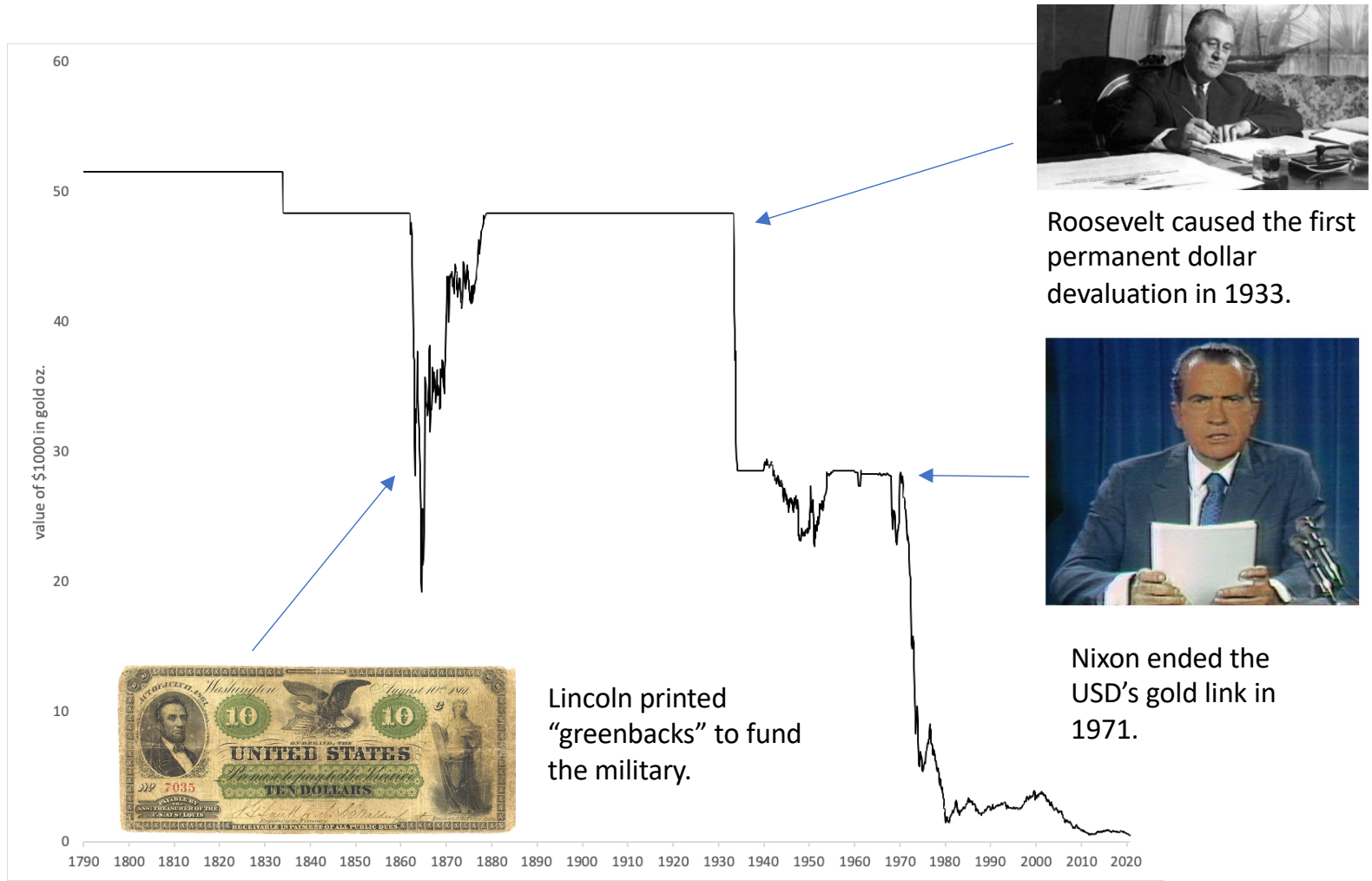
1x

=



90x

These events defined the macro conditions of the time.



