

The 'Barbarous Relic' – It's Not What You Think

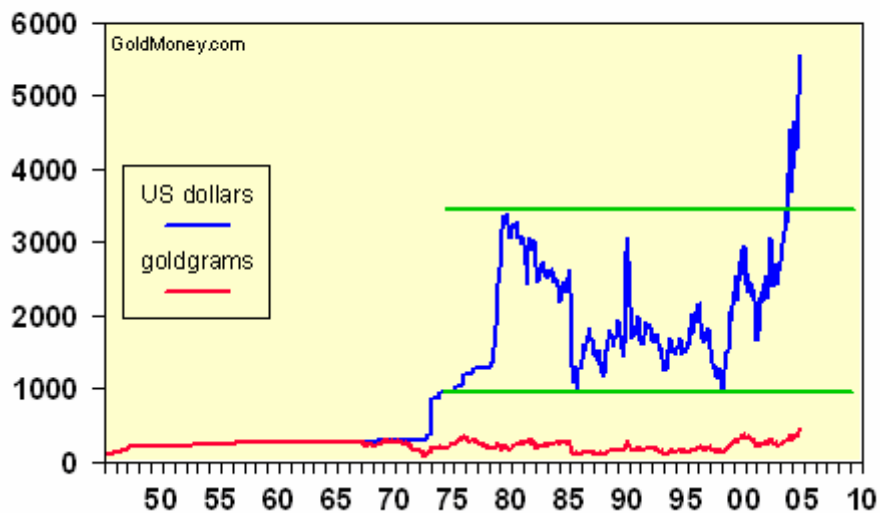
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I'm no fan of John Maynard Keynes. I find most of his economic theories to be just plain wrong. But for the sake of truth and accuracy, I would like to correct a terrible injustice levied upon Keynes, and at the same time also correct an equally terrible injustice that is time and again inflicted upon gold.

How many times have you heard gold described as the "barbarous relic"? It is a favorite phrase of gold-bashers everywhere trying to make gold the object of derision. Every time I hear it, which is all too frequently, I cringe because gold is neither barbarous nor a relic, as can be easily explained with the following chart.

Crude Oil Prices (Base of 100)
December 1945 through August 2005



This chart presents a base 100 analysis of crude oil prices in terms of dollars and grams of gold, i.e., goldgrams. In other words, to establish the useful comparison depicted above, this analysis assumes that one barrel of crude equals \$100 and 100 goldgrams as of December 1945, and then calculates the month-end price thereafter based on the actual dollar price of crude oil and the prevailing dollar-to-goldgram rate of exchange.

Gold Is Neither Barbarous Nor a Relic

We can see that the price of crude oil in goldgrams is essentially unchanged throughout this period. So it is clear that gold communicates economic value very effectively, which is the primary feature of money. Because money is the tool upon which economic activity is based, which is a reality that therefore makes money

central to society, money is not barbaric. Consequently, gold cannot possibly be barbaric because gold is money.

Nor is it a relic because gold communicates value today as effectively as it did fifty years ago, and much better than the US dollar, which is a point made clear by the above chart. In contrast to today's national currencies, gold tends to hold its value, or in other words, its purchasing power remains relatively unchanged.[1] In fact, this precious attribute of gold is timeless because the aboveground stock of gold grows approximately at the same rate of world population growth and new wealth creation.[2]

So how could anything so valuable and useful as gold be barbaric? And because gold is as useful today as it ever was, how could it possibly be a relic?

This gold pejorative is readily attributed to Keynes. But here is what he really wrote in 1923 in *A Tract on Monetary Reform*: "...the gold standard is already a barbarous relic."

Note that it is not gold that is the barbarous relic, but rather, Keynes is taking aim at the gold standard. There is a very big difference here. The gold standard is the mechanism by which national currencies at one time were defined as weights of, and redeemable into, gold.

Though the United States continued to define the dollar in terms of gold when Keynes penned those now infamous words, it had become the exception. Most of Europe had stopped the redeemability of paper currency into gold with the outbreak of hostilities in 1914. What's more, after the war European countries were slow to return to the gold standard because their currencies had become terribly debased by the expansion of credit and the concurrent printing of money that had occurred over the intervening years.

