



JE KINDLE-NOTITIES VOOR:

## Economics of a Pure Gold Standard

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### 16 Highlights

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Highlight (Geel) | Locatie 101

Gold has three unique features: First, gold provides a stable numeraire for the world's monetary system, one that closely matches the "monetarist rule." Second, gold has had an amazing capacity to maintain its purchasing power throughout history, what the late Roy Jastram called "The Golden Constant." And, third, the yellow metal has a curious ability to predict future inflation.

Highlight (Geel) | Locatie 105

Historical data confirm that the aggregate gold stockpile held by individuals and central banks always increases and never declines. Moreover, the annual increase in the world gold stock typically varies between 1.5 and 3 percent, and seldom exceeds 3 percent. In short, the gradual increase in the stock of gold closely resembles the "monetary rule" cherished by Milton Friedman and the monetarists, where the money stock rises at a steady rate.

Highlight (Geel) | Locatie 109

Compare the stability of the gold supply with the annual changes in the paper money supply held by central banks. The global money-supply index rose as much as 17 percent in the early 1970s, fell to 3 percent in the 1990s and early 2000s, rose to 6–7% during the late 2000s, then skyrocketed after the financial crisis of 2008. Moreover, the central banks' monetary policies were far more volatile than the gold supply. On a worldwide basis, gold proved to be more stable and less inflationary than a fiat money system.

Highlight (Geel) | Locatie 132

Fortunately, Jastram's classic study has been updated through 2007 by the World Gold Council with an introduction by Pierre Lassonde, Chairman of Franco-Nevada. The new editors, led by Jill Leyland, make an important discovery in reviewing nearly fifty years when the gold price has been de-controlled. They confirm that gold is still a "constant," and maintains its purchasing power over the long run. But more importantly, the World Gold Council demonstrates that gold moves in precisely the opposite way of what it used to do. Now the price of gold goes up when inflation goes up, and falls when inflation falls, or deflation hits. Even more importantly, gold is now a superior inflation hedge. It performs better than the underlining rise in the Consumer Price Index. Gold is an inflation beater.

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Highlight (Geel) | Locatie 155

financial assets.” By this, he means that gold often moves the opposite of other markets and industries. I note with interest that gold actually rose when the stock market went through a severe and volatile bear market in 2000-2010.

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Highlight (Geel) | Locatie 202

Fortunately, gold-based supply shocks are not inherently cyclical. The subsequent rise in prices is not necessarily followed by a deflationary collapse, since the monetary stock rises but never declines. Prices are likely to remain at a higher plateau rather than drop precipitously after a gold rush.

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Highlight (Geel) | Locatie 204

A pure gold standard is not likely to support a stable price level, however. In fact, prices are likely to decline gradually over the long run if gold production does not match economic growth. Under the classic gold standard in England and the United States (1821–1914), the wholesale price index tended to be slightly deflationary (see figures 3a and 3b, p.92 and 93). A gently falling price level should not present any difficulties, however, as long as prices remain flexible and free from government control. At the same time, wage rates may not fall in the face of gently declining prices if worker productivity rises. Interest rates, reflecting the relatively stable monetary growth pattern, are likely to remain low, thus providing a favorable climate for economic growth and long-term financing. (Under the classic gold standard, some long-term bonds matured in 100 years!) Significantly, monetarists have recently begun to recognize the natural advantages of a genuine gold standard. Milton Friedman, in particular, has reversed his position that gold mining is an economic burden on society. He now acknowledges the argument, made originally by Professor Roger Garrison (Auburn), that the cost of mining and storing precious metals has not diminished since the world went off the gold standard. In a recent conversation, Friedman suggested that there were no longer any economic arguments against gold as an ideal monetary system, only political deterrents. That’s a dramatic change from a generation ago when virtually all economists, including Ludwig von Mises and Joseph Schumpeter, felt that the gold standard could only be justified on political, not economic, grounds.

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Highlight (Geel) | Locatie 283

However, there are still a great many concerns about free banking, especially with regard to potential system wide bank runs and crises of confidence. With banks able to set reserve ratios as low as 2 percent, the potential for inflation and a subsequent destabilizing boom-bust cycle seems high.<sup>6</sup> Selgin and White deny any problems as long as banks are permitted to adopt nationwide branch banking, contractual suspension clauses, and mutual-fund-based payment accounts, but other free-market economists fear that free banking provides far less confidence than a 100 percent program. But why adopt a monetary system that raises issues of confidence when the nation can embrace a monetary system that guarantees stability?