Roosevelt caused the first permanent dollar devaluation in 1933.



Nixon ended the USD's gold link in 1971.

Value of \$1000 in gold oz, 1790-2020

How do you fix “inflation”?

Keynesians:

We need less “aggregate demand” so:
Higher taxes, higher interest rates;
Less government spending, lower wages.

= **“fiscal austerity” = recession**

Monetarists:

Contraction of “money supply” by central bank until aggregate spending
(=nominal GDP) hits target.

= **“monetary austerity” = recession**

Classicals:

Stabilize the value of the currency. At least, don’t let it drop any further.
(Maybe, allow it to rise somewhat.)

Lower taxes, reduce impediments to business and production (housing, supply
chain, etc.)

= **stable money + good policy = economic boom**



“Reaganomics”:

Lowered top income tax rate from
70% to 28%.

Volcker and Greenspan stabilized
USD vs. gold and commodities.

Everyone said it wouldn’t work.

It worked!

Stabilizing currency value fixes “monetary inflation.”

You can stabilize currency value in a crude, ad-hoc fashion as Volcker and Greenspan did (and as Powell has done since mid-2020).

Or, you can formalize and institutionalize the process by explicitly linking your currency to some external benchmark.

In the past, this was gold.

Today, over 100 countries link their currencies to the USD, EUR or something else. (The IMF bans gold standard currencies today.)

Even hyperinflations have been fixed instantly when currencies are stabilized:

1923: German mark stabilized vs. gold.

1949: Japanese yen stabilized vs. gold and USD.

1991: Argentine peso stabilized vs. USD

1997: Bulgarian lev stabilized vs. German mark/euro.



Emperor Constantine ended hyperinflation in Eastern Rome by establishing the gold solidus coin in 312. It was unchanged for seven centuries.



Napoleon ended hyperinflation in France in 1801 by linking the franc to gold. It was unchanged until 1914.

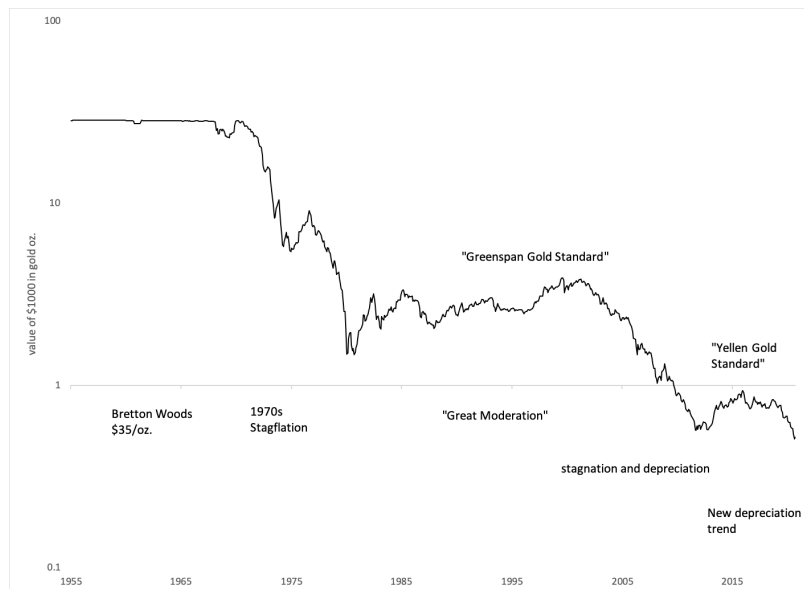


Mao Tse-tung ended hyperinflation in China in 1949 by linking the yuan to gold.



Elizabeth I replaced Henry VIII’s junk coinage in 1560. The British pound was unchanged until 1931.

The “PhD Standard” → chronic long-term currency decline.

