The Gold Coin Currency and The Gold Price

By Olivier Ledoit

Using gold as money should be an option, not an obligation. Usage of money typically requires two parties, such as a buyer and a seller, or a saver and a banker. Whenever both parties agree to use gold as money, their right to do so must be legally protected. This is not the case right now. The US outlawed gold ownership and circulation in 1933, so it could happen to you anytime.

Switzerland has a project to amend the Constitution to protect those who wish to use gold as money. This is the “Gold Franc” project. It was launched last year by a Swiss citizen named Thomas Jacob. Mr. Jacob’s idea attracted a number of followers, who started to meet regularly, and eventually decided to found the “Gold Franc Association”. He managed to convince a group of parliamentarians from the largest party in Switzerland to deposit an initiative to institute the Gold Franc as a parallel currency to the paper Swiss Franc. This initiative is currently under review by the Economics and Taxation Committee. Parliamentary hearings are expected later in the year.

The Gold Franc would be defined as a fixed weight of gold, such as One Decigram. Its exchange rate with the paper Swiss Franc would fluctuate freely according to market forces, like any other currency.

This is not a “return to the Gold Standard”. When Keynes famously coined the phrase “barbarous relic”, he was not applying it to gold *per se*, but to the Gold Standard as it had been practiced in the interwar era. Current Fed Chairman Ben Bernanke himself said that the Great Depression was due to “a structurally flawed and poorly managed international Gold Standard”. We are not returning to that. We are inventing a monetary system that combines the best of both worlds, and that has never been seen before on the face of the Earth.

On the one hand, we will legalize a *Gold Specie Standard* such as the one that underpinned progress in the Western world from the Middle Ages until the outbreak of World War I. This is the period that allowed Europe to rise above the rest of the world in terms of prosperity, science and technology. In simple terms, it means that gold coins will circulate as monetary and savings instruments.

On the other hand, paper money will be allowed to continue its existence. It will even remain *legal tender*, meaning that if both parties in a transaction disagree as to what money should be used, paper wins over gold. We are very much willing to concede this advantage to paper, because in the end it does not matter. You cannot force people to accept gold as payment if they prefer paper. Just keep your gold and give them paper!

Thus, for the first time in history, gold coins (100% commodity-backed money) will coexist with pure fiat money. This has never happened. We believe that it will be extremely beneficial to Switzerland, and to any other country who subsequently adopts this system. Everybody should have the right to use the type of money they prefer. This is, first and foremost, about **choice**.

If and when this constitutional amendment goes through, for the first time in our lifetime, gold will be money. Currently, gold is not money. Gold is *perceived* as money by some people. Gold was money *in the past*. Gold may become money again *in the future*. But gold is not used as money anywhere in the world right now.

Gold will be money, at least in Switzerland. Switzerland is small geographically but big financially. Basel is home to the *Bank for International Settlements*, the world's oldest international financial organisation, and #1 international banking regulator of the past few decades. Zurich is a – if not *the* – leading market in the world for physical gold. Zug hosts many of the world’s largest commodity traders. Therefore the Gold Franc project is a development of worldwide importance. It means that physical demand for gold will no longer be limited to Indian jewelry: there will be an additional Swiss monetary component.

Obviously, after the Swiss reform has proven successful, other countries may be tempted to adopt similar laws, thereby putting further upward pressure on the gold price. But let’s just focus on Switzerland for the moment.

Total Assets Under Management (AUM) for Swiss pension funds was estimated at roughly USD 700 bn in 2010. In addition, AUM held by insurance companies in the same year were at roughly USD 300 bn, according to FINMA numbers (when only considering bankable assets). Putting these two figures together gives us an estimated USD 1000 bn of assets held by insurers and pension funds. Assume only 1% of these assets are switched out of the paper Swiss Franc into the Gold Franc. With the gold price at USD 1600 per ounce we could buy 6'250'000 ounces of gold, which corresponds to about 195 tonnes. In 2010, total annual gold demand was about 3800 tonnes, of which about 1300 was identifiable investment demand. Therefore, every 1% of Swiss assets that switch into the Gold Franc increase investment demand for gold by 15%.

An academic study from the City University Business School in London estimates the price elasticity of gold in the range from -0.5 to -1.0. Let’s take -0.75 as a median number. This means that every 1% of Swiss assets that switch into the Gold Franc would push up the gold price by approximately 11%. This eleven-fold multiplier is impressive, given there are only 8 million people in Switzerland! It is due to two main factors: 1) the importance of Switzerland as a global financial center, and 2) the tiny size of the physical gold market.

Further information is available under the Gold Franc Association’s website www.goldfranc.org.