In effect, by the 1920's the classical gold standard was essentially dead, which was the reality observed by Keynes. It was dead because banking interests, working hand-in-hand with governments, killed it. They killed it because governments wanted more money to meet their growing spending aspirations, and seeing the profit opportunity this circumstance presented, bankers wanted to lend it to them. The discipline of the classical gold standard prevented the unbridled extension of credit and the resulting creation of new money, with the result that it had to go.[3] So is that why the gold standard had become a 'barbarous relic'?

To answer this question, we have to understand why the gold standard came into existence in the first place. Its origin can be traced back to events resulting from the formation of the Bank of England in 1694, but to really understand the gold standard in order to explain Keynes's trenchant observation, we have to go back even further into monetary history to extract one key truth – the history of money is really the history of currency.

The Distinction Between Money and Currency

It is important to note that money doesn't really change. Money is the function it performs, so money is still the same thing it always has been from the moment when it was first invented in pre-history. Namely, money is a mental tool used for economic calculation[4] that ingeniously enables each of us to communicate what we

value in an exchange. What changes throughout monetary history is currency. It evolves, and the biggest change ever occurred in 1694.

Up until that time currency was always an asset, i.e., something tangible. Gold and silver were the most popular forms of currency, but history records that other assets were also used, such as cows, food crops, shells, beads and other tangible items considered to be useful and/or rare.

The nature of currency evolved as mankind progressed, and various scientific achievements made currency more efficient and more reliable. For example, if you look at the evolution of coins over the centuries, you can see marked improvement.

These improvements were important. By making coins more reliable, the costs of conducting commerce were reduced, and reducing costs is always a good thing. By lowering the impediments to commerce – and the costs of handling currency and making payments are an impediment – commerce itself is promoted, and as commerce expands and develops, our living standards rise. So it was natural that new advancements that improved the currency of the day were widely welcomed, as was the advancement introduced by the Bank of England concurrent with its creation in 1694.

Gold and silver coins had disadvantages that were well recognized. They were bulky, hard to carry, not practical in large denominations because of the weight that would be required, etc. What's worse, the coins wore out from usage, wasting some of the precious gold and silver used to make the coin.

In this environment the Bank of England introduced an important advancement that made currency more efficient. Its innovation enabled gold and silver coins to remain safe and secure in the bank's vault, while paper promises to pay weights of precious metal – dubbed banknotes – circulated as currency as a substitute in place of these coins. Paper as a circulating medium had obvious advantages in terms of efficiency and cost and could at any time – or in other words, on demand – be redeemed for coin. What's more, because it was opened under a royal charter, the Bank of England and its paper currency were perceived to be safe, and so it was – for about three years.

By 1697 the world's first banking crisis was underway. The Bank of England had issued far more paper than it had physical metal on hand^[5], basically silver, because that was still the preferred metal of the day in England. Therefore, the crisis arose because people rushed to convert their paper currency into silver coin, with the result that the Bank of England's new currency appeared to be a failure.

Despite ongoing monetary upheaval, the Bank of England nevertheless persevered (even back then, government sponsored enterprises seemed to take on a death-defying life of their own). But this monetary crisis did have one beneficial and constructive result. It made self-evident to everyone at the time that a paper currency promising to pay metal (a money-substitute) was different from money (gold or silver) itself. After all, a bank liability is fundamentally different from a tangible asset.

What the Bank of England had done was turn currency on its head. Currency had always been money (mainly gold and silver fabricated into coins). In other words, until 1694 the currency of the day and money were one and the same. Thereafter,

paper currency was not money; it was only a money-substitute. Thus, currency was no longer a tangible asset; it had become a liability of a financial institution. This difference is as great as night and day, or more to the point, between assets and liabilities.

The impact of this change was so profound that it had an invasive impact on the economy, mainly with adverse consequences. The insidious monetary turmoil wrought by the Bank of England's new currency persisted. So to figure it all out, the British monarch, William III, turned for help to the greatest mind of the day, Sir Isaac Newton, who in 1699 was appointed as Master of the Mint.