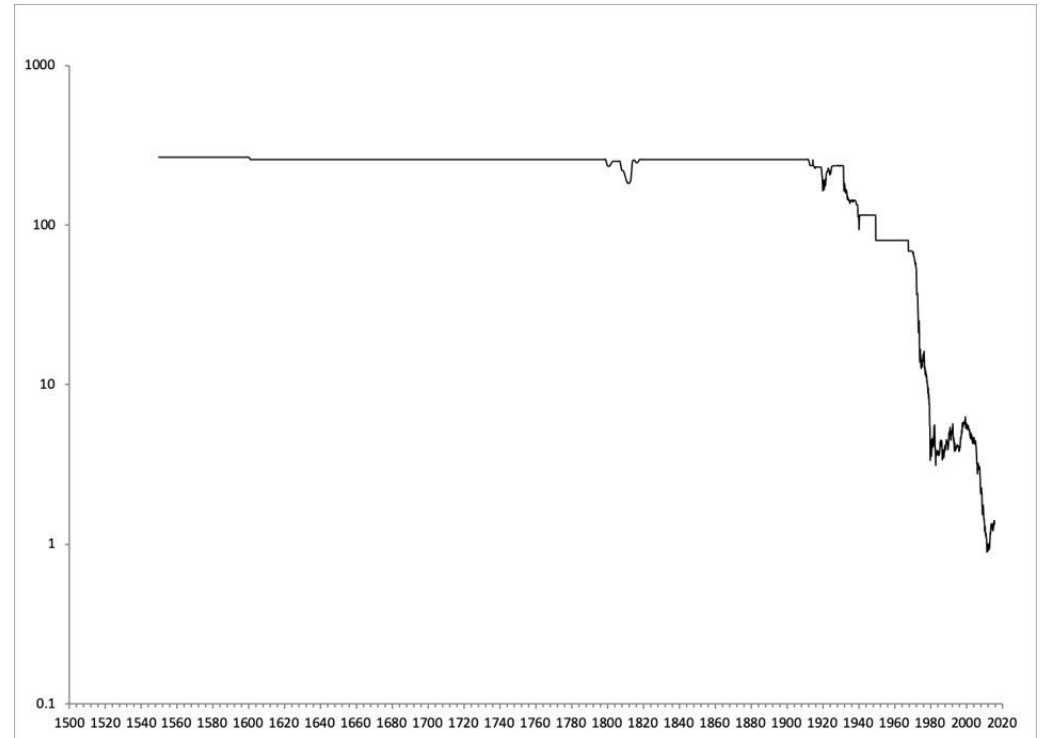
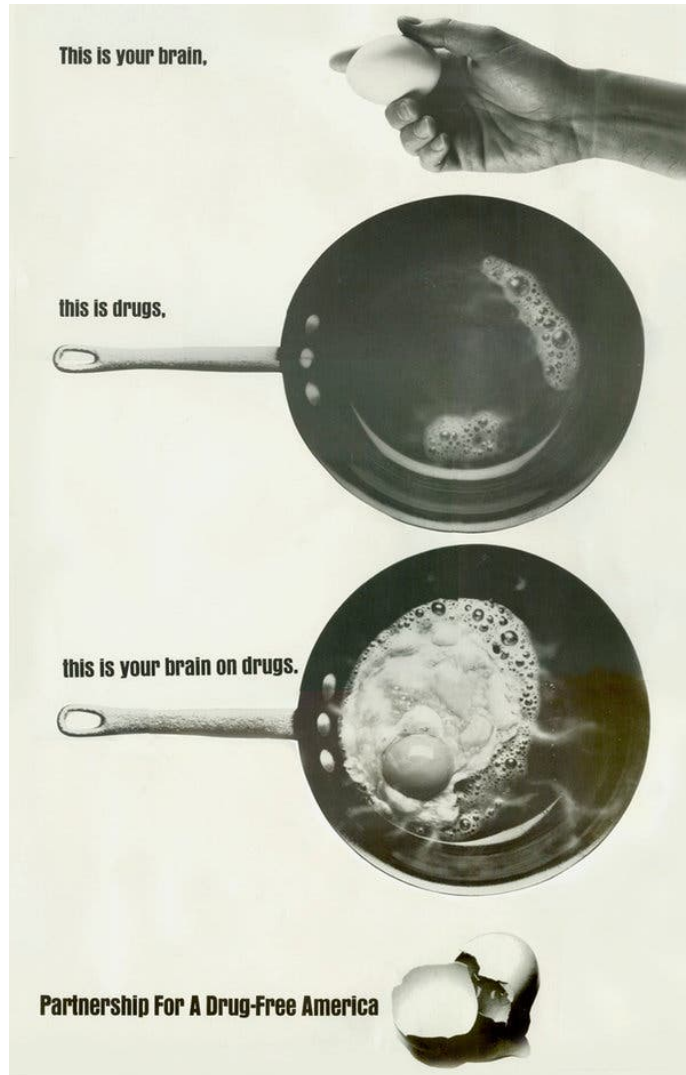


