Posted to the Gilder forum - September 28, 1999

Gold as money

Ken:

>>>So far as I can tell, you didn't address any of the points I made about gold except to say money is nothing but a contract.

That is correct. I was in the midst of a long reply when it occurred to me that verbiage is the problem where money and gold are concerned. Or as John Kenneth Galbraith said: "Much discussion of money involves a heavy overlay of priestly incantations." Further: "Those who talk money... gain prestige, esteem and pecuniary return, as does a doctor or a witch doctor, from cultivating the belief that they are in privileged association with the occult..." I suddenly came to the conclusion that if we recognize that money is a contract, then all the mystery is gone. But, since you insist, I will try to answer you point by point.

>>>Money is not a contract (except maybe in the widest sense of the term). It is the common denominator of all economic transactions. It serves as a medium of exchange, is universally acceptable to all participants in an exchange economy as payment for goods and services, and thus can used as a standard of market value and as a store of value (i.e., a means of savings).

The definition of money is: "Money is a contract." The rest that you mention are descriptions of what money can be used for. So we have no argument here.

>>>What commodity best serves as a medium of exchange is not arbitrary - it's determined objectively. It needs to be durable, divisible, relatively scarce, have high unit value and be portable.

Gold has some problems. Suppose we go to Mars, I would rather take a ton of air with me than a ton of gold. I'm sure we will find a way, we will make a pact, a contract, to regulate how we pay for things in the absence of gold on Mars.

Any commodity, even a piece of pretty paper can serve as money. Gold has some real problems when used as currency. Every time you make a payment the gold you hand over has to be weighted and assayed. Most time consuming. Much better to hand over some slips of paper or a piece of plastic. In 17th century Europe there were over 800 currencies being traded and it created an immense amount of confusion. I quote from "Money" by John Kenneth Galbraith: "Not only did the American treasure enlace profits and stimulate commerce and industry, it also enlarged the opportunities of all who saw money as a way of making money. The silver coinage of the time contained some copper. It was not difficult for counterfeiters to produce an excellent imitation that contained little, or even a great deal, more. They were assisted by the fact that the minting of money, even if as in Spain closely regulated, was still extensively a form of private enterprise. The merchants of Amsterdam at the end of the sixteenth century — a hundred years after the great flow of silver had started — were the recipients of a notably diverse collection of coins, extensively debased as to gold or silver content in various innovative ways. A manual for money changers issued by the Dutch parliament in 1606 listed 341 silver and 505 gold coins. Within the Dutch Republic no fewer than fourteen mints were then busy turning out money; there was, as ever, a marked advantage in substituting plausibility for quality, For each merchant to weigh the coins he received was a bother; the scales were also deeply and justifiably suspect. Adam Smith told, 170 years later, of the solution..." The establishment of the Bank of Amsterdam.

The utility of gold as a medium of exchange is a fairy tale. It is such a pain in the ass that we invented paper money. In the beginning, the paper represented gold and over time the gold backing of the paper disappeared, much the same way as gold and silver disappeared from coinage to be replaced by copper. Gold is not to be trusted because it is too easy to counterfeit, sweat, file and clip. This brings us to modern times where money is a piece of paper that the government guarantees. This did not happen because government wants to screw us. It happened because it was necessary, just as the Bank of Amsterdam was necessary to bring order out of chaos. You probably will answer that you do not trust the government. Hard to argue with that. But you allow the government to stockpile atom bombs, hydrogen bombs, bombers, deadly chemicals, tons and tons of high explosives, an arsenal big enough to wipe the earth clean of life. You trust the government to start wars and to send your sons and daughters to get killed. But you don't trust them with your money. The only thing I can add to that is: "Fix the government."

But a fix already exists. It's the Internet and world wide money trading. Already some people have said that they don't trust the traders. But who are the traders? I trade my stocks over the Internet, most of us do. Are the traders so different from us? I don't think so.

>>>But if you lent $10,000 convertible to a specified quantity of gold, and the contract called for you to receive money back convertible to the same quantity of gold, your principal would return intact (regardless how many paper dollars the government had printed).

I would use JDSU shares and not gold as the standard and I'll be much better off. <G>

>>>If the government begins inflating the currency beyond the growth in goods and services, people will buy gold to protect the value of their savings.

If they are smart they will buy shares in Telecosm.

>>>The fact that the price of gold is suddenly rising substantially is not a good sign.

Agreed, but the problem is not inflation, the problem is that there are too many people still living in the dark gold ages.

>>>But if the money supply is being expanded faster than the growth of goods and services...

Quote from Lester C. Thurow taken from the Forward of "The Great Depression of 1990" by Dr. Ravi Batra: "Thus in August 1982 the American Federal Reserve Board announced that it was giving up on its attempts to control the American money supply on the grounds that new money market instruments were being invented so rapidly and in such large numbers that it could not effectively control the money supply. Economic forces had essentially taken over the government's nominal role as printer of money."

>>>the issue of the money supply and how it's restrained from being inflated should be especially relevant to GTR subscribers and investors. As our investments grow, only a stable money supply can guarantee their value will be protected.

I quote from "Stocks for the Long Run" by Jeremy J. Siegel:

"But worse-than-expected inflation is also bad for the stock market. As we noted in Chapter 6, stocks have proved to be poor hedges against inflation in the short run. Stock investors fear that worsening inflation increases the chances that the Federal reserve will tighten credit, reducing corporate profits."

"These observation are not at odds with our insistence that stocks are excellent long-run hedges against inflation. In the long run, inflation is primarily a monetary phenomenon, caused by an increase in the money supply at a rate in excess of the growth rate of the economy. Since stocks represent claims on real assets, they will ultimately reflect the prices of the goods produced by these assets. But in the short run, monetary factors play a subsidiary role in the inflation process, Potential tightening by the Fed, higher effective real tax rates, and increased costs of inputs are the short-run concerns that occupy investors when inflation increases."

We seem worlds apart in our opinion about money, gold, inflation and Telecosm stocks. My policy is to be fully invested in high tech stocks — no cash, no gold, the only real estate is where I live. When the market looks rosy I go on margin to a maximum of 20%. When the market looks glum I reduce margin and might even go to 10% cash. I use my credit cards and my margin accounts for money management, I keep very small bank balances. Since I'm only 60, I'm in the market for the long run!!!

I hope this answer answers!

Denny