Over the next several years, Newton returned order to where there had been Bank of England created chaos. He did this by inventing and putting into practice what we now call the classical gold standard. It is a monetary system that operated under rules[6] he established that were voluntarily followed by banks and those governments that eventually adopted in their own country the Bank of England's new paper currency invention.

Newton's rules resulted in automaticity, which is what made the gold standard so effective. It was reliable and predictable. It was self-regulating when left unhindered, with capital flows over time harmonizing trade imbalances arising from disparate economic conditions in different countries.

Newton recognized that the paper banknote was an important advancement that made currency more efficient. But he also understood that paper currency wasn't money, and even more so, that paper currency could be created to excess, which would result in monetary and economic turmoil. In other words, he realized that paper currency was useful, but only if it had some standard by which it could be measured and controlled. He achieved these objectives with the gold standard he created.

The Demise of the Gold Standard

Newton's invention remained largely untouched from its implementation in 1707 until 1914. I say 'largely' because the rules of his classical gold standard were occasionally broken. During periods of war, for example, the redeemability of paper into coin was often suspended and credit was expanded beyond the prudent limits that normally prevailed. But the rules governing the gold standard more or less remained in place, with the wartime suspensions usually lifted soon after hostilities ceased. Further, redeemability of banknotes into coin was re-established at the pre-war rate, which deflated the war induced credit expansion.

Over time, however, bankers and politicians began to understand that if they broke Newton's rules, they could gain an advantage. Bankers would make a greater profit because they could expand credit (make loans) beyond the self-imposed constraints. Politicians could gain greater power because instead of being restricted to just spending gold, they envisioned creating a seemingly unlimited amount of money-substitutes and spending those instead. Newton's rules were voluntary and worked only so far as banks and governments agreed to them. By the 20th century, bankers and politicians were not just breaking the rules – they were discarding them.

Thus, given the powerful interests lining up against it, it is not surprising that the classical gold standard began being painted as undesirable, despite its splendid 200-

year track record of maintaining relatively stable prices. What's worse, it started to be blamed for things for which it was not responsible. For example, it was not the gold standard that caused the Great Depression, but rather, it was imprudent credit expansion by the banks, which was made worse by the growth of government and the rising expenditures this burden entailed.[7] The last vestiges of the gold standard were jettisoned in August 1971[8], ushering in the present era of fiat currency.

So is it now clear why Keynes was taking a potshot at the gold standard? It is not surprising that Keynes – a statist who supported government management of the monetary system – would claim that the gold standard is a barbarous relic. But even though Keynes was no fan of gold, he no doubt understood that it would be foolhardy to attack gold itself. That would come later, from anti-gold propagandists and central bank apologists misusing what Keynes really wrote. But that is not quite the whole story.

The Real Barbarous Relic

There is indeed a barbarous relic, but we now know it is not gold, nor the gold standard because of the useful role it played for two centuries. Rather, the barbarous relic is central banking.

Central banks are barbarous too in part because they conspired to put an end to Newton's brilliant invention that safeguarded sound money for 200 years. But it is the process of central banking itself as it has come to be practiced that deserves the greatest ire.

Central banking is barbarous for the following reasons:

1. Money is a product of the free market. It is a fundamental building block of our society because it allows people to interact with one another in the market process. Money existed long before governments and central banks began 'managing' it. Tragically, instead of being a neutral and unhindered tool in commerce fair to one and all, money has now become a matter of force and decree, which is disruptive to the market process and therefore harmful to society.
2. Prior to the creation of the Bank of England, every exchange in this interchange of activity we call the market process traded value for value. In other words, gold was exchanged for land, silver for food, etc. – assets were traded for assets.[9] The Bank of England changed this process by creating money substitutes. Its banknotes are not a tangible asset like gold or silver. Banknotes are merely money substitutes and not money itself. Money substitutes are a liability of the bank issuing that paper currency, which brings with it all sorts of payment risk that one does not have when using tangible assets as currency.
3. Central banks act in secrecy, and consequently, they are not held accountable. They consider themselves – and act as if – they are above the law. What's more, this secrecy favors the insiders, and it is this fundamental principle upon which central bank market intervention has been constructed, including, for example, the ongoing intervention in the gold market.[10]
4. Central banks have freed governments from the need of having to ask their citizens – through their elected representative – for more taxes.[11] Central banks

can acquire government debt and use it to create currency out of 'thin air' for governments to spend on their latest whim. What's worse, through their policies that create inflation, central banks enable governments to steal from their citizens.