The USD today is worth about 1/50th of its value in the 1960s vs. gold. (\$1800/oz. vs. \$35/oz.)

During these five decades, every central banker was against “inflation” and currency depreciation.

It just happens anyway.

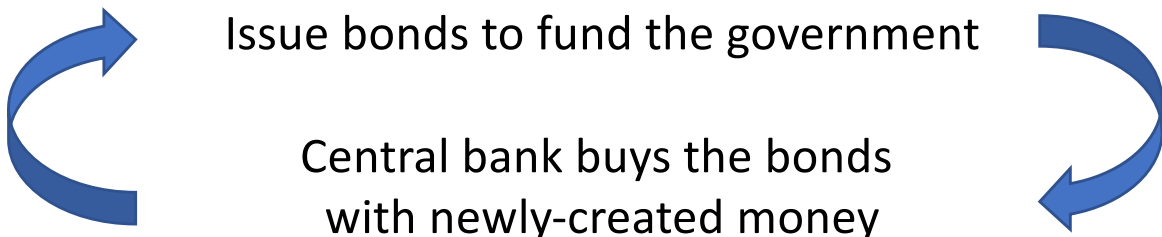
Ideas have consequences.



**This is your currency on
Keynesian/Monetarist manipulation.
(="PhD Standard")**

Value of 1000 British pounds in gold oz., 1560-2016. Log scale.

Government printing-press finance → hyperinflation “fiscal dominance”



Confetti currency



Yugoslavia, 1993



Israel, 1983



China, 1949



Russia, 1995



Venezuela, 2021



Iran, 2018

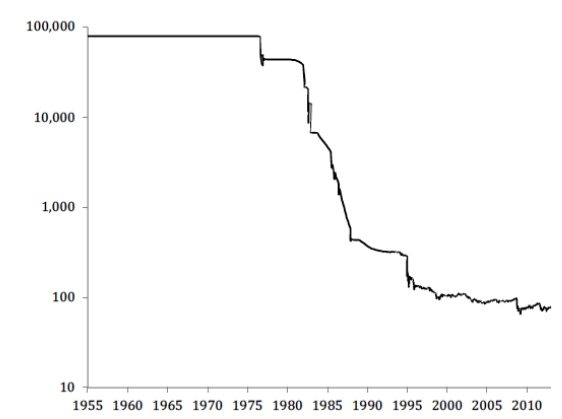


Figure 16.2: Mexico: Value of 1000 Pesos (1 Million pre-1993 Pesos) in U.S. Dollars, 1955-2012
logarithmic scale

Mexico in the 1980s

People knew exactly what a gold standard system was for.

