Why I Own Gold

In 1920 a $20 gold piece was worth, well, $20. That is, you could trade a one ounce coin (which was roughly 97 percent gold, with a sprinkling of copper) for 20 one dollar bills.

At the moment, gold trades for about $1,180 per ounce. You can trade an ounce of gold for 1,180 pieces of paper called the U.S. dollar. Gold is today "worth" 59 times what it was worth in 1920.

The value of an ounce of gold varied between $19 and $21 from 1800 to 1930. For an astounding *130 years* the price of gold remained essentially constant. Why? Because the United States government was on the gold standard. Citizens could use gold coins for purchases, but even when they used paper currency they knew they could always trade in their paper dollars for solid gold. The federal government often borrowed money, but the lenders expected to be paid back—in gold if they insisted. The gold standard kept the government from spending money it did not have.

Then, along came Franklin Delano Roosevelt who, as president, decided we no longer needed to remain on the gold standard (or follow the U.S. Constitution). Gold was even confiscated from private citizens (on April 5, 1933). Why, after all, did anyone need to retain gold coins? Could they not trust the government? Americans *should* have revolted but, being a generally trusting and naïve lot, they did not. After all, FDR promised to save them from the Great Depression, had he not? Surely he knew best!

The minute the nation went off the gold standard, of course, the government started printing money as fast as it could. Those thousands of make-work jobs FDR created through a multitude of unconstitutional programs had to be paid for, so he raised taxes (which he had promised not to do) and printed money (which he figured no one would notice). Businesses obviously noticed the rising taxes, and responded by contracting their operations and reducing their work forces. FDR's tax hikes (among other significant blunders) caused a severe recession to turn into a depression.

Most Americans did not notice that FDR was printing money or, if they did, they appreciated his doing so because they were the ones getting it. An unemployed person is happy to get a job, of course, even if he is being paid with dollars that are worth less than they used to be worth, and even if everybody will be worse off in the long run.

As all governments do, once unrestrained by something as quaint as a gold standard they continue to print money. After all, with more money you can give people "more stuff." Giving away "more stuff" gets you reelected. And you can always print more money. So, print more money the government did. But the amount of money rose faster than the amount of "stuff," meaning that considerably more cash was chasing the nation's goods and services. The result is always inflation. (The word "inflation" comes from the process of "*inflating* the money supply." Inflation does *not* mean rising prices; inflation *results in* rising prices. Artificial economic "bubbles" should instead be called "balloons;" they are not a phenomenon that occurs randomly like soap bubbles, they are the result of "blowing up" some or all of the economy unjustifiably. Providing the air—the money—for the balloon is the government.

As the government prints more money, the value of that money falls. If you now earn $50,000 per year but used to earn $25,000 per year, you are *not* necessarily better off financially—because the prices of goods and services have increased while your salary has risen. You may actually be worse off. If prices have increased *faster* than your salary, your $50,000 will now buy *less* than your $25,000 used to. In fact, even if prices have increased at the exact same pace as you salary, you are still worse off—because you may have been pushed into a higher tax bracket. (Don't think the legislators in Washington, D.C. aren't aware of that. Politicians use the hidden tax of inflation because most people are fooled into believing they are better off: "I make three times what I used to make, so I *must* be better off.")

Rather than looking at the value of goods in terms of raw dollars—it's only paper, after all—stop to consider the cost of goods in terms of "percentage of income." If you make $50,000, for example, don't look at a $25,000 car as costing $25,000, look at that car as costing 50 percent of your annual income. Years ago, when you bought a car for $10,000, how much was your annual income? If your income was then $20,000, the car cost 50 percent of your income, just as it might today. *But* if you then earned $25,000, that $10,000 car cost only 40 percent of your income—not 50 percent.

As a percentage of income, most people would agree that cars and houses cost more than they did in the past, even though certain items, like refrigerators and televisions, cost less. A reasonable person might assume that most Americans would rather pay more for refrigerators and televisions and less for houses and cars. (It is worth noting that it is typically products produced by unionized labor whose prices have increased at the fastest pace.)

Many people, if they look at the cost of goods and services, may now find that they are worse off than they used to be, even though they earn more money than they ever thought imaginable. How many people who earned $10,000 per year 35 years ago thought, "If I could only earn $15,000 per year, I'd be on easy street." Now, they make considerably more than $15,000 per year… and easy street is still on the other side of the railroad tracks.

