

“In effect, there is nothing inherently wrong with fiat money, provided we get perfect authority and god-like intelligence for kings.” – Aristotle

Gold and Fiat Currency: Forty Years Later

August 15, 1971 – August 15, 2011



By: Nick Barisheff

Monday, August 15, marked the 40th anniversary of the U.S. default on the dollar's convertibility into gold. It was the world's de facto reserve currency and thus began an experiment with a reserve fiat currency that was doomed to failure before it began, because there has never been a successful fiat currency in all of history.

August 15, 1971, was just like any other day for most people and President Nixon's unprecedented decision to cut the U.S. dollar's gold international convertibility was largely ignored by the public. The majority of citizens didn't understand the implications for their financial future.

Contrast that to today, where a historic downgrade of U.S. debt and a very public \$2 trillion increase of the debt ceiling dominated headlines and the television news.

Tale Of Contrasts

Forty years later, it is a tale of contrasts between U.S. dollars and gold. The U.S. dollar is the world's reserve currency despite the fact that it is being issued by the world's largest debtor nation. Investors around the world flee to it during times of crisis, even though it continually loses value through debasement. Gold, meanwhile,

is dismissed as a viable asset, ignored by most pensions, institutions, and asset managers despite increasing from \$35 in 1971 to over \$1,800 last week.

THE LAST 40 YEARS			
	1971	2006	2011
M3*	\$800 Billion	\$10.4 Trillion	\$14.2 Trillion
US Federal Debt	\$400 Billion	\$8 Trillion	\$14.6 Trillion
Unfunded Liabilities	-	\$50 Trillion	\$115 Trillion
Price of Gold	\$35	\$675	\$1,745

*M3 stopped being reported in 2006, Shadowstats.com has been tracking it since.
 Source: Shadowstats.com, Usdebtclock.org, Pacific Exchange. ©2011 Bullion Management Group Inc.

It is important to note that on this historic day 40 years ago, the dollar quietly ceased to be money and instantly became a currency. Money and currency are often considered as one and the same; however, there are meaningful and significant differences between the two. While fiat currencies function well as a medium of exchange and a unit of account, they fail miserably as a store of value. The U.S. dollar has lost more than 80 per cent of its purchasing power compared to gold in the last decade alone. Gold, however, has endured as money for more than 3,000 years, and maintained its purchasing power throughout that time because it meets all of the criteria for money. To satisfy the functions of money, an item must be a unit of account, a medium of exchange, and a store of value. Gold is all of these things; it is durable, portable, divisible, consistent, intrinsically valuable, and, of crucial relevance today, it cannot be created by central banks.

Gold is a tangible asset, something that is real and in limited supply, as opposed to fiat currency, which is merely worthless paper that governments can produce at will. It is only the promise written on the paper enforced by a government decree that gives it any value. The more governments produce, the less value it has.

In light of this, it makes sense to earn currency and then protect its value through precious metals ownership of gold, silver, and platinum.

The current monetary system, which, in its current form, began in 1971, has two critical features that have profound implications for our financial future:

- Fiat currency is created out of debt via the banking system and the Federal Reserve
- The amount of currency created must continually expand

In May 2006, we wrote *August 15, 1971 Inflation Unleashed*, and I direct you to key statistics of just five years ago.

There are limits to debt expansion, and it is my guess that we are now entering the phase where the compounding of the debt and the loss of our purchasing power is not only more noticeable, but also about to become exponential. In three years time, it is quite possible that these numbers could be double what they are today.

Chris Martenson quotes Dr. Bartlett, an emeritus professor of physics at the University of Colorado, who said, "The greatest shortcoming of the human race is the inability to understand the exponential function." I encourage you to spend eight minutes viewing the following presentations on exponential growth and compounding from Chris Martenson's 'Crash Course' – www.chrismartenson.com/crashcourse/chapter-3-exponential-growth; and 'Compounding is the Problem' – www.chrismartenson.com/crashcourse/chapter-4-compounding-problem

It puts into context why the only logical conclusion that can be drawn from the ever-expanding debt and money supply problems that the U.S. and other countries are facing is hyperinflation. (See John Williams 'Hyperinflation Report' – www.shadowstats.com/article/hyperinflation-special-report-2011).

Beyond Their Means

Until governments around the world stop spending beyond their means, running huge deficits, incurring massive debts, and creating endless amounts of fiat currency, precious metals will continue to rise and fiat

currency values will continue to erode. The best way to protect portfolios and preserve wealth from this impending crisis is to own precious metals.

When we consider that total global financial assets are estimated at more than \$200 trillion, but total global above-ground gold bullion is a modest \$3 trillion, and only growing by approximately \$100 billion a year, we can see that once a shift towards gold occurs, there will be too much paper currency chasing too little gold. Of the \$3 trillion of above-ground gold bullion, about half is owned by central banks and half is privately held. The central banks have been net buyers since 2009 and most of the privately held gold is not for sale at any price. If only five per cent of the \$200 trillion in financial assets were to allocate to gold, there would be about \$10 trillion trying to buy the \$1.5 trillion of privately held gold bullion. Under that scenario, the price of gold will trade substantially higher than the levels today.

There have been suggestions in the media that holding gold is too risky. It has been called a useless, over-valued relic that pays no interest and is in a bubble. We heard this same rhetoric when gold was \$300, then \$500, \$800, \$1,000, and last week at \$1,800. This advice has been costly to those who listened. In truth, gold is not rising; fiat currencies are falling and will continue to do so until governments around the world begin to act responsibly. There is nothing on the horizon to indicate this will happen any time soon.

Financial Mess

It is difficult to predict how the financial mess the major economies of the world are in will unravel. Some economists believe the increase in money supply will have an inflationary effect, while others believe the lack of demand and lack of growth will result in deflation. Federal Reserve Chairman Ben Bernanke made it quite clear in his famous “helicopter” speech that there will be no monetary deflation on his watch. Other historical examples indicate we will end up in a hyperinflation followed by a deflationary collapse. Recent examples of this have occurred all over the world (See <http://en.wikipedia.org/wiki/Hyperinflation>).

The best defense in either eventuality, however, is to hold precious metals.

The lack of understanding in the difference between money and currencies is so pervasive that even Warren Buffett, who has received many accolades for his investment track record, has criticized gold in the past. In a speech to the 1998 Harvard graduating class he said:

“Gold, it gets dug out of the ground in Africa or someplace. Then we melt it down, dig another hole, bury it again and pay people to stand around guarding it. It has no utility. Anyone watching from Mars would be scratching their head.”

Medium Of Exchange

In contrast to this view of gold, fiat currency is nothing more than a medium of exchange that is susceptible to abuse by the governments that produce it. Trees are cut down, turned into paper, a number is written on it and by force it is declared legal tender. It is created out of thin air, backed by debt, printed without limit and its value decreases as the amount of printing increases. There has never been a successful paper currency in history; the longest-standing currencies, the British pound and the U.S. dollar, have both lost 99.5 per cent of their purchasing power. Currency completely fails as a store of value. Anyone watching from Mars would be scratching their head at this, as well.

Perhaps the former chairman of the Federal Reserve, Alan Greenspan, explained the importance of the gold best when, in 1966, he said, “In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. There is no safe store of value.” Forty years after President Nixon ended the dollar’s convertibility to gold, it seems that Greenspan was correct. ■

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