Gold Standard, 1876-1933

- Gold was part of Monetary Base
  - Public, domestic and foreign, could demand gold at will for dollars.
  - Government essentially had no control over monetary base.

Why Gold for Money

- High value to weight ratio.
- Does not corrode or rot.
- Homogenous.

Gold was not universal:
India, among others, used silver.

Some Problems with Gold

- Adulteration with Base Medals
- Clipping Coins
Some Problems with Gold

- Adulteration with Base Medals
- Clipping Coins
- Solution: Government Mints
  - Assays Gold
  - Stamp Coins
  - Mill them

The London Goldsmiths

- Why keep gold at home?
  - Keep it secure at your goldsmith.
- And why actually use gold for purchases?
  - Transfer receipts
  - Essentially Checking Accounts

The Goldsmith

- You hold 100 oz of gold for the following accounts.
  - Smith: 40 oz
  - Jones: 40 oz
  - Green: 20 oz
- Withdrawals and deposits average out.
  - 90-110 oz

You have invented fractional banking!
The Goldsmith

• Wilson comes along and wants to borrow 20 oz of gold.
• You give him a gold receipt.

- **Assets**
  - 100 oz of gold
  - 20 oz IOU from Wilson

- **Liabilities**
  - 120 oz of gold accounts

You have invented fractional banking!

Eventually…

- **Assets**
  - 20 Oz of Gold
  - 180 Oz of Gold IOU’s

- **Liabilities**
  - 200 Oz of Gold Deposits

Why this ratio? Why not?
The key point is that you only want to keep fractional reserves.

One of your depositors strikes gold

- Mines 80 oz of gold, gets it minted by the government and brings the coins to your bank.

- **Assets**
  - 100 Oz of Gold
  - 180 Oz of Gold IOU’s (including the new 80 oz)

- **Liabilities**
  - 280 Oz of Gold Deposits (including the new 80 oz.)

One of your depositors strikes gold

- Mines 80 oz of gold, gets it minted by the government and brings the coins to your bank.

- **Assets**
  - 20 100 Oz of Gold
  - 780 900 Oz of Gold IOU’s

- **Liabilities**
  - 280 1000 Oz of Gold Deposits
The Consequences

• Your customer is better off.
• Prices rise 5 fold.

End