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

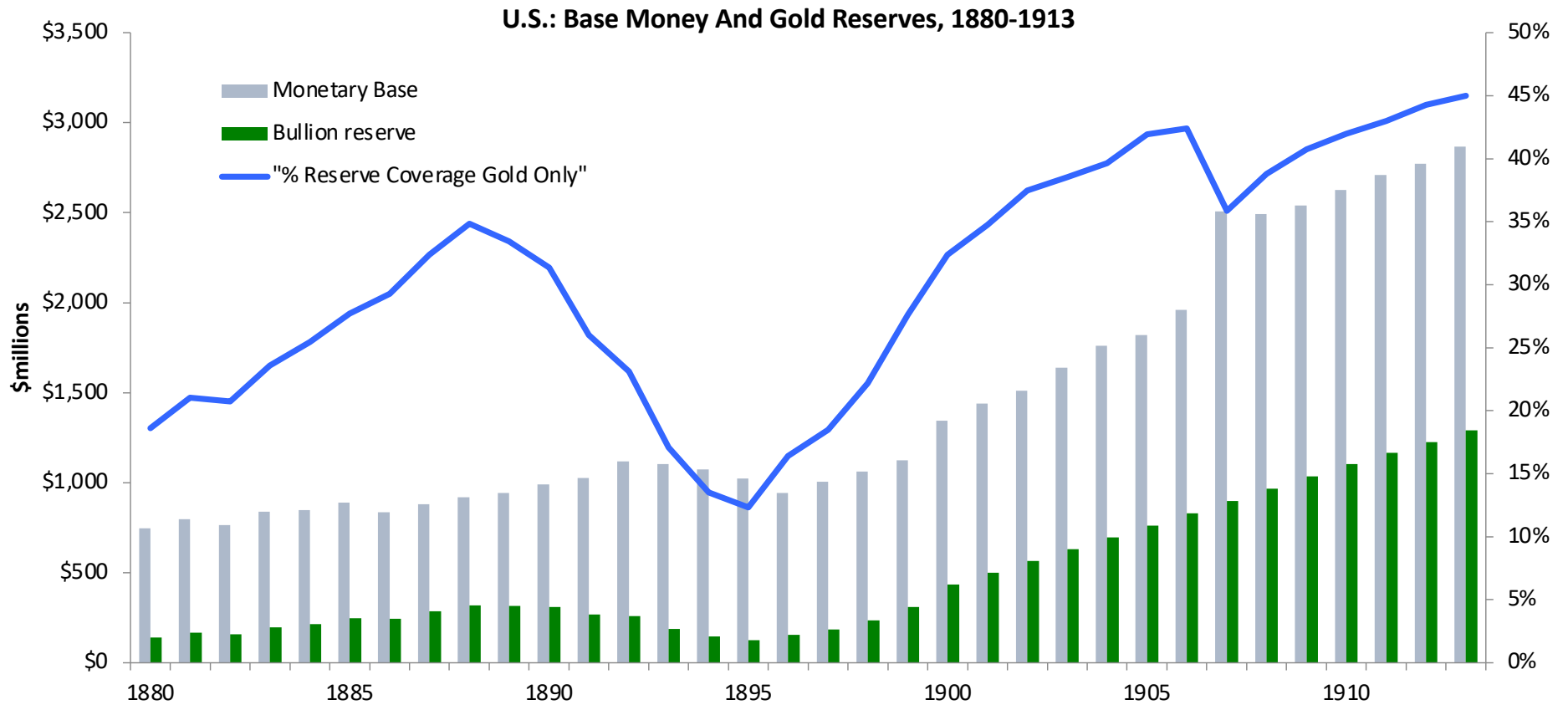
David Ricardo, “Proposals for a Sound and Economical Currency,” 1816



