Goldmoney Insights® Special Edition

The Golden Revolution, Revisited

Back in 2012 John Wiley and Sons published my first book, The Golden Revolution, the core thesis of which was that a longer-term consequence of the global financial crisis of 2008 would be the remonetization of gold. This would occur initially at the international level, that is, as a mean to settle accumulated international imbalances in trade and cross-border investment. The book then also explored how this might come about, what the implications were for the price of gold and for the financial markets more generally.

Now, five years later, it is my pleasure to announce the arrival of the new, Revisited edition, containing an entirely new section on the monetary sources of inequality; multiple new chapters on 'FinTech', including cryptocurrencies and digital gold; and updating the text throughout for recent developments in international economic and monetary affairs.

This new, Revisited edition will be published by Goldmoney and will also appear as a special series of Goldmoney Insights over the coming months. In this first instalment I introduce the new book while also including the original introduction from the 2012 edition.

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INTRODUCTION TO THE REVISITED EDITION

"If we went back on the gold standard and we adhered to the actual structure of the gold standard as it existed prior to 1914, we'd be fine. Remember that the period 1870 to 1913 was one of the most aggressive periods economically that we've had in the United States, and that was a golden period of the gold standard. I'm known as a gold bug and everyone laughs at me, but why do central banks own gold now?"[1]

ALAN GREENSPAN, JUNE 2016

Much has transpired since the publication of The Golden Revolution in April 2012. The Golden Revolution, Revisited is thus more than just a new edition. It is substantially expanded, revised, and updated. There have been significant monetary, economic, and political developments during the past five years that have, in their various ways, reinforced or confirmed certain views or predictions and are worthy of inclusion. Yet there have also been unforeseen developments that, nevertheless, relate to the subject of international monetary regime change and, in some cases, provide for a deeper understanding of our current place in what I call the "monetary cycle of history."

Let us begin here: if there is one thing that I hope readers of this book take away it is the perspective provided by the broad study of monetary history. This is absolutely essential if one is to understand what may seem a truly extraordinary set of contemporary economic circumstances, ranging from zero (or negative) interest rates; a near-decade of hyperactive monetary policies in much of the world; the continuing existence of too-big-to-fail institutions; persistence of government deficits; and, to bring these abstruse topics home to many, the increasingly evident evisceration of the middle class of society. This latter topic, referred to in dangerously facile fashion as simply "inequality" by most, and deserving of a separate book in its own right, is the central topic in the entirely new, first section in this revisited edition.

Also entirely new in Revisited is a discussion of the astonishing rise of interest, public and private, in so-called digital- and/or crypto-currencies. While Satoshi Nakamoto's original bitcoin paper was published in 2008, it took the creation of bitcoin in 2009 and several years more for blockchain technology to capture even the imagination of the tech community, much less that of the public at large. But somehow, in early 2014, the topic suddenly went mainstream and publications such as the New York Times and Newsweek investigated and reported on the bitcoin phenomenon and its potential implications.

1 Former Fed Chairman Greenspan made this (surprising) comment during a 2016 interview on BloombergTV. He elaborates on this view somewhat in his February 2017 interview published in Gold Investor, the periodical of the World Gold Council. This can be found at www.gold.org.

About one year later, major central banks, including the Bank of England, began to study the topic in earnest and published extensive papers regarding the potential implications of blockchain, as a more general reference to the technology behind bitcoin, rather than the bitcoin algorithm itself. It has subsequently become a mainstream view that so-called blockchain technology will contribute to the disruption and disintermediation of a wide variety of financial and commercial activities and many so-called FinTech (or financial technology) start-up firms are seeking ways to provide practical applications and solutions. Even banks have come to embrace the technology, with internal working groups seeking ways in which to apply it to realize efficiencies and streamline operations across multiple divisions.

It is a discussion of the implications of FinTech more generally that comprises the final new chapter in this edition. The Golden Revolution did touch on this at a few points along the way, but recent developments demand and deserve an expanded and more thoughtful treatment about how FinTech is not only about realizing greater efficiencies in transactions, payments, settlements, and regulatory protocols but about a range of developments which, in my view, are going to facilitate, perhaps even catalyze, a return to a gold-backed monetary system for much if not all of the world. Exactly how this would come about is of course unclear. Of all the various possible scenarios presented in the original edition, the spontaneous, "bottom-up" process of individuals simply refusing, one by one, to use fiat currencies for commerce and to switch to gold instead, seemed perhaps the most far-fetched at the time. No longer. Financial technology could be a game changer in this regard, as I explain at the end of Section III.

