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# Gold

## When money loses its glitter

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*The Wizard of Oz*: Ray Bolger, Jack Haley, Judy Garland and Bert Lahr in the 1939 film directed by Victor Fleming.

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# Follow the yellow brick road

BY RICHARD GRECO

Gold is not only experiencing a bull market, it is making a comeback in the minds of economists and legislators who have come to question the goodwill of governments that back currencies with nothing but the wizardry of goodwill.

*“Paper is poverty... it is only the ghost of money, and not money itself.” – Thomas Jefferson in a letter to Edward Carrington, 1788*

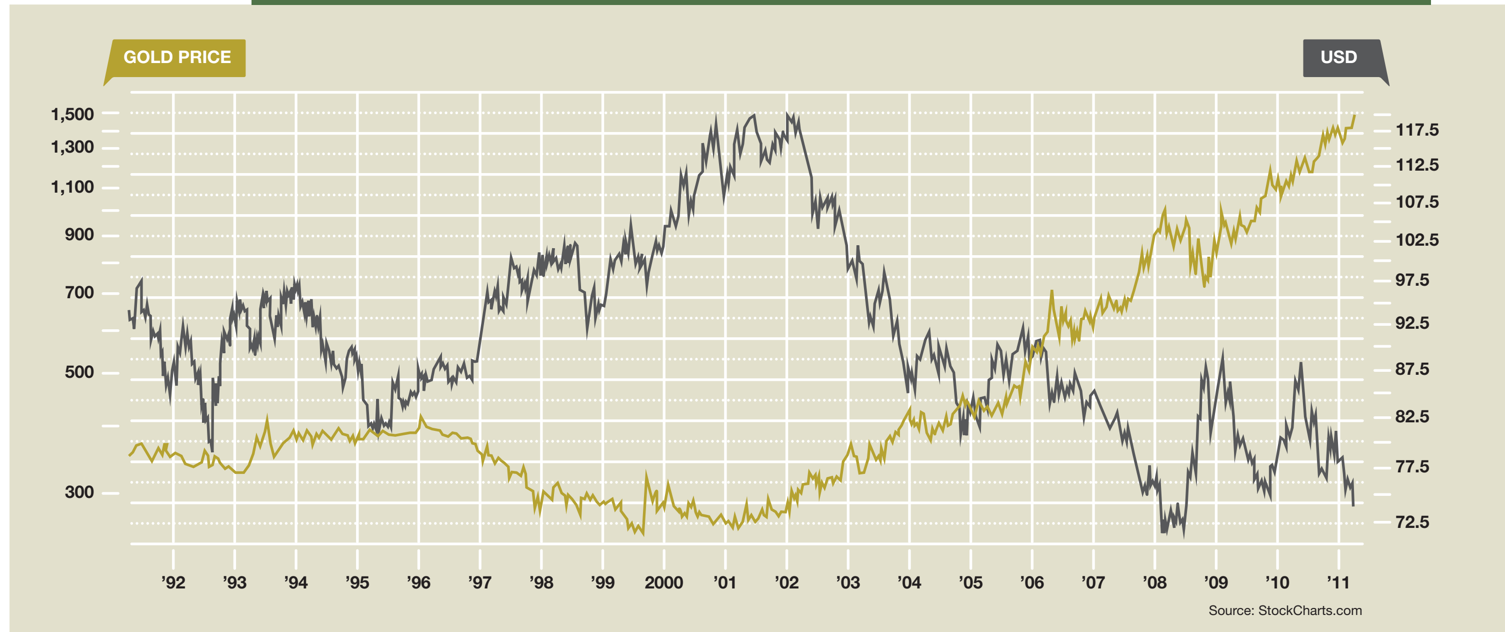
On March 25, 2011 Utah Governor Gary Herbert signed into law the Legal Tender Act, making gold and silver coins legal tender in that state for the first time in more than 100 years. Article I, Section 10, Clause 1 of the United States Constitution grants this power to the states: “No State shall . . . make any Thing but gold and silver Coin a Tender in Payment of Debt.” The practical effect of the legislation is to exempt transactions of gold and silver from capital gains taxes, since only investments – and not money itself – can be taxed. But symbolically, the legislation sends a loud and clear message to Washington: Restore fiscal responsibility and stop eroding the value of the dollar, or else the people will take monetary policy into their own hands. In the one year since Governor Herbert signed the law, no fewer than ten other states have introduced similar legislation, including Minnesota, North Carolina, and Idaho.