5. There are several tools in the central banks' arsenal, and one of them is disinformation, which they regularly practice. For example, central banks have come to make us believe that inflation is "rising prices". But wet streets do not cause rain. By changing the definition of inflation to one of "rising prices" rather than what it really is – monetary debasement engineered by central banks – the true culprit – which is the central banks themselves – is masked, which leads into the next point.

6. Not only are central banks guilty of disinformation, deception is one of their most frequently used tools. The history of banking is replete with examples that demonstrate not just a lack of disclosure, but rather, outright deception. To give just one example, look how central banks today account for their gold loans. They carry gold in the vault and gold out on loan as one line item on their balance sheet.[12] In effect, central banks are saying they can ignore the truthful disclosure established by generally accepted accounting principles, and they can as a result report cash and accounts receivable as one and the same thing. Accounting like that would make even the people at Enron blush, but it also highlights the seventh point.

7. Central banks have in effect turned the market into a command economy. The power to create money out of thin air brings with it the much greater power to control a nation's economy and therefore the economic destiny of millions. Central bankers today are no different than the former Soviet Union politburo members, who pulled strings and pushed buttons to try making the economy – which means each and every one of us who participate in the economy – bend to their beck and call. But it is not only the economic destiny of millions that is determined by central banks, which brings us to the eighth reason central banking is barbarous.

8. Central bankers and their comrades in government know that this command economy power forces them to walk a fine line between prosperity and economic collapse, given the inherent fragility of this credit-based monetary system they operate. To try reducing this ever-growing fragility – in a vain attempt to make it easier for central banks to effectively and totally control this command economy – governments take away peoples' freedom to act. Central banks usher in controls (like the reporting now required by the Patriot Act) and policies (ever hear of the 'too big to fail' doctrine that underwrites bad decisions at banks with taxpayer money) to perpetuate their stranglehold on power regardless whether they are doing a good or bad job – and it is usually bad – in commanding the economy.

9. The command economy that central banks operate encourages the growth of debt, rather than savings. Banks want to expand their balance sheets – i.e., make more loans – in order to earn greater profits, and governments want central banks to accommodate this objective because the resulting credit expansion provides opportunities to acquire new things, which create an illusion of prosperity that makes people believe their wealth is rising. The result of this debt-induced, pseudo-prosperity is a complacent populace, the net effect of which tends to perpetuate government power and politicians' perquisites. Instead of following a sound and time-tested 'pay as you go' policy, consumers, businesses and governments have adopted a new creed – 'buy now and pay later'. So the mountain of debt that exists in the US today, and the excessive consumption that continues to enlarge that mountain, is directly the result of central banks and their need to grow more debt to

avoid the inevitable 'bust' that would follow if this growth in debt were to stop. Newsletter writer Richard Russell explains it very simply in just three words – "inflate or die".[13] That reality explains why Ben Bernanke (presently the chairman of the President's Council of Economic Advisors, but a former Federal Reserve governor who reportedly is being considered to replace Alan Greenspan as chairman) has said that he would in effect drop \$100 bills from helicopters if necessary to inflate the economy.[14]

And lastly,

10. What central banks do domestically, they also do to the international monetary system. Thus, the inherent fragility and the huge structural imbalances arising from cross-border trading exist today because of central bank actions. The automaticity of the classical gold standard ensured that imbalances such as trade deficits were relatively short-lived. In contrast, present central bank policies have perpetuated the long running US trade deficits, which are now several decades old. What's worse, the US trade deficits are growing. The debt being created to finance these deficits impacts the monetary environment of each US trading partner. So central bank engineered imbalances are not just domestic problems; they also have global implications.