It is my hope that this new, revisited edition—nearly a new book some might say—will draw interest not only from the original audience but also an entirely new one that, during the past five years, has become more interested in the future of money, banking, and finance generally. The evidence that the current financial system is chronically dysfunctional is now glaringly obvious amid zero or negative interest rates, poorly capitalized banks, and stagnant or declining per-capita real income growth. The increasingly ad-hoc, strained, even outright illogical explanations of mainstream economists as to why their policies are not as effective as claimed or are producing nasty, unintended, counterproductive consequences, are ringing increasingly hollow. As Thomas Kuhn argued so cogently in his masterwork, The Structure of Scientific Revolutions, these are clear and present symptoms of a fundamentally flawed intellectual paradigm, in this case for the understanding the proper role of money in the economy and, by extension, in society. While even now only a comparable few have been willing to consider that it is the use of debt-backed fiat money itself that is the fundamental systemic flaw, their ranks are growing.

For those who have been following developments closely, such as recent calls by senior economic officials in multiple countries that cash should be outright banned, it may still feel as if we are continuing to proceed down the "Road to Monetary Serfdom," to paraphrase Nobel laureate Friedrich von Hayek. However, ahead in that road lies a largely hidden, sudden curve: one that leads back along the well-established monetary cycle of history.

Revolutions represent historical tipping points: as with the road described above, their causes and effects are nonlinear. Each and every individual can make a difference, and the best way to start is to become informed. It is my great hope that all my readers, new and old, find that this book contributes to their understanding not only of the monetary cycle of history but the unique role that they each might be able to play within it. In the words of the revolutionary Karl Marx, "Philosophers have interpreted the world, in their various ways. The point, however, is to change it."

INTRODUCTION TO THE ORIGINAL (2012) EDITION: WHY A GOLD STANDARD LIES IN OUR FUTURE

"More and more people are asking if a gold standard will end the financial crisis in which we find ourselves. The question is not so much if it will help or if we will resort to gold, but when."

CONGRESSMAN RON PAUL

FOREWORD TO THE MINORITY REPORT OF THE US GOLD COMMISSION, 1982

Contrary to the conventional wisdom of the current economic mainstream that the gold standard is but a quaint historical anachronism, there has been an unceasing effort by prominent individuals in the US and a handful of other countries to try and reestablish a gold standard ever since President Nixon abruptly ended dollar-gold convertibility in August 1971. The US came particularly close to returning to a gold standard in the early 1980s. This was understandable following the disastrous "stagflation" of the 1970s and severe recession of the early 1980s, at that time the deepest since WWII. Indeed, Ronald Reagan campaigned on a platform that he would seriously study the possibility of returning to gold if elected president.

Once successfully elected, he remained true to his word and appointed a Gold Commission to explore both whether the US should, and how it might, reinstate a formal link between gold and the dollar. While the Commission's majority concluded

2 Although this is the original introduction from the 2012 edition of The Golden Revolution, it has been amended in order to refer briefly to the additional section and content included in The Golden Revolution, Revisited.

that a return to gold was both unnecessary and impractical—Fed Chairman Paul Volcker had successfully stabilized the dollar and brought inflation down dramatically by 1982—a minority found in favor of returning to gold and published their own report, "The Case for Gold," in 1982. Also around this time, in 1981, future Fed Chairman Alan Greenspan proposed the introduction of new US Treasury bonds backed by gold as a sensible way to nudge the US back toward an explicit gold link for the dollar at some point in future.

In the event, the once high-profile debate in the US about whether to return to gold eventually faded into relative obscurity. With brief exceptions, consumer price inflation trended lower in the 1980s and 1990s, restoring confidence in the dollar as a somewhat reliable store of value. By the 2000s, economists were talking about the "great moderation" in both inflation and the volatility of business cycles. The dollar had been generally strong versus other currencies for years. "Maestro" Alan Greenspan and his colleagues at the Fed and their counterparts in many central banks elsewhere in the world were admired for their apparent achievements.

We now know, of course, that this was all a mirage. The business cycle has returned with a vengeance with by far the deepest global recession since WWII, and the global financial system has been teetering on the edge of collapse off-and-on for several years. While consumer price inflation might be low in the developed economies of Europe, North America, and Japan, it has recently begun to creep higher, notwithstanding growth rates that are very weak in a historical comparison. Stagflation is returning and may well come to exceed that of the 1970s in size and scope before long.

The economic mainstream continues to struggle to understand just why they got it so wrong. They look for explanations in bank regulation and oversight, the growth of hedge funds and the so-called shadow banking system. They wonder how the US housing market could have possibly crashed to an extent greater than occurred even in the Great Depression. Some look to global capital flows for an answer, for example China's exchange rate policy. Where the mainstream generally fail to look, however, is at current global monetary regime itself. Could it be that the dollar-centric global monetary system is inherently unstable? Is our predicament today possibly a long-term consequence of President Nixon's fateful decision to "close the gold window" in 1971?

This book argues that it is. But it also goes farther. The unbacked dollar reserve standard has now done so much damage to the global financial system that it is beyond repair. The current global monetary regime is thus approaching a transformation that will carry it in some way back onto some form of global gold standard, in which monies, at least in official, international transactions, are linked to gold. This may seem a rather bold prediction, but it is not. The evidence has been accumulating for years and is now overwhelming.