In 1920, the average American worker's income was about $1,200 per year, and gold was about $20 per ounce. Today, gold is selling at about $1,180 per ounce, or *59 times* what it sold for in 1920. But is the average American worker's income now 59 times what it was in 1920? Is it $70,800 (59 times $1,200)? Not by a long shot. The average American household income is about $50,000—but that is *household* income, often with *both* husband and wife working. In 1920 there was usually only one breadwinner in the family. Today's median income per household member (including all working and non-working members above the age of 14) is about $26,000. Today's average income (age 25 or older) is about $32,000.

Over a period of 89 years (1920 to 2009), average income has gone up about *27 times* ($32,000 divided by $1,200). But the price of gold has gone up *59 times* ($1,180 divided by $20). The value of gold has risen twice as fast as the value of labor.

Again, between 1800 and 1930 the price of gold remained constant. By 1935 it rose to about $35 per ounce. (Why? Because FDR took the United States off the gold standard.) Then, slowly, each year gold's value increased. By the mid-1970s it was appreciating rapidly, as the government engaged in deficit spending and simply printed money to pay its bills. Today, the federal government is printing money by the hundreds of billions of dollars. That cash is now sitting in banks—which are at the moment reluctant to lend it. But if and when the national economic situation improves, that currency will be released into the economy in the form of commercial real estate, home mortgages, auto loans, and business loans. Banks are today sitting on a whopping *$850 billion* in excess reserves. That is, they have about $850 billion they can lend without running afoul of minimum reserve standards. Imagine what will happen to prices when most of that cash "hits the streets." Jimmy Carter's inflation (remember the "misery index?") will look like the good old days.

When the hyperinflation strikes, the price of gold will go up even more. But, understand it is not so much that gold will be worth more—it is the U.S. dollar that will be worth *less*.

A few weeks ago the Reserve Bank of India purchased 200 tons of gold for $6.7 billion from the International Monetary Fund (IMF) using its foreign currency assets. (India dumped U.S. dollars.) Although $6.7 billion is not a tremendous amount by government standards, the move was significant because it signaled that India is stating a preference for gold over U.S. dollars—India expects the value of the dollar to drop even more. India chose to purchase gold, which it expects to appreciate in value, rather than U.S. Treasury T-bills, which are paying very little interest. India knows that if it purchases T-bills, its loan to the U.S. government will eventually be paid back with U.S. dollars—dollars that Obama, Geithner, and Bernanke are printing as fast as they can. India wisely decided that gold is better than paper. China may soon decide the same thing, promises of "hope" and "change" notwithstanding. (As if it hasn't been enough that Republicans have been asking how the Democrats are going to pay for a national health care program, when Obama was in Beijing he was asked the same thing by the Chinese government.) China has been busy converting its 30-year bonds to one-year bonds; they are doing that for a reason, and it certainly isn't an expectation that interest rates will be going down or that the dollar will be going up.

The Obama administration now faces a dilemma: if it raises interest rates to attract foreign buyers of its massive debt, it risks further harming the U.S. economy; the economy isn't going to recover if interest rates rise dramatically. But if the administration (via the complicit cooperation of the Federal reserve) leaves interest rates too low, it will find few buyers of its debt and will have to print money to cover the enormous budget deficit. That, in turn, will cause the value of the dollar to go down, and will make investments in gold or other commodities even more appealing than T-bills. No matter what Obama does he will create a disaster… either a deepening recession or hyperinflation. What will Obama do? He will fire Treasury Secretary Timothy "TurboTax" Geithner to shift the blame and make it look like he is doing something—and he will keep printing money. Geithner will survive the firing, but America may not survive the hyperinflation.