So central banking is indeed barbarous, but I have only completed one-half of the bargain. Having provided some of the many reasons why central banks are barbarous, I also need to explain why central banking is a relic, but that's easy to do.

Central banking has been around for more than 300 years. In that time, an institution becomes either a venerable object or an obsolete relic. If central banks once served a useful purpose, it was when they were governed by the discipline of the classical gold standard. Having abandoned Newton's rules, central banks are abusive to free markets and antithetical to sound money. The reasons that make central banks barbarous also make them an unwanted relic. Central banks are a relic of empire, nationalism and war.

Having existed now for hundreds of years, they have survived not because they advance commerce or contribute to raising mankind's standard of living, but rather, solely because they are disingenuous, slavish parasites dutifully serving the omnipotent State, no matter how mindless or harmful that bidding may be. Central banks pursue reckless policies that erode – and in some cases destroy – the value of the currency. In this way, central banking is not only a barbarous relic of the past, it has become dangerous as well.

So when confronted with attempts by anti-gold propagandists to bash gold, we now know how to respond. The barbarous relic is central banking and any central bank that prevents the restoration of sound money.

Not too many years from now – when the US dollar collapses, as just one in a long list of fiat currencies that have collapsed before it – people will look back and ask themselves how it was possible barbarous institutions like central banks could have hoodwinked so many people into thinking that central banks were a good thing. The answer is that central banks have created the illusions of prosperity. Because people think they are well off, they have no reason to question basic tenets that they are led to believe. For this reason, people are easily coddled into believing that gold is the

barbarous relic, that central banks are doing a good job, and that their financial future is secure, but nothing could be further from the truth. It is what some on Wall Street like to call “bubble mentality”, and while it may be true that this condition is a state of mind, it is also true that it arises without any thinking going into it.

So in conclusion, the gold standard is dead, but as the chart at the beginning of this essay shows, gold remains the standard. It is the value by which all things are measured, just as it was when Newton’s great invention, the classical gold standard, reigned supreme.

This observation is important to the future of gold, which needs to circulate once again as currency in parallel to – and competing with – government controlled and central bank ‘managed’ national currencies. The future of gold depends on the opportunity for gold to do what it has always done throughout history, namely, to provide a neutral tool that people can use voluntarily – without force or coercion – as currency as we go about our business each day participating in our market economy to fulfill our needs and wants. It is upon this vision that my partners and I are building GoldMoney.

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[1] There are many examples that illustrate gold’s ability to maintain its purchasing power. Items as dissimilar as men’s suits, Colt-45 revolvers and the set menu lunch at London’s Savoy Hotel have been used to demonstrate that gold retains its purchasing power, as the price of these items in terms of gold remains relatively unchanged over long periods of time. For a detailed analysis of the historical relationship of gold to commodity prices, see *The Golden Constant: The English and American Experience, 1560-1976*, Roy W. Jastram (John Wiley & Sons: New York, 1977).

[2] This observation rests largely upon logic because it is difficult to locate all the hard facts needed to support it. World population growth is estimated at 1.14%, <http://www.cia.gov/cia/publications/factbook/print/xx.html>. The World Gold Council estimates that as of 2002, 147,000 tonnes of gold have been mined throughout history, <http://www.gold.org/value/stats/faqs/index.html>. Allowing for additional production since then of about 2,500 tonnes per year, total production is 154,500 tonnes. Because gold is accumulated – in contrast to other commodities, all of which are consumed – most of this gold exists in today’s aboveground stock. The weight of gold lost due to shipwrecks, attrition of circulating coinage, etc. is unknowable, but generally believed to be fairly small because of the care given to gold in view of its high value. If we therefore assume that the aboveground gold stock is 150,000 tonnes after adjusting for the weight of gold lost over time, then 2,500 tonnes of new production is increasing that stock by 1.66% annually. The rate of new wealth creation is harder to determine. The CIA Factbook referenced above estimates world GDP grew by 4.9% last year, but not all of this economic production increased the world’s net wealth. It is in my view therefore not unreasonable to assume that the rate of new wealth creation rests approximately somewhere between 1.14% and 1.66%, which explains why gold’s purchasing power remains consistent over long periods of time.

