



Benjamin Graham

“In an oversimplified phrase, we may say that we are placing the farmer and other raw materials producers in the same category as the owners of gold mines, by according the same monetary status to basic commodities as a group, that has long been conferred on gold.”

~ Storage & Stability. 1937. 229

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Beyond Ben Graham's Currency Proposal Retrospect and Evolution

Joseph Potvin
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Government of Canada

Keynote Address to the
Second Annual Symposium on Value Investing
Conference of the Multinational Finance Society
Rethymnon, Crete, Greece
29 June 2009

Agenda

Part 1: A Look Back at Ben Graham's
Commodity-Reserve Currency Proposal

Part 2: Why Graham's Proposal Did Not Prevail

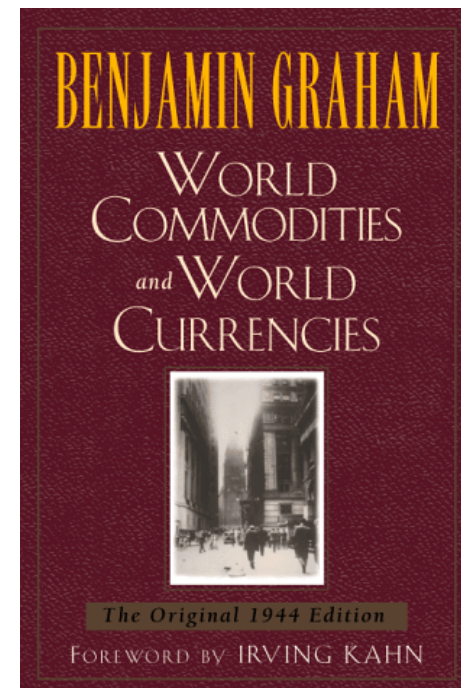
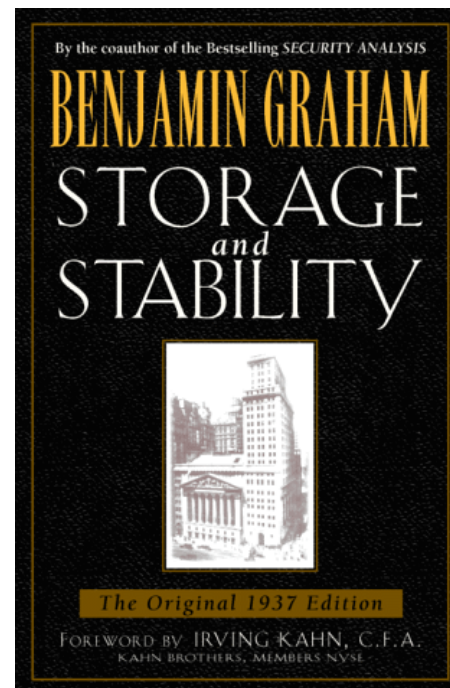
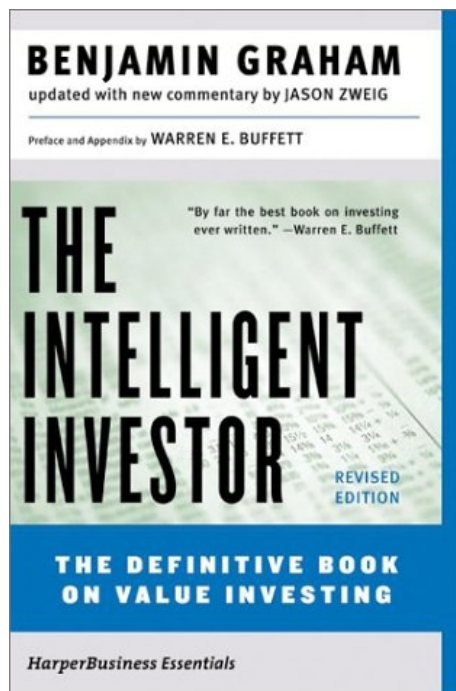
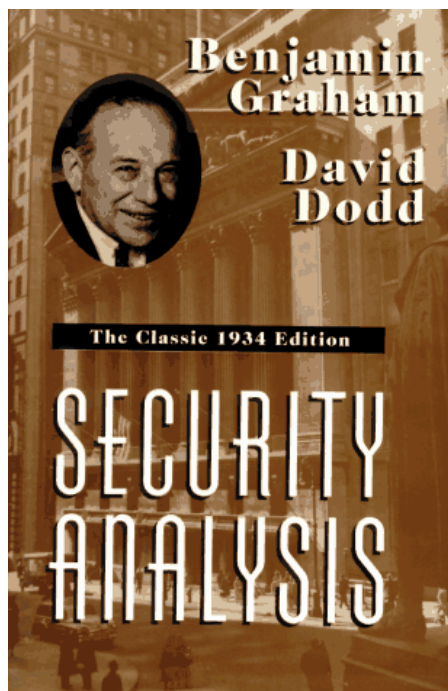
Part 3: Building Upon Graham's Essential Concept