Arguably, Obama may not have much choice but to print money to pay the bills. Over the next 12 months or so, about $2 trillion in short-term T-bills will be expiring. Their owners (individuals, financial institutions, and foreign governments) will either want the return of the dollars they loaned to the government, or they will roll them over into more T-bills. *Obama's problem is that they will want a higher interest rate.* If he does not provide them with a higher rate of return, they will take their dollars and put them somewhere else. Of course, Obama does not have the $2 trillion to return to those lenders—so the Federal Reserve will have to refinance that debt. It will do so by printing money. In addition to that $2 trillion that has to be refinanced, Obama also has his administration's staggering annual deficits to finance. There simply isn't enough money in the world to finance all that debt, because other nations (notably Great Britain and Japan) are also swimming in their own red ink. Even Americans themselves cannot finance the incredible debt load of the U.S. government. If they completely emptied their savings accounts and patriotically marched down to their banks to buy U.S. Savings Bonds, the amount would be approximately $700 billion. That's a mere six months of Obama deficits. If billionaire Warren Buffet gave Obama every dime of his vast fortune, it would be burned through in a few days. (On paper, Americans have about $7 trillion "ín the bank." But their cash is of course not all "in the bank," it has been loaned to others to start businesses, buy homes, and finance auto loans. Banks have only about 10 percent of their assets on hand—about $700 billion. If *every* American were to actually withdraw *every* dollar from his bank account, *all* banks nationwide would fail. Although a portion of bank deposits—about $4.7 trillion—are insured by the FDIC, that agency doesn't have $4.7 trillion either; it has a "line of credit" of about $500 billion. It's all smoke and mirrors, and it "works" only while people have trust and faith in the government to "do the right thing.")

So, Obama will print money. With every dollar he prints, the value of the dollar will fall. The more he prints, the faster its value will decline. Every day it will be *worth less*, and at some point it could even be *worthless*. (The citizens of Zimbabwe learned that the hard way. Zimbabwe's government was so cash-strapped it even had to borrow money to buy the paper and ink to enable it to print more money. People were walking around with trillion dollar bills in their wallets—which did not mean too much when a loaf of bread cost 20 trillion dollars.)

India understands this. With its gold purchase, India was making a proclamation to the world that it thinks Western currencies are bankrupt. Investors expect gold to continue its climb as long as the U.S. government—and many other nations—maintain irresponsibly high annual deficits. Printing paper money that continues to decline in value cannot help but boost the price of commodities like gold, silver, platinum, and copper. When inflation is inevitable, gold becomes the hedge for many.

Central banks around the world have also been increasing purchases of the euro and the yen, in place of the dollar. On a trade-weighted basis the U.S. dollar has lost 20 percent of its value since 2002, mostly because of the irresponsible deficit spending by the Congresses of both political parties. Traders in currency are moving slowly, because too quick a move to dump the dollar will result in an even faster decline in its value, but they are nevertheless trending away from U.S. currency. Some investors expect the dollar to recover against the euro in the short term, but over the long term the prospect is good only if the U.S. government reduces its enormous deficits—something most believe is impossible.

"But the stock market has been going up! Isn't that a sign that the economy is improving?" Observed investment guru Peter Schiff, "It looks like stocks are going up but on a real basis they're going down." That is, stocks may be worth more in U.S. dollars, but the dollar itself is worth less. The Dow Jones Industrial Average is today worth about 9 ounces of gold; in 2000 it was worth 43 ounces of gold.

What should be done? The federal government must *drastically* cut spending to show the world it is serious about reducing the deficit. As a start, the Department of Education should be eliminated completely. That would save $141 billion. (Its budget was $60 billion under Bush; Obama more than doubled it.) Next, eliminate the Department of Energy, which does little but prevent American companies from accessing domestic energy supplies and stop the construction of sorely needed nuclear power plants. Don't spend any more of the "stimulus funds." (The money isn't there anyway.) Don't pass national health care legislation that will cost another trillion or more dollars the government does not have. Reduced spending means both reduced borrowing and reduced printing of worthless money.

In other words, the federal government has to learn to live within its means. If you expect it to do so, hang on to your paper dollars. If you expect it to keep doing what it has been doing for generations, buy gold.

Don Fredrick

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P.S. the United States Mint has stopped selling one ounce American Eagle gold coins because it cannot keep up with the demand, and the Federal Deposit Insurance

Corporation (FDIC) is essentially broke.

P.P.S. The amount of paper currency in the world, of all nations and all denominations, is estimated to be about $253 trillion. Based on the approximate amount of gold in the world, if everyone suddenly demanded gold instead of paper currency, the value of an ounce of gold would shoot up to $47,000 per ounce.

I recommend the following article about the African nation of Zimbabwe and how its inflation began and was ended:

http://www.kitco.com/ind/Field/nov112009.html

Also, refer to the calculator, at the following web site, which determines the value of the dollar from one year to another:

http://www.measuringworth.com/ppowerus/index.php