[3] Of the books that explain how and why banking interests and governments killed the gold standard, my favorite is *Pieces of Eight: The Monetary Powers and Disabilities of the United States Constitution* by Edwin Vieira, Jr. (Sheridan Books: Fredericksburg, Virginia, 2002), <http://www.piecesofeight.us>. For my recent review of this book, see: <http://www.fgmr.com/pieces8.htm>

[4] See *Human Action*, Ludwig von Mises, p 209. Mises describes the “exchange ratios between money and the various goods and services” to be the “mental tools of economic planning”. Given that money is the means that enables individuals to communicate their subjective view of value, money itself is also a mental tool. On p. 177 Mises states: “Language is a tool of thinking as it is a tool of social action.” In my view, the same thing can be said about money because like language, money is a means of communicating.

[5] This process is known as fractional reserve banking. Banks only keep in reserve a fraction of the total weight of metal needed for them to redeem all of their liabilities to pay metal. For a detailed discussion of fractional reserves, see Murray N. Rothbard, *The Case for a 100 Percent Gold Dollar: In Search of a Monetary Constitution*, Leland B. Yeager, ed., Cambridge, MA: Harvard University Press, 1962, pp. 94-136, and Auburn, AL: Ludwig von Mises Institute, 1991. <http://www.mises.org/story/1829>

[6] The key rules accomplished the following: (1) defined the British pound in terms of a specific and unchanging weight of gold, (2) confirmed that pound banknotes circulating as money substitutes were redeemable into coin upon demand of the holder of the banknote, (3) confirmed that pound coins and pound banknotes were of equivalent value, meaning they could be exchanged 1-for-1, and (4) established that the Bank of England was responsible for maintaining prudent policies to ensure redeemability of banknotes into coin, which was essential for an orderly monetary system. The practical result is that it became accepted Bank of England practice in the 18th and 19th centuries to maintain a gold reserve equal to approximately 40% of its gold liabilities. The British pound became the world’s international currency, largely supplanting gold in that role because even though banknotes were not 100% backed by gold, the pound was generally considered to be ‘as good as gold’. The expansion of the British Empire was not just the result of the British navy; sound money also played an important role. The pound – managed as it was under the classical gold standard – enabled the global expansion of commerce. “The gold standard had become, in effect, the global monetary system. In all but name, it was a sterling [i.e., British pound] standard.” See Niall Ferguson, *Empire: The Rise and Demise of the British World Order and the Lessons for Global Power*, (Basic Books: New York) 2003, p. 245.

[7] The cause of the Great Depression should be “placed where it properly belongs: at the doors of politicians, bureaucrats, and the mass of ‘enlightened’ economists.” This quote is from *America’s Great Depression*, Murray N. Rothbard (Sheed and Ward, Inc.: 1975, 3rd Edition), p. 295.

[8] On August 15, 1971, President Nixon declared the ‘gold window’ of the Federal Reserve to be closed, which meant that dollars were no longer redeemable into gold.

[9] From the July 2005 issue of *The Moneychanger* by Franklin Sanders, www.the-moneychanger.com, which included a noteworthy critique of central banking.

[10] See the work published by www.GATA.org for a detailed analysis of this intervention. I also recommend the analysis of John Embry and Andrew Hepburn, *Not Free, Not Fair: The Long-Term Manipulation of the Gold Price* published in August 2004 by Sprott Asset Management, www.sprott.ca, an investment firm based in

Toronto, Ontario, Canada.

[11] See footnote #9.

[12] See for example the European Central Bank's balance sheet, <http://www.ecb.int/pub/annual/html/index.en.html>. Also, this point is reviewed in the Embry/Hepburn paper; see footnote #10.

[13] Richard Russell is the editor of *Dow Theory Letters*, <http://www.dowtheoryletters.com/dtlol.nsf>

[14] See <http://www.federalreserve.gov/boarddocs/speeches/2002/20021121/default.htm>