Annex 1: Brainstorming an Earth-Reserve Currency Standard

Part 1:

*A Look Back at Ben Graham's
Commodity-Reserve Currency Proposal*

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal



Value Investing:

The identification and purchase or sale of stocks in relation to their intrinsic value.

- *Security Analysis*, 1934 (with David Dodd)
- *The Intelligent Investor*, 1949

Commodity-Reserve Currency:

Alignment of the monetary system with intrinsic value, to remove uncertainty about the value of money from investment decisions.

- *Storage and Stability*, 1937
- *World Commodities and World Currencies*, 1944

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

Origins in the 1920-21 Recession

- End of World War I
- Market decline of 1920-21
- Graham new on Wall St.
- Observes need to:
 - Contain speculative price volatility during a bull market
 - Accommodate surplus capacity during a bear market.
- Wilson Dam mega-project, Tennessee River, Alabama
- Started in 1918 near end of WWI
- Construction stalled by recession
- US Congress debate on \$30 million in Treasury bonds to finance completion

Henry Ford's Currency Proposal

New York Times, 4 December 1921

- 100-year lease on Wilson Dam
- Treasury to issue, and loan to Ford Inc. \$30M in currency backed by
 - The natural resource
 - The capital infrastructure
- Ford Inc. to pay 4% annually
 - Paid in 25 yrs
 - Gov receives rent for 75 yrs
 - No government debt to service



New York Times, 6 Dec. 1921

- Thomas Edison's support

Thomas Edison's Currency Proposal

New York Times, 20 Feb. 1922

- Letter to bankers and economists
- Warehouses to store commodities
 - Fed to issue money worth 50% of 25-yr-avg market value of stored commodities
 - Fed to issue equity certificates worth 50% of the 25-yr-avg market value, that producers could hold, sell, or use as collateral.
- Edison proposed both ideas in fixed proportion:
 - 90 per cent commodity reserves backing (Edison's concept)
 - 10 per cent resource and infrastructure backing (Ford's concept)



Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

Resource/Commodity Reserve Currency Proposed & Declined (1920s)



President Harding on trip to cottage with Ford, Edison and Firestone and families.
July 23-24, 1921.

- Controversy: public versus private ownership/operation of infrastructure
- Ford/Edison monetary proposal rejected by Congress
- Wilson Dam stalled for 10 years until public Tennessee Valley Authority finance on debt, Roosevelt's New Deal

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

Idea Revisited in the Post-1929 Depression

- 1929 market crash
- 1931 further decline
- 1931 Graham circulates “The Commodity-Reserve Plan” at meetings of New School for Social Research, Manhattan
- 1933 "Stabilized Reflation", *The Economic Forum*

Concurrent ideas...

- 1930 Bank of Sweden
- 1932 Jan Goudriaan, Rotterdam
- 1936 Paul Einzig, London
- 1936 Adolf Berle & Victoria Pederson, Boston

Earlier foundations...

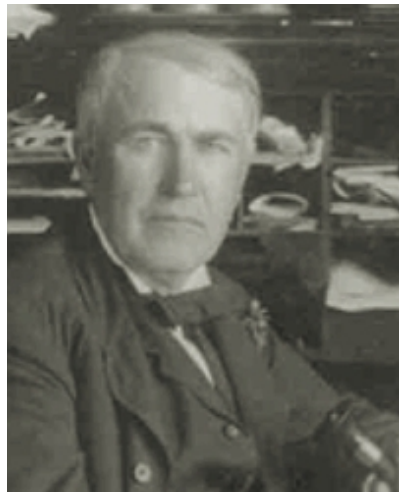
- 1877 W. Stanley Jevons: “tabular standard of value”
- 1888 Alfred Marshall, Cambridge: “symmetalism” or “bimetalism” fixed ratio