Six months later, on September 26, 2011, Utah hosted the first annual Utah Monetary Summit. The delegates of the Summit, which included Europeans and Asians as well as Americans, produced the Utah Monetary Declaration, affirming inter alia that: 1) all people necessarily enjoy the inherent and unalienable right to lawfully and honorably acquire, use, hold and exchange whatever form or forms of money they may prefer, including especially gold and silver coin; 2) all free and sovereign states bear the moral, political, and legal obligation to maintain reliably stable currencies; and 3) no government should erect barriers to the unfettered circulation of monies issued under the authority of its sovereign trading partners. In the preamble to the declaration, they wrote that history attests that monopolistic monetary systems (i.e., fiat currency systems managed by central banks) tend toward manipulation of the supply, composition, and nature of money, resulting in lost purchasing power, inequitable wealth redistributions, misallocation of resources, and unemployment, thus potentially destroying life, liberty, property, and happiness. The delegates further affirmed that only gold could save us from such destruction.

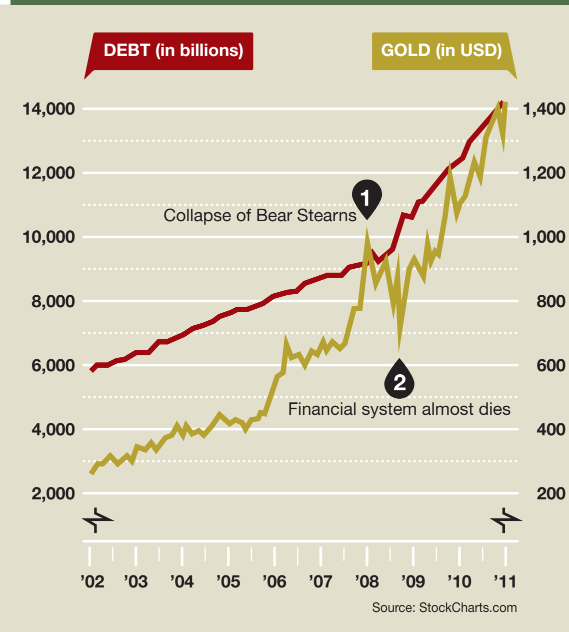
If the Utah Monetary Declaration were written in pre-crisis 2007, one might think its authors to be a bit alarmist, if not extremist. One might even be able to ignore it. But it was written in the midst of the worst economic downturn since the Great Depression, when the credit ratings of the US and many European nations were cut for the first time in history; the euro was on the verge of collapse; violent riots were occurring in Athens and Rome; unemployment in the US was nearly 10%; the US dollar had lost 98% of its purchasing power since the establishment of the Federal Reserve Bank in 1913; bloated social welfare budgets necessary to fund runaway healthcare and social security benefits were reaching crisis levels; and commodity prices were rapidly rising – especially gold, which was trading at $1630 an ounce – and predicted a vengeful return of inflation. In a very real sense, government was failing the average citizen, not just in America but worldwide.

The themes of the Utah Monetary Declaration may appear to be populist ideology; indeed, they have been expressed for years by perennial presidential candidate Ron Paul, who is often described as a populist. But recently, mainstream Republican presidential candidates Newt Gingrich, Rick Santorum, and even Mitt