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Highlight (Geel) | Locatie 473

First, 100 percent supporters have consistently raised the ethical and legal deficiencies of fractional reserve banking, particularly with regard to the customer-banker relationship. Banking authorities, for example, have

failed to come to grips with a problem that persists even to this day, i.e., the popular misconception that funds left on deposit with a bank are legally owned by the bank's customers. In reality, ownership is maintained by the bank, which becomes a debtor, while the customer becomes a creditor. Second, the 100 percent group was the first to recognize the importance of demand deposits over banknotes in forming the largest portion of the stock of money (the British Currency School being a notable exception). They also offered significant theoretical implications on how changes in demand deposits affected loan demand, the money supply, and economic growth and stability (and vice versa). Third, the idealistic hard money proponents have highlighted the harmful effects of excessive credit expansion through fractional reserve banking and inconvertible notes, and how credit expansion created cyclical patterns of boom and bust. Fourth, gold advocates emphasize the central role of the free-market price of gold as a barometer of economic and monetary stability in the world.

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Highlight (Geel) | Locatie 798

banks would be legally excluded from all lending activities. On the contrary, as an entirely separate function, banks would be able to obtain moneys for lending purposes from the following main sources: (1) their own capital, (2) bona fide savings accounts, with varying degrees of maturation, and (3) money earned from maturing loans.<sup>68</sup> On this subject,

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Highlight (Geel) | Locatie 940

One of the most important distinctions of a pure gold standard is that a monetary deflation is virtually impossible. The world supply of gold and hard monetary reserves is always increasing. It is, in fact, inconceivable that a monetary collapse could occur under 100 percent reserves, as happened in 1929–32. During the Great Depression of the 1930s, the money stock fell by one third.<sup>13</sup> Admittedly, this monetary deflation occurred when the United States was on a gold standard, but it was a fractional reserve-based gold standard. Under a pure gold standard, banks would be required to maintain a 100 percent reserve, which would calm the fears the public might have regarding the solvency of banks. Why would panicky depositors want to withdraw their money when the total amount owned is stored safely in the bank's vaults? And even if they did withdraw their funds, the total amount of money would remain unchanged. Under a fractional reserve system, converting deposits to cash can sharply curtail the money supply, but under 100 percent backing, it can have no such effect. Thus, bank runs would have no impact on the supply of money. Moreover, the government could not blunder in reducing the money supply because the monetary stock would consist entirely of gold bullion and coins.

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Highlight (Geel) | Locatie 975

Although this growth rate may not be as constant as the mechanical monetarist rule that Milton Friedman and other monetarists advocate (3–4 percent), it is remarkably stable, and certainly historically more stable than monetary fluctuations under central banks. While there are no precise figures on the total amount of metal held by governments, individuals, and industry, estimates of growth rates in gold supplies can be made based on fairly exact production statistics since the fifteenth century.

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Highlight (Geel) | Locatie 1019

rush is over. In addition to the virtual elimination of monetary deflation and bank failure, some hard money advocates have pointed to the ability of such a system in combating business fluctuations.<sup>25</sup> Both Hayek and

Rothbard have argued that though shifts in the production of specie may cause inflationary or deflationary effects on the overall price level, no business cycle necessarily develops as a result of a pure commodity standard.<sup>26</sup>

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Highlight (Geel) | Locatie 1257

The concept that the universal supply of specie money does not matter is promulgated by many hard money adherents, in addition to Carroll. Mises, for instance, maintains that an increase in the stock of money does not increase general welfare, but only changes the distribution of wealth through price changes: “. . . for it can only benefit a part of the community at the cost of a corresponding loss by the other part.”<sup>67</sup> Rothbard also writes on this subject:

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Highlight (Geel) | Locatie 1763

The issue of wage and price rigidity is usually dismissed or even ignored as a result of legislative bias favoring certain wage-earners and industries. Believers in the 100 percent commodity plan have little concern over the general price level, arguing that individuals in the marketplace are only concerned with specific prices, not with an artificial general price index. There may be times when prices are generally rising or generally falling, but there should be no effort to maintain a level price index. This view, of course, is in sharp contrast with the Chicago School, which envisions a stable consumer price level through manipulations of a fiat money supply.

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Highlight (Geel) | Locatie 1846

Money market funds are a perplexing example in this regard. These funds are essentially liquid money market mutual funds that invest solely in high-yielding paper such as bank certificates of deposit, prime commercial paper, bankers' acceptances, and U.S. government securities such as 90-day and 180-day Treasury bills. Since virtually all of these securities are marketable in the money markets at any time, the investors of these cash management funds are able to withdraw their money at any time by liquidating their shares, often through special checks. Here we have money market funds that appear in many ways as an example of 100 percent reserve banking, since for every dollar of securities purchased and invested, there is a dollar of securities stored for safekeeping. But more importantly, these funds reflect the dilemma facing advocates of the 100 percent reserve program. Here are legitimate time deposits which can be redeemed on demand. Is this another form of evasion of the 100 percent rule, and could it result in the artificial expansion of the money supply beyond reserves? This problem would be even more exacerbating with intermediate bond and municipal bond funds, where assets of the funds are long-term, but redemption is on demand with checking account privileges.

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