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

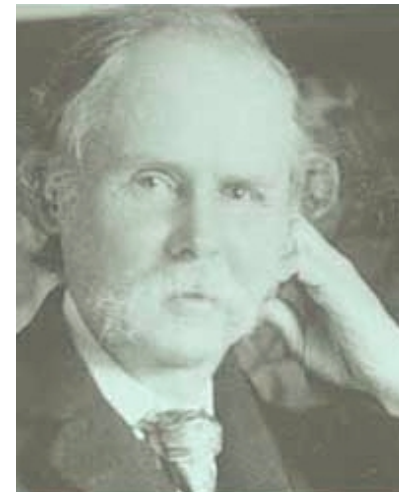
Ancient Roots

- Confucian “Ever-Normal Granary” in China “from 54 B.C. to the present time” (Today: State Reserve Bureau)
- Commodity reserve systems in Peru, Egypt and Rome.

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal



Direct Influences



- Graham on Edison:

“We must add, however that Edison's monetary philosophy was much broader than his specific plan. ... We should like to claim for our plan that it carries out the fundamental concepts of the great inventor, which his own plan would fall short of realizing.”

- Graham on Marshall:

“It will be recognized that the underlying principles of symmetalism and of our commodity-unit currency are identical. Our monetary proposal may therefore be defined as symmetallism applied to a fairly large group of basic commodities, instead of to gold and silver.”

Ben Graham's Currency Proposal

- Banks and investors depend upon coherence in the monetary system
- Operational banking principles are necessary but not sufficient
- More basic value principle:
Currencies should be *genuinely liquid* thus reliably convertible into useful physical commodities
- Requires stable price and supply
- *Standard composite unit* of reference commodities
- Commodity unit monetized directly



Ben Graham's Currency Proposal



- *“We define the dollar as equivalent to the commodity unit ... essentially sounder than the gold dollar”*
- Incrementally replace conventional currency:
 - No increase in money supply
 - No inflationary effect
 - Used in normal trade
- Network of commodity-reserve banks buy or sell standard commodity bundles
 - Maintain average price of the composite unit
 - Relative prices amongst the commodities vary

Ben Graham's Currency Proposal

- *“Such an arrangement would amount simply to putting the State in the role of a shrewd long-term operator in basic commodities, blessed with an unlimited bank roll.”*
- *When average market price of the basket of commodities reaches a low threshold:*
 - *The Treasury purchases commodities* for storage in the defined standard proportion with commodity-reserve money (instead of fiat or gold-backed money)
- *When average market price of the basket of commodities reaches a high threshold:*
 - *The Treasury sells commodities* from storage in the defined standard proportion in exchange for any type of money



Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

Components of Graham's Proposed Unit of Traded, Standardized, Storable Commodities

- Wheat (all grades)
- Barley (No. 2)
- Cocoa (Accra)
- Corn (No. 3 white & yellow)
- Cottonseed oil (yellow refined)
- Oats (No. 3 white)
- Rye (No. 2)
- Sugar (granulated)
- Cotton (middling upland NY)
- Silk (Japanese 13-15)
- Wool (raw)
- Flaxseeds (No. 1)
- Rubber (smoked sheets)
- Cottonseed meal
- Tobacco (avg farm price + 10%)
- Coffee (avg import price)
- Tallow (inedible)
- Copper (electrolytic)
- Lead (refined)
- Tin (straits)
- Zinc (prime western)
- Petroleum (Kansas-Oklahoma price at well + 20%)

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

Graham's Key Concepts:

“Money as Pure Commodity”

- *“Not so much to give commodity value to money as to give monetary value to commodities.”*
 - ~ Graham, 1947, *Money as Pure Commodity*.
- *“We are placing the farmer and other raw materials producers in the same category as the owners of gold mines.”*
 - ~ Graham, 1937, *Storage and Stability*

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

Graham's Key Concepts:

“Liquidity Concept”

- Commodity inventories are the most liquid of assets
- Cash is only as liquid as its purchasing power
- Graham opposed to:
 - Unsecured currency
 - Government-bond-secured currency
 - All ‘secured’ currency where the intrinsic value of the security is less than money issued against it.

