Gold: The Once and Future Money

Reviewed by John P. Collins, CIMA®

Reading *Gold: The Once and Future Money* felt like coming home for me. A little more than 30 years ago, I earned a degree in economics, and I specifically chose my college for its strong suit in The Austrian School. Author Nathan Lewis' historical references and quotes from John Stuart Mill, David Ricardo, Adam Smith, Ludwig Von Mises, Friedrich Von Hayek, Murray Rothbard, and Henry Hazlitt felt comfortably familiar, like renewing old friendships.

It also struck me while reading this book that many of us, myself included, have a rather incomplete understanding of the nature of money. Many of us understand that creating more money can lead to generally rising prices. Most of us understand that open market operations by central banks can be used to target interest rates, or to attempt to influence the value of one currency in relation to another. Some of us may even recall the monetarist principle that the money supply should be managed to provide for stable price levels, i.e., tied to gross domestic product.

But, if you are like me, you probably do not give the concept of money itself much thought. We are distracted by economic growth or employment figures, stock and bond prices, and other economic data. Money is just there, in the sense that air is just there. We know we are breathing, we just don't think about it. But Nathan Lewis, author of *Gold*, says thinking of the supply of money as simply driving general price levels is far too simplistic.

Prices of commodities, products, and labor are driven in part by monetary actions of central bankers, but they also are driven by other economic forces, such as supply and demand for the commodity, products, and labor themselves. Prices reflect countless individual and business decisions, and therefore they convey valuable information about the allocation of resources in the economy.

What money should provide is a stable measure of value, much like weight, volume, or distance measures. If we did not have standards of metric measurement, imagine how difficult mechanical engineering would be. Without similarly fixed monetary standards, prices cannot convey accurate economic information.

Throughout history, central banks have been very adept at pegging currencies to something; that is, identifying a target and conducting open market operations to manage the supply of money to "peg" to that target. The target could be gold, at a fixed exchange rate, with free convertibility. If more people are exchanging cash for gold, indicating a lower demand for money, the central banks would contract the money supply. If people were exchanging gold for cash, indicating increased demand for money, the central banks would increase the supply of money. But, by pegging the value of the cash to gold, it provides that fixed standard of measurement businesses and households require to manage their affairs efficiently and profitably.

Central banks can peg their currency to other things, such as interest rates or other currencies. Again, central banks have proven adept at maintaining these pegs as well. However the desire to maintain a certain interest rate within an economy and to maintain a certain exchange rate with other currencies inevitably will become at odds with one another, and it destroys the fixed measurement information value of money, leading to inefficient and unprofitable business and household decisions.

The practice of managing interest rates itself leads to inefficient economic decisions because it affects the way both physical and financial capital are allocated in an economy (the recent global housing bubble and ensuing financial crisis provide an object lesson). It also muddles the distinction between money and credit—another thing we perhaps don't think deeply enough about, and which the author clarifies in his book. When individuals are left to make their own economic decisions with money providing that fixed measure of value, growth and stability are maximized. When central banks introduce noise into the money equation, they create distortions in the information individuals use to make decisions, and the real effects of these bad decisions are usually far worse than the evils of simple, general price inflation.

The common argument against gold as a monetary standard is that money needs to be managed to produce economic stability, yet the preponderance

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of historical evidence refutes this argument. Both the Dutch guilder (whose name is derived from the Dutch word for gold) and the British Pound Sterling served as favored global currencies for international trade for centuries because the market recognized that these currencies conveyed the best information about value for the purpose of making sound economic decisions. Interest rates in those currencies also remained remarkably stable during the time they were pegged to gold.

This book is a fascinating historical read; I had a hard time putting it down. It is rigorous in its articulation of the economic principles involved. And it is timely, given the fact that virtually the entire global currency structure is untethered to gold or any other commodity.

Do not base the decision to read this book on what you currently believe about the advisability of a return to the gold standard. Whether Mr. Lewis reinforces your belief or causes you to change your mind, you will likely find this an enjoyable and intellectually stimulating work.

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Gold: The Once and Future Money
By Nathan Lewis
464 pages, hardback
ISBN-10: 0470047666
ISBN-13: 978-0470047668
U.S. $40, John Wiley & Sons, Inc., 2007