Money can function as such only if there is sufficient trust in the monetary unit as a stable store of value. Lose this trust and that form of money will be abandoned, either suddenly in a crisis or gradually over time in favor of something else. History is replete with examples of "Gresham's Law" that "bad" money drives "good" money out of circulation, that is, that when faith in the stability of a money is lost, it may still be used in everyday transactions—in particular if it is the mandated legal tender—but not as a store of value. The "good" money is therefore hoarded as the superior store of value until such time as the "bad" money finally collapses entirely and a return to "good" money again becomes possible. This monetary cycle, from good to bad to good again, has been a central feature of history.

Most societies like to believe that they are somehow superior to those elsewhere or that have come before, although it is only natural that this assumption is called into question during difficult economic times. But there are some laws to history and one of them is that money not linked to some form of physical standard—most often but not always metals—is doomed to a short, ignominious existence. The historical record is crystal clear on this. All purely fiat currencies eventually fall to their intrinsic value of zero.

Why should this be? Is not the story of civilization the story of progress? I believe that it is, but within certain limits, as provided by human nature. We may be civilized, but we are also human. All of us experience feelings of fear and greed at times in our lives, perhaps with respect to our basic needs, wants, and desires or perhaps higher aspirations. There are those of us who might be overwhelmed by such feelings from time to time, those in power in particular, who tend consistently toward corruption regardless of whether they serve the public in a democracy or attempt to rule it in a dictatorship. One need look no farther than several modern, supposedly representative "democracies" now facing sovereign bankruptcy and default to see this potentially dark side of human nature in action.

To understand what is happening in the world of banking, finance, and economics today, please don't read an economics textbook full of equations or other mainstream, Neo-Keynesian claptrap. Read history instead. It may not necessarily repeat but it certainly rhymes. We are deep into a crisis of monetary confidence from which there is no escape without a return, one way or another, to a metallic money standard. The evidence is there for those who care to look. But few are prepared to countenance that some of the more painful lessons of history must be relearned in our time.

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There has been much written about why the price of gold is moving higher and will continue to do so. It will. Probably much higher, when denominated in units of dying fiat currencies. But while this is certainly useful advice, it does not fully prepare the reader for the practical reality of the transition to the coming global gold standard, which is going to be substantially different from the fiat monetary and financial regime of today. It is not just money that is going to change. The nature and business of banking will change. So will finance in general. A gold standard will benefit certain industries, markets, and countries but be potentially harmful to others. It follows that investment strategy and asset allocation methodologies must adapt.

A new global gold standard is coming. It is only a matter of time and how orderly or disorderly the transition is. Those who are prepared will prosper or at a minimum protect their wealth during the potentially rough transition period and be ready for what comes next. Those who don't may lose entire fortunes built up with the hard work of several generations. The stakes are high and they are real. It is time for us to leave the false comfort of our fantasy fiat currency "wealth" behind and get on with the business of practical preparation for the inevitable. And don't expect our so-called leaders or representatives in government to help. They are more likely to obstruct than assist in this critically important task.

This book is divided into four sections. Section I examines the deleterious economic and social effects of unbacked, fiat money, in particular how it exacerbates inequality, with monetary inflation acting as a largely unseen, regressive tax falling disproportionately on the poor and, in the event they reside inside a welfare state financed through taxation, on the productive middle class.

The second expands on the points made here regarding why the world is headed inexorably back onto some sort of gold standard. It explores just why the fiat-dollar standard was always potentially unstable and how the seeds of its demise were sowed many years ago, unseen by the economic mainstream. It then demonstrates how recent events, interpreted through the lens of the "monetary cycle of history," imply that a return to gold is not only inevitable, but imminent.

Section III considers what the transition period might look like, including some historical examples of both orderly and disorderly monetary regime changes as well as provocative, hypothetical ones. History provides a rough guide for what to expect, to be sure, although we must give due consideration to the specific structure of contemporary international politics, including major geopolitical rivalries. In this section, we also consider how much the gold price is likely to rise as it becomes remonetized. Finally, Section III takes a look at recent innovations in money and payments technology, including bitcoin and other so-called cryptocurrencies and various other ways in which FinTech firms are seeking to disrupt and disintermediate key aspects of the banking and payments systems. It then concludes with a discussion of how FinTech may also facilitate the spontaneous remonetization of gold.

Section IV explores how the world of banking, finance, and investment will change under a future, technologically advanced gold standard, which industries, countries, and markets are likely to benefit, and which are likely to suffer. Further, it looks at the implications for practical investment strategy and asset valuation. By fundamentally changing the very foundation of the global monetary order, the return to gold will affect interest and exchange rates, yield curves, corporate credit spreads, equity valuations, and the volatilities of all of the above.

The book concludes with a few thoughts on how the future gold standard will impact society more generally. It is this author's strong opinion that a world that has returned to a gold standard will be a far, far more pleasant, productive, peaceful, stable, and moral place than that which we for a time allowed ourselves to be deluded into believing was, in certain respects, the best of all possible worlds. After all, they don't call particularly prosperous historical episodes "Golden Ages" for nothing.