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

Graham's Key Concepts:

“Automated Buffer Stock Mechanism”

- Reserve commodities introduced to and removed from the market by the treasury under an automatic predictable formula

“Flexible to Relative Supply & Demand Changes”

Each commodity could fluctuate in price, becoming a larger or smaller component of the commodity unit, and reflect supply and demand changes.

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

Graham's Key Concepts

“Generalization of Commercial Bills”

- Generalization and socialization of the *commercial bills* instrument (delivery redeems the bill, which then goes out of circulation)

“Counter-Cyclical Monetary Strategy”

- *Appealed to orthodox banking principles, but reversed implications.*
 - Downturn: commodities taken off the market, money expands
 - Upturn: commodities released to market, money contracts

~ Perry Mehrling, Columbia University

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

Commodity-Reserve Currency Proposed & Declined (1930s)

- 1931, Graham's plan “receiving serious consideration in Washington” via a friend of NY Governor Roosevelt
- 1933, a possible method of financing under the **Commodity Credit Corporation**.
- 1933, Roosevelt's **Agricultural Adjustment Act** disappointed Graham:
 - Storage funded by tax
 - Farmers paid to take land out of production, and to destroy crops/livestock

Commodity-Reserve Currency Proposed & Declined (1940s)



- **International Monetary and Financial Conference at Bretton Woods, New Hampshire, in July 1944:**
 - *Graham's World Commodities and World Currency, 1944*
 - Friedrich A. Hayek's "*A Commodity Reserve Currency*" 1943
 - Supporting rationale by Frank D. Graham of Princeton



- Dollar convertible to gold
- Other currencies pegged to US dollar
 - No commodity price stabilization
 - No connection to tangible commodities

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

Commodity-Reserve Currency Proposed & Declined (1960s)



- 1964 Nicholas Kaldor, Jan Tinbergen and Albert Hart
- **United Nations Conference on Trade and Development (UNCTAD)**
- Refashioned Keynes' “bancor” to Graham's reserves (30 commodities)
- Limited interest amongst monetary economists or financial executives
- 1969 IMF "Special Drawing Rights" (SDRs) based on a basket of currencies

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

1970s – 1980s – 1990s – 2008

- Opposition to the very intent of a commodity-reserve system:
 - Against intrinsic value
 - Money just a market lubricant
 - No counter-cyclical moderation
- 1971 unilateral US termination of Bretton Woods structure
- Money based upon virtual units of credit obligation
- 2006 US Federal Reserve terminates reporting on M3

“The Fed is really saying that it doesn't believe money matters.” The Economist, March 2006

