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The Golden Truth

Gold still represents the ultimate form of payment in the world. Fiat money in extremis is accepted by nobody. Gold is always accepted.

Alan Greenspan, May 20, 1999

The first panacea for a mismanaged nation is inflation of the currency; the second is war. Both bring a temporary prosperity; both bring a permanent ruin. But both are the refuge of political and economic opportunists.

Ernest Hemingway

Ever wondered how money came to be? How we progressed from a barter system to a modern financial system utilising electronic credits in exchange for goods and services? And did you know that up until 1971 all money was based partially off the value of an ounce of gold?

Before coinage and paper ('fiat') money there was barter. This system of direct exchange had limitations. For a start for somebody to buy something he wanted he had to find somebody who wanted precisely what he had available for exchange. A second issue was one of divisibility or indivisibility. How could a seller divide larger goods into lesser units in exchange for other smaller goods? For instance how could a person sell his house in return for horses, cars or even a fridge? They could not divide the house up into units; clearly this is not practical. Society needed a means of indirect exchange whereby a good is used not merely for its own sake, but whereby it is used by everyone for exchange for all other goods. In other words every commodity or good is priced only in terms of one commodity.

If one good is more marketable than another—if everyone is confident that it will be more readily sold—then it will come into greater demand because it will be used as a *medium of exchange*. It will be the medium through which one person can exchange his product for the goods of others. When a commodity is used as a medium for most or all exchanges, that commodity is defined as being *MONEY*.

Society did not pick the medium of exchange out of thin air. Individuals chose a commodity heavy in demand, highly divisible, and as it had to be easily portable, it had to have a high value per unit weight. To have such a property, requires a good which is not only in great demand but also relatively scarce; as such a combination would yield a high price, or high value per unit weight. Importantly the 'money commodity' should be highly durable, so as to maintain itself as a store of value for a long time.

In all countries and all civilisations from the Ancient Romans to the 20th century, two commodities fit these prerequisites of money, namely gold and silver. They have been dominant as money all this time. Originally, gold and silver were highly prized for their lustre and ornamental value. They have always been in great demand, they have always been relatively scarce, and hence had a valuable per unit of weight, which made them portable. Lastly their durability and divisibility made them long term stores of value. In recent times, silver, being relatively more abundant than gold, has been found more useful for smaller exchanges, while gold is more useful for larger transactions. This also explains why gold has commanded a higher price, but as both have been used as a commodity medium for all exchanges, they have both served as a unit of account for present, and expected future prices. In reality the free market or free society (i.e. you and me) has found gold and silver to be the most efficient monies. So proponents of a return to a gold standard are not delusional 'gold bugs,' they simply recognise that gold and silver has always been selected by the market as sound money throughout history.

The emergence of 'commodity money' was a great boon to the human race. Without 'money' – without a general medium of exchange – there could be no real specialization, no advancement of the economy above a bare and primitive level of existence. Money has helped an elaborate structure of production develop, with land, labour and capital goods interacting to advance the production of goods and services, whilst receiving payment in money.

The world could not operate without a widely accepted medium of exchange; yet this existence of a common and widely accepted medium of exchange rests on a single convention – faith. Our whole monetary and thus financial system rests solely on the mutual acceptance or faith of this medium, as payment or exchange for goods and services. This faith is no fragile concept. Even under the greatest provocation of the medium's validity, the value of having a common money is so great that individual's will stick to this faith.

Under a free market, that of a gold money system, this faith would not waiver. Gold is homogenous. An ounce of pure gold is exactly that an ounce of pure gold, equal the world over. In a free market, gold and silver would be exchanged directly as 'grams' or 'ounces'. The price of money, then, is just the effectiveness of a monetary unit (or unit of weight). It is its purchasing power. But what determines the price of money?

'Supply and demand' - the same forces that determines all prices on the market. If the supply of a good increases, the price will fall and vice versa. Likewise if the supply of money rises, it will tend to lower its 'price'; an increase in the demand for money will raise it.

Let us put this another way. If people value cash (or their cash balances) more highly, the demand for money increases, and prices fall. The same total sum of cash now confers a higher 'real' balance, i.e. it is higher in proportion to the prices of goods – to the work that money has to perform. In short, the effective cash balances of the public have increased. Conversely, a fall in the demand for cash will cause increased spending and higher prices. The public's desire for lower effective cash balances will be satisfied by the necessity for given total cash to perform more work. If asked, most people will say I want more money, as much as they can get. However what they really want, are more effective units of money (higher purchasing power). They want a greater command of goods and services for same amount of money.