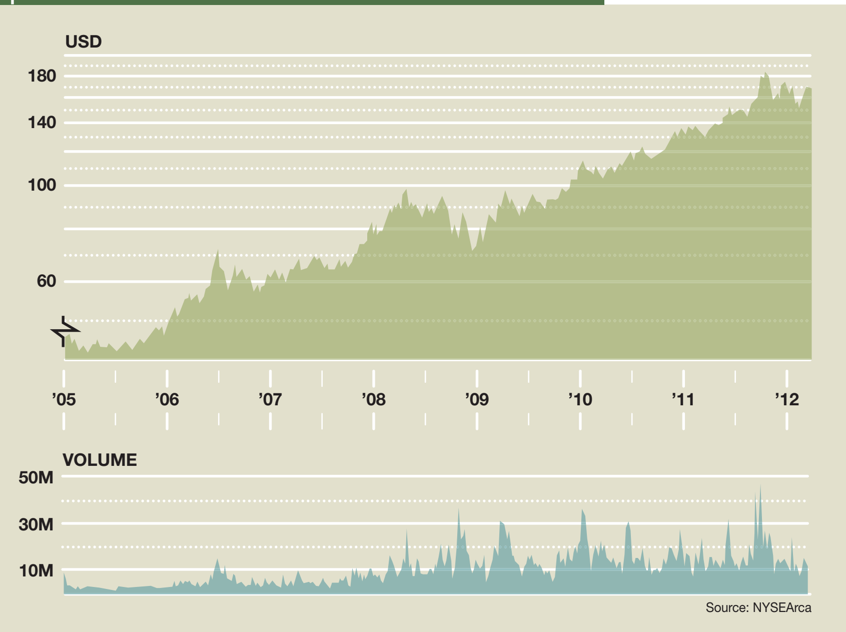
**GOLD VS US DOLLAR**




**US DEBT VS GOLD**




**SPDR GOLD TRUST**




Romney have publicly stated that, if elected president, each would consider innovative ideas for stabilizing the national currency, including the creation of a Gold Commission to study the role of gold in the modern monetary system. These politicians are in the comfortable company of respected economists and commentators such as Lewis Lehrman, Lawrence Kudlow, and Malcolm Stevenson Forbes, who all agree that paper currencies must be backed by more than governmental goodwill, since in an era of historically high government debt, negative real interest rates, structural imbalances and budget deficits, and the genuine threat of default, there is no more government goodwill. These economists argue that a return to something real, like the gold standard, is necessary to ensure the fiscal responsibility necessary to restore credibility and stability to paper currency.

These "young gold-bugs" are supported philosophically by distinguished older economists of the Austrian school, such as Frederick Hayek, Ludwig von Mises, Jacques Rueff, and a younger Alan Greenspan, who all held the view that money can only logically originate in a non-monetary commodity like gold. According to the Austrian School no one can print dollars on the purely free market because *there are, in fact, no dollars*; there are only commodities, such as wheat, automobiles, and gold. Only money begotten of gold is permanent and real because any other money could be inflated away. In 1966 Alan Greenspan famously wrote, "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. If one grasps this, one has no difficulty in understanding the statist's antagonism toward the gold standard." Even the anti-Austrian John Maynard Keynes was forced to agree that fiat monetary systems can have negative consequences when guided by the wrong hands: "By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens."

All economists, no matter their school of thought, agree that what backs a currency is a three-fold confidence 1) in a government's ability to pay its debt; 2) in its government system; and 3) in its economy. They also agree that the ability to both print and regulate paper money bestows on government an awesome power that can be abused since government can raise money to pay its debt, fund its government system, and support its economy by simply printing it. A Swiss economist, Peter Bernholz, has written, "A study of about 30 currencies shows that there has not been a single case of a currency freely manipulated by its government or central bank since 1700 that enjoyed price stability for at least 30 years running."