Part 1: A Look Back at Ben Graham's Commodity-Reserve Currency Proposal

1998 – 2008

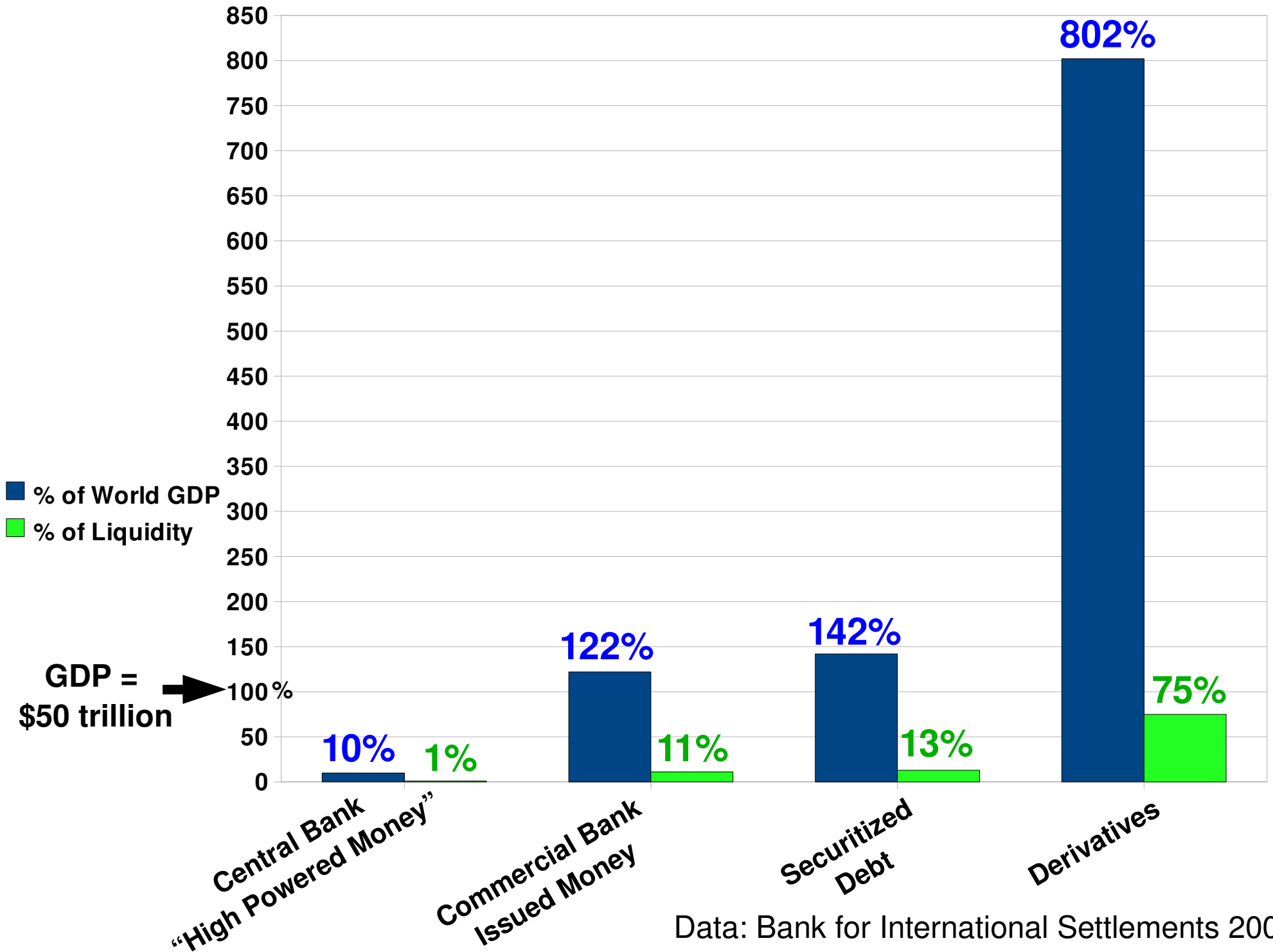
Hyper-extension of pseudo-liquidity
through “derivatives”

- Beyond M3
- Beyond public accountability
- No intrinsic value

“Megacatastrophe risk”

*“Financial weapons
of mass destruction”*

~ Warren Buffett
Berkshire Hathaway
2002 Annual Report



Data: Bank for International Settlements 2008



2009: “Reform the International Monetary System”

Zhou Xiaochuan

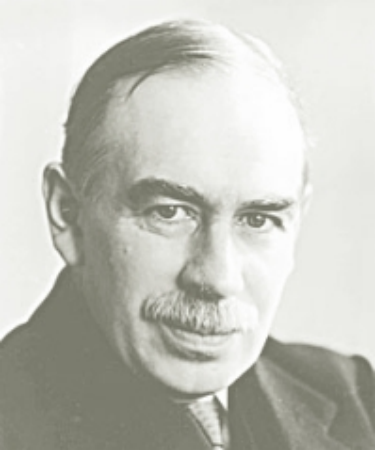
Governor of the People's Bank of China

<http://www.pbc.gov.cn/english/detail.asp?col=6500&id=178>

- Calls for an international reserve currency
 - Disconnected from individual nations
 - Able to remain stable in the long run
 - Offset deficiencies of credit-based national currencies
- Highlights the 1940s proposal for an international currency unit based on the value of 30 representative commodities
 - “*Unfortunately, the proposal was not accepted*”
 - Commodity-reserve “*may have been more farsighted*”
 - [Attribution issue]

Part 2:

Why Graham's Proposal Did Not Prevail



Part 2: Why Graham's Proposal Did Not Prevail

Keynes' Critique of the Commodity-Reserve Currency Proposal

- Flexibility
- Organizational Prerequisites
- Sovereignty
- Consensus



Part 2: Why Graham's Proposal Did Not Prevail

Friedman's Critique of the Commodity-Reserve Currency Proposal

- Comprehensive
- Free Market
- Neutrality
- Motivation
- Sectoral Equivalency
- Predictability
- Responsiveness