So it goes to show if you increase the supply of money, you dilute its purchasing power. Whilst we see that any increase in supply of any good or money lowers it price, the increase offers no social value whatsoever. Initially we may feel rich as we have 'more money', but as we rush out and spend our surplus money, prices will rise. The last person to spend will be worse off. Just like a counterfeiter, whether it is the government or an individual introducing more money into the economy, the first to benefit are the counterfeiters, (whilst prices are still low.) Yes, if the government increases the money supply, they will benefit first. If one understands this truism one can begin to comprehend to what extent money is not money today. Under a gold backed currency supply cannot be increased, with which to 'confiscate' goods and assets. It is for this reason that government has sought to control money and the supply of it.

The most important thing about money is to maintain its stability…You have to chose 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, 1928

If the American people ever allow private banks to control the issue of their currency, first by inflation, then by deflation, the banks and corporations that grow up around them will deprive the people of their property until their children will wake up homeless on the continent their fathers conquered.

President Thomas Jefferson

The stark reality is that the free market money, gold and silver, has throughout history been usurped by government decree. The emergence of money not only spawned a boon in prosperity and higher living standards but it also opened a subtle route for the government expropriation of resources under the guise of 'nation building'. Such expropriation or seizure was and is called 'taxation'. However taxation is often very unpopular. To obtain such taxation, fiat ('by order') money or pieces of paper were issued and would be accepted as payment of taxes. In fact it was decreed by legal tender laws that fiat currency must be used/accepted for all payments of debt, public or private. So in essence all government debt is money and the faith in money (if it is not gold) must rest in the belief that government can receive enough future tax revenue to repay all its debts.

Excessive taxation we know is unpopular so governments will engender a more subtle kind. To 'balance the books' under a fiat money system the temptation is too great not to issue more money. Government merely puts ink to more pieces of paper or today just increases electronic money at the banks. They may even in extremis take their own or foreign government bonds and convert this money they owe (after all a government bond is merely an IOU) into new money. This insidious form of taxation, which reduces the effectiveness of a unit of money, is the true reality of inflation. Inflation is merely a confiscation of your wealth over time, as the purchasing power of your money dwindles.

Nations initially attached the credibility of such paper money to a unit of gold, thereby usurping the faith associated by the people to the solidity of gold or silver as a medium of exchange. For instance the 'price of gold' in 1933 was misleadingly defined as 'fixed at twenty dollars per ounce of gold', likewise the British 'pound sterling' originally signified a pound weight of silver, but was now considered exchangeable for 5 dollars (actually $4.87) instead of ¼ of an ounce of gold. These sovereign labels had now been assigned to the value of money, rather than the free market value of a unit weight of gold. Once such a label or symbol existed the unit of weight could eventually be replaced as now a dollar or a pound sterling piece of paper could be associated with gold but without actually being backed by a unit weight of it. It was not until 1971 that we fully detached from any form of money backed by gold (all be it a bastardised version – the gold exchange standard formalised under Bretton Woods in 1945.)

On August 15th 1971 the then-President, Richard Nixon signed an executive to abandon the gold (exchange) standard. At that moment in history, the United States decided it would no longer redeem its paper dollars for gold. The world accepted the most 'stable' currency, the U.S. dollar, to take the place of gold. The world has been on a dollar standard ever since. Since that time, the American dollar has lost almost 70 percent of its purchasing power and is losing more every day. It is remarkable that a fiat currency which in the case of the dollar has become the reserve currency off the world should last for so long. This can be attributed possibly to the 'might' of the US military dominance in the world. The US had the financial clout to police world politics both implicitly and explicitly. Never have we gone such a long period in modern history with one nation controlling the reserve currency for so long un-backed by the constraints of gold, which unlike fiat paper cannot be printed.

The natural tendencies of government under a fiat system, particularly, the US government, is to expand credit. Money has been made freely available at low rates of interest, which has distorted an already fragile financial mechanism, now co-existing on a fiat system. The proliferation of new financial assets to provide a yield for the pension industry and revenue for bankers has led to excessive inflationary growth, mainly in assets, but also in goods prices. The distortion of consumer price indices by government has helped hide the realities of this inflation. (Remember social security payouts are index linked.) In reality asset inflation benefits those who are most profligate and speculate with their money. Those who save watch the value of their money erode. It is politically expedient for an incumbent government to spend our future generation's productive capabilities; as society wants the good life now and politicians can remain in power by granting people this wish – all be it an illusion. We are all culpable, but at the root cause of all our problems is a government run paper currency system. Man cannot be trusted, for just these reasons alone not to 'print' more money.