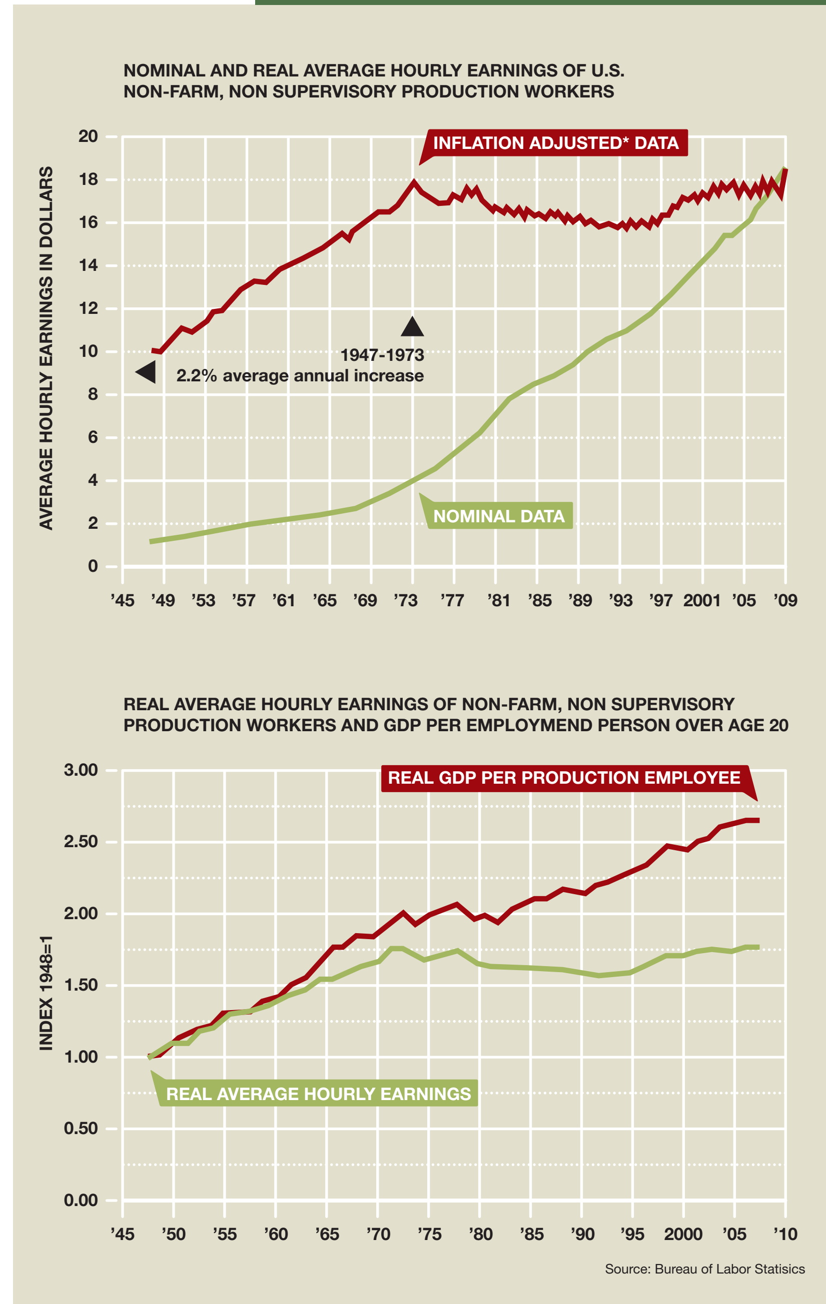
One may argue that such power is supposed to be checked by central bankers, who – in principle – are independent from political influence and will wisely guide monetary policy, money supply, and interest rates and keep stability and confidence in the financial system. In the words of an older Alan Greenspan, 35 years after he commented that only gold stands in the way of deficit spending and confiscation of wealth, as he testified before Congress, "A central bank properly functioning will endeavor to, in many cases, replicate what a gold standard would itself generate," namely stability, confidence, and self-regulation. Greenspan essentially described an equivalency between the central bank and the gold standard. The only difference is that central bankers are human and fallible, whereas gold is inanimate, self-functioning, and automatic. If the logic of Greenspan is correct, then it follows that a central bank *improperly* functioning would justify, if not necessitate, a replacement by a gold standard.

Have the world's central banks stopped functioning properly? If so, is the answer to return to the gold standard of history? In the absence of other real solutions or the political will to implement them, are we at a point where the people will decide more and more between paper and gold? From the vantage point in 2012 of Salt Lake City, or Athens, or Rome, or Paris it certainly seems so.

Follow the Yellow Brick Road to Oz, or rather Salt Lake City, and on your way stop at the US Bureau of Labor Statistics. There you will find evidence of the following: From 1792 to 1971 Congress defined the dollar as a specific weight unit of gold. Under the gold standard, the purchasing power of the dollar remained steady for the 80 years from 1834 to 1914, except for the Civil War. But in the 40 years of the pure paper dollar, 1971-2011, the purchasing power of the dollar adjusted by the consumer price index has declined 85%. In the same period, median household income has barely risen. Actually, one can argue that median household has *fallen* by 50% in real terms because it now takes the two incomes of working fathers *and* mothers for families to make ends meet. And of course, the phenomenon of two income families has created a whole array of social problems that can hardly be measured or described. More pointedly, hourly wages – which were on a steady 2.2% rise from World War II until 1971, when President Nixon effectively ended the gold standard, suddenly began a 40 year period of stagnancy. Of course, correlation does not mean causation, but the data is compelling.

Advocates for a return to a gold standard are quick to point out gold's intrinsic characteristics: it is rare, durable, pure, fungible, imperishable, indestructible, malleable, portable, transportable, and divisible. Unlike paper money, which has zero marginal cost and can be overproduced, it requires real capital and labor to be produced. In other words, it will not be produced unless it will render a minimum return on investment and therefore has a built-in mechanism to automatically regulate supply. In other words, money supply based on gold will grow only at the rate the gold supply increases, and most studies show that the supply of gold has increased in history roughly according to population growth. High levels of inflation under a gold standard are rare, and are observed only when warfare destroys a large part of the economy or when a new major source of gold becomes available.

Advocates also say that through long periods of history gold has been considered a stable store of value, a stable measure and unit-of-account, a universal-




ly accepted means of payment, and already has a long track record of being free trade money. Gold can provide fixed international exchange rates between those countries that have adopted it, reducing uncertainty in international trade. Imbalances between price levels in different countries would be offset by an automatic balance of payment adjustment mechanism. Gold is a check on government deficit spending as it limits the amount of debt that can be issued. Most importantly, gold prevents government from inflating away the real value of already existing debt through currency devaluation and allows savers the comfort of knowing that their savings will not be devalued or destroyed.