Part 3:

*Building Upon
Graham's Essential Concept*

Part 3: Building Upon Graham's Essential Concept

Design & Prototype

- A Call for Collaboration
 - Graham's monetary work should be revisited
 - New ideas based on the intrinsic value money concepts
- Objective
 - Reflect on and discuss the potential and problem-resolution
 - Develop and prototype
 - Test practical options of various scopes and scales:
 - International reserve currency
 - National currencies
 - Sectoral or regional currencies

Part 3: Building Upon Graham's Essential Concept

Design & Prototype

- Suggested methodology (reflected in the structure of this paper):
 1. Enhance documentation of commodity-reserve proposals
 2. Understand why the proposals were not successful
 3. Refine design requirements for a monetary systemAnnexes: Derive new proposal
- Enablers
 - Web-based collaboration (eg <http://www.brettonwoodsII.org>)
 - Free/libre terms & conditions

Part 3: Building Upon Graham's Essential Concept

Suggested Requirements

- Information Function of Money
- Resilience Over Stability
- Pluralistic View
- Well-Defined, Validated, Accessible Data
- Transparency and Freedom of Information Systems
- Straightforward Comprehensible Logic

Annex 1:

*Brainstorming an
Earth-Reserve Currency Standard*

*Inspired by, but departing from
Graham's commodity reserve system*



ANNEX 1: Brainstorming an Earth-Reserve Currency Standard

David Ricardo on “Economic Rent”

- Economic rent is payment for the productive powers of the land on condition that the land's generative and regenerative powers are maintained
- *"The laws which regulate the progress of rent are widely different from those which regulate the progress of profits, and seldom operate in the same direction"*

~ David Ricardo. 1817

The Principles of Political Economy and Taxation

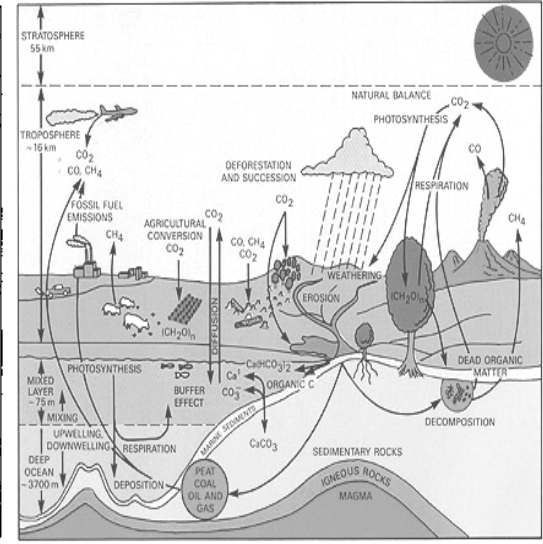
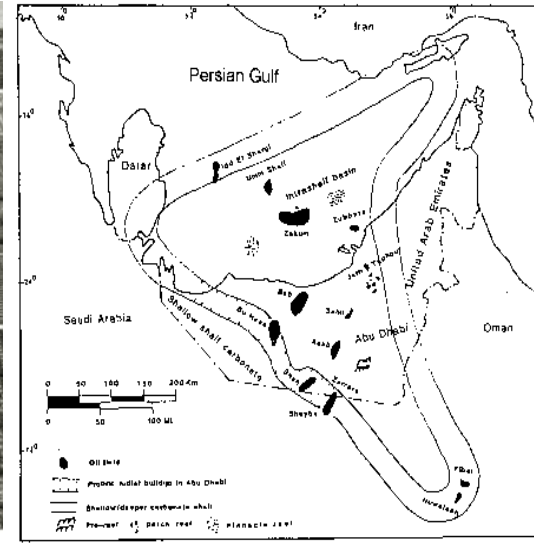
ANNEX 1: Brainstorming an Earth-Reserve Currency Standard

In place of Graham's Composite Commodity Unit, An Earth-Reserve Composite Index

*Kinetic
Commodities
Tracked
in Physical
Warehouses*



*Commodity
Potential
Tracked
in a Data
Warehouse*



In place of Graham's Composite Commodity Unit, An Earth-Reserve Composite Index

Storage Function

- Shifted back one stage in the production chain
- The Earth itself is the warehouse
 - Topsoil
 - Water
 - Species
 - Habitats & routes
 - Biogeochemical cycles
 - Infrared reflectivity
 - Production/depletion of exhaustible resources