A fiat money system controlled by a central economic planning agency (a nation's government and central bank) ultimately distorts the true cost of capital (money) and encourages entrepreneurs to invest in non-productive goods. Too much overconsumption and overinvestment is encouraged which leads to malinvestment or misdirected investment away from the production of 'needed' goods. This is invariably accompanied by over-indebtedness and it is this expansion of credit or availability of 'cheap' debt that leads to the continuous cycle of vicious booms and busts. Inevitably as the liquidation process of a bust arises too few individuals understanding the mechanisms at fault that led to the preceding boom, advocate yet more monetary and fiscal expansion. This only lengthens and deepens the malaise by trying to reflate a by now insolvent (mal)investments.

The fiscal and monetary imprudence of the US has led to bad money driving out good as other nations have systematically devalued their currencies by the same means in order to compete with the production of goods from other nations. Semi- fixed exchange rates under a fiat system have exaggerated the distortion of prices as Asian creditors have funded the largesse of an indebted US and to a lesser extent other nations in the West. Nonetheless expanding fiscal and trade deficits that have grown into trillions (a phrase in of itself symbolising the inflation of recent years) are but a symptom of a corrupt fiat paper system. The irredeemable, unlimited supply of paper money is the true root of all evil. Sound money under a gold backed system is not. The developing crisis we are experiencing has exposed the faith individuals have in fiat currencies, as they realise these irredeemable electronic credits are backed solely by government(s). Governments, that are slowly but surely bankrupt and have resorted worldwide to the temptation of 'printing' money.

Epilogue

It should be noted that there is potentially an endless supply of paper money, but that there is a finite supply of commodities. However gold supply is a misnomer as it is not destroyed or consumed. It lasts forever and does not degrade. Almost all the 160,000 tonnes of gold mined (almost the size of a tennis court cubed) exists in some form, jewellery, bullion, coins, ancient Egyptian artefacts or scrap. At $900 an ounce this cube is worth some $4.5 trillion, a mere 3% of the $150 trillion pool of available financial assets. Half of this cube is comprised of national and artistic treasures, religious artefacts, heirlooms and treasured possessions that will never see come back into the 'market' - i.e. the area of exchange – so gold only comprises a derisory 1.5% of the pool of financial assets. The market capitalisation of gold producers is also a paltry $200 billion and they can only produce gold annually at close to 2.5% of the existing world supply. This falls far short of the increases of money supply that run into double digits for most leading countries.

Government has by and large managed to nullify the impact of gold's fiduciary value in the mindset of society (mostly the 'developed' world.). But now that individuals begin to obsess about the validity of the current capitalist structure, the weight of trillions upon trillions of printed money will eventually overwhelm a small and ultimately finite supply of gold and silver. Government will not want to relinquish control of money, however the free market is once again dictating that gold is money. This will ultimately overwhelm any governmental suppression. Since 1971 gold has returned 12% annualised and throughout that time government has had the will and gold with which to hold back its ascent to fair value. Now western central banks are running low of gold whilst others wish to increase their holdings against the potential devaluation of their dollar currency reserves. Remember there are many governments in the world today who will ultimately pursue their own interests. It's the nature of the beast – man is his own enemy. If they do not buy gold the man in the street will begin to. *Gold is a UNIVERSAL currency. Gold is MONEY*. It is undervalued, under-owned and mis(understood). It is not only advisable to own gold, it is a must.

An almost hysterical antagonism toward the gold standard is one issue which unites statists of all persuasions. They seem to sense – perhaps more clearly and subtly than many consistent defenders of laissez-faire – that gold and economic freedom are inseparable, that the gold standard is an instrument of laissez-faire and that each implies and requires the other… This is the shabby secret of the welfare statists' tirades against gold. Deficit spending is simply a scheme for the confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights.

Gold and Economic Freedom, Alan Greenspan, 1967

Gold stands for liberty, prosperity and peace.

The classical or orthodox gold standard alone is a truly effective check on the power of the government to inflate the currency. Without such a check all other constitutional safeguards can be rendered vain.

The Theory of Money & Credit, Ludwig Von Mises

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