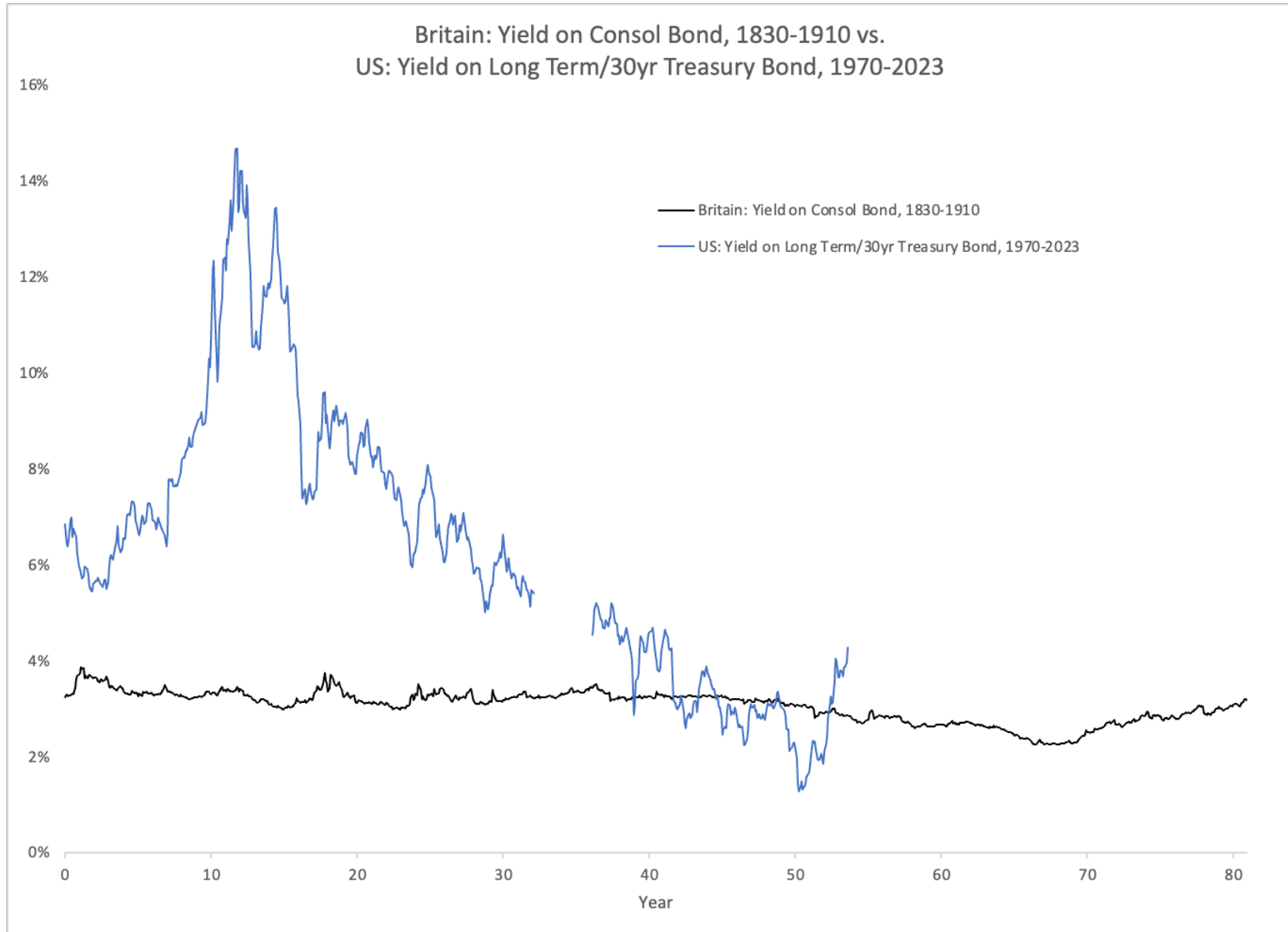
Ricardo played a key role in returning Britain to a gold standard system in 1821. At the time he wrote this, the British pound had been a floating currency for 19 years, and many people thought it should stay that way – so they could manage interest rates (no kidding!)

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!



This is how Capitalism is supposed to look:



Thank you

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