Critics of gold say that gold is anachronistic and outdated and cannot possibly be part of the solution to today's complex monetary problems. They argue firstly that the total supply of gold is limited, and since the money supply will grow only when the supply of gold increases, the economy as a whole will remain limited in size. They also argue that unequal distribution of the world's gold deposits would shift economic advantage and ultimately military advantage to gold-producing countries including China and Russia and could perhaps trigger new "gold wars," to exploit gold-rich emerging nations of Africa and South America. Most importantly, gold takes away any monetary solution to economic downturns, an important tool that has been used successfully to absorb economic shocks. Some historians have actually concluded that the Great Depression was perpetuated because the US was still on a variant of the pure gold standard, while countries who suspended the gold standard during the Depression recovered faster. Going to the very heart of the government credibility question, critics of gold say that nothing can stop a government from abandoning the standard once it goes back on the standard. They point out that there are many instances of the US government temporarily abandoning the gold standard in order to finance deficit spending, wars, and economic crises, including the Civil War, the Great Depression, World War II, and the Vietnam War. In other words, like the unbacked gold dollar, a backed gold dollar is only as good as the government's credibility to stick to it.

Gold will always have its advocates and critics, and each side will make convincing arguments. In this difference of opinion, it is interesting to see what the markets might be saying about gold or a return to the gold standard. The current bull market in gold is generally believed to have begun after the attacks of September 11, 2001, when a new era of uncertainty and global government expenditure, especially on national defense, began. But, one can make a case that it actually began two years earlier on September 26, 1999, when 11 European central banks, representing nearly 50% percent of the world's official gold holdings, and the President of the European Central Bank signed the Central Bank Gold Agreement, which stated very clearly that gold will remain an important element of global monetary reserves. The unanimity and clarity of the message among the most major central banks on the eve of the introduction of Europe's unified paper currency likely began speculation that European leaders had doubts about the long-term stability of the euro even before it was introduced and wanted to ensure that gold remained a supporter of last resort.

Investors may have begun to reason that any move away from fiat currencies in favor of a gold standard would likely benefit gold-related investing products, such as new gold exchange-traded funds (ETFs), exchange-traded notes (ETNs, or gold-backed senior debt notes issued by banks or companies), and other types of closed-end funds (CENs). The first gold ETF, Gold Bullion Securities (GOLD), was launched in March 2003 on the Australian Stock Exchange and attempted to create a global platform to bring the gold market to average investors. Another ETF, State Street's S&P Depository Receipt Gold Shares (SPDR GLD), is now the second-largest ETF in the world by market capitalization and actually has more gold reserves than the Chinese Central Bank. The explosion of gold-related investment products and the corresponding dramatic rise in global trading volumes, may be predicting that central banks around the world will eventually agree to adopt a gold standard, since the central banks will have to increase their stores of gold. This increase in demand would, in turn, likely drive prices higher, benefiting all ETFs and gold-mining companies that are directly linked to physical gold bars and coins. If a gold standard is implemented and central bank demand for gold rises, the equity of companies which are responsible for mining gold will likely increase too, benefiting from rising prices.

Whether or not the current bull market in gold will continue, and whether or not it is predicting a return to the gold standard, puts the debate in the US in striking terms: *Either* the privilege of the dollar's role as the world's primary reserve currency will allow American policy makers and economists to continue rationalizing that its reserve currency is a boon to the economy, instead of a malignancy leading ultimately to national insolvency; *Or* America leaders may finally acknowledge that the dollar's world reserve currency role is an insupportable burden instead of a privilege because decades of supplying dollar reserves to the world in the form of dollar debt has caused a rising and unsustainable burden of foreign and domestic debt. This process enabled America to finance ever-increasing budget and balance-of-payment deficits without institutional limits. But, these deficits have also axiomatically triggered market arbitrage mechanisms which will cause inflation both at home and abroad. Lehrman observes that this appears to be the very same pattern of gradual decline that the British imperial pound experience for three decades after Word War II, until it collapsed, finally making clear to the world the general collapse of British power. Perhaps the people of Utah and the gold markets sense that this is coming to America. Often, the people are wiser than their governments.

SARINA FINKELSTEIN / REUTERS

**A chalkboard quotes the price of gold on November 20, 2009 at $1,145/oz., as compared with the 1852 price of $12-16/oz.**

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