Information Function

- Distributed data warehouse, instead of commodity warehouses:
- **Measured Data:** Biogeochemical Sciences, Commodity Market & Currency Statistics
 - Indicators
 - Base year & current year
 - Geographic data
- **Modeled Data:** Biogeochemical Sciences, Market Analysis, Socio-Economic Policy
 - “Worst Case Scenarios”
 - “Best Case Scenarios”

Invitation to Participate

www.brettonwoodsII.org

Applications Places System Joseph Potvin Sun 21 Jun, 20:40

BrettonWoodsII.org : Intrinsic Value Macroeconomics - Mozilla Firefox

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Home

This is a participatory project management website with structured functionality for revision control and issues management, running on an instance of RedMine with SVN.

- You are invited to participate in any of the free/libre/open projects maintained here. To register, please use the link at the top right, and review the Site Design & Guidelines.
- We will be grateful if you let us know how this site can be improved. Don't worry about being too critical. We like helpful bug reports even more than we like kudos! This site has only recently been launched (early 2009) and is supported through volunteer efforts.
- Please be patient with some of the default terminology of the interface, which is oriented to source code assets. This site contains natural language text and presentation graphics, in addition to source code.

Mission

This commons-based peer production site supports collaboration amongst people concerned with intrinsic value in economics and investment who want to help situate market-based monetary and fiscal concepts and operations within the boundaries of ecosystem science and resource availability. All works distributed on this site are licensed free/libre/open, and are supported with structured versioning and issues management workflow so that errors (bugs) and extensions (features) can be identified and addressed.

Context

The G20 Leaders Summit on Financial Markets and the World Economy in 2008 has been referred to by many commentators as Bretton Woods II. But if the process it launched is to match what was accomplished during the lead-up to, and in the negotiations of the Bretton Woods Conference of 1944, then it must be open to a profound re-thinking of concepts, instruments and governance frameworks of monetary and fiscal management. A new process worthy of the name Bretton Woods II ought to be nothing short of a broad reconstitution of macroeconomics

http://en.wikipedia.org/wiki/Commons-based_peer_production

Latest projects

- Commodity-Reserve Currency** (06/21/2009 09:35 AM)
The project documents the contributions to commodity-reserve monetary theory of individuals such as W.Stanley Jevons, Alfred Marshall, Henry Ford, Thomas Edison, Benjamin Graham, Frank Graham, Nicholas Kaldor, Jan Tinbergen, Friedrich Hayek and Albert Hart, and of major organizations such as in ancient and modern China, 17th century France, and ancient Peru, Egypt, and Rome.
- About www.BrettonWoodsII.org** (01/03/2009 07:53 AM)
The rationale for anyone to participate in this global effort is the free/libre/open model itself, explained in seminal papers like *The Cathedral and the Bazaar* and *Coase's Penguin*. The mission for this site is nothing more, nor less, than what it states. Ideas are placed here for peer review and collaborative evolution.
- Earth-Reserve Currency** (01/01/2009 10:52 PM)
In an Earth-Reserve currency system, Benjamin Graham's physical commodity reserve currency concept is shifted back one stage in the production process so that the Earth itself is the warehouse. Instead of stockpiles of a limited range of commodities produced and transported into a logistically complex global network of constructed warehouses, the Earth-Reserve system is based upon changes in the measured preconditions of economic rent in each economy, which are ecosystem integrity and resource availability.
- Refactoring Macroeconomics: 2** (01/01/2009 09:52 PM)

BrettonWoodsII.org : I... [BenGrahamsCurren... BenGrahamRetrospe... GIMP

Invitation to Participate

www.anywhereyoulike.org

The present economic crisis is sufficiently profound and complex that the monetary work of Benjamin Graham *et.al.* should be given urgent, open and thoughtful consideration and development. With the benefit of hindsight, it is time to consider afresh how we might build on their counsel to align money with intrinsic value, to respect core banking principles, to concern ourselves with sustainable commodity supply, demand and pricing, and to harness market forces in the public interest. Professionals in economics, finance and banking ought to read the intrinsic value currency proposals, reflect on them, and participate in re-fashioning some variants of them suitable to our life and times, through at least the next half century.