The Gold Standard

The journal of The Gold Standard Institute

The Gold Standard Institute

The purpose of the Institute is to promote an unadulterated Gold Standard

www.goldstandardinstitute.net

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Editorial

Representative Kevin Brady (R-TX), Chairman of Congress' Joint Economic Committee, has established a committee…

> *"to examine the United States monetary policy, evaluate alternative monetary regimes, and recommend a course for monetary policy going forward."*

That gold will be on the agenda is a given. Do you remember how unreal this wholly predictable, evolving scenario was for people just four short years ago? The Institute will continue to advocate for a real gold standard; the only such advocacy and the only solution to the crisis.

The loss of bank customers' money in Cyprus has the hint of a game-changer about it. Many large paper holders must be quietly now contemplating the virtue of gold. The damage done over the last few weeks is minor compared to the real problems that are still to surface. Head of the Euro Group, Jeroen Dijsselbloem, stated that this would be a template for the solving of future bank problems. Though he then quickly back-pedalled, it was confirmed by many others including Daniel Gros, director of the Brussels-based Centre for European Policy Studies. The illusion of government guaranteed bank accounts is at an end.

Meanwhile, the IMF sinks to new lows. No sooner had the scandal and the arrest and incarceration of Dominique Strauss Kahn in N.Y. for "sexual impropriety" began to fade, than a new one emerged. His successor, Christine Lagarde, appointed to clean up the image of the troubled organisation, has had her apartment raided by the French fraud squad looking for evidence of "financial impropriety". If Lagarde is off to the slammer then the IMF will be without a boss again. Let's see a show of hands for Silvio Berlusconi.

The paper money rot is now seriously eating into the foundations. While the eventual outcome, understood by any serious thinker, is deeply troubling, it is hard to avoid a wry smile at some of the preceding theatrics.

Philip Barton

News

Yahoo News: Paper money is a "recipe for worldwide bankruptcy," Weiner told Arizona lawmakers Monday. "Everybody is going bankrupt on this system so we need a sound and honest money system, such as gold and silver."

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Washington Post: Obama administration pushes banks to make home loans to people with weaker credit. What a great idea, what could possibly go wrong?

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San Francisco Chronicle: Sounds like David Stockman has it about right, and Paul Krugman still has it precisely wrong.

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Telegraph: The subject of gold confiscation makes the mainstream UK media.

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Mineweb: India bans gold jewellery from Thailand

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Yahoo Finance: Texas seeks repatriation of its gold from the Fed

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Bloomberg: Argentinians turn to gold. A breathless report from Bloomberg about the rise in the 'price of gold' in Argentina.

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Daily Mail: Cyprus President looking after his mates

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BBC: Cypriot government raids savings accounts. This precedent should make bank depositors in other EU countries rather worried.

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Guardian: Japanese jewellers Tanaka Kikinzoku, have cast Lionel Messi's left foot in pure gold - 3.5 million UK£s worth worth.

Gold Miners and the Gold Standard

One of the many arguments used against the gold standard is that gold is at the mercy and whim of a single industry: the gold mining industry. The gold mining industry decides how much gold is available. This argument that gold miners decide the amount of gold available for money fails on at least four accounts.

First, current mining of gold provides only a small fraction of gold available for monetary use. Nearly all the gold ever mined is available. Gold miners typically provide about 2500 tons of gold per year to a world stock of around 155,000 tons.

Second, when the real bills doctrine and decentralized banking accompany the gold standard, the quantity of paper money (credit money) available does not correspond to the quantity of gold available. Bank notes and checkable deposits can expand and contract to meet the needs of commerce independently of the quantity of gold. Gold mining does not have a monopoly on gold-based money.

Third, gold's monetary value depends on the integrity of the monetary unit and its issuer and not just the quantity of money. Having a definite fixed monetary unit is more important than the actions of gold miners.

Fourth, the profit motive guides gold miners. They have an incentive to provide their customers as much gold as they demand in a cost-effective way. Profits of gold mining increases as output increases and production cost decreases. The desire for profit drives gold miners and not the monetary needs of the country or the desire of gold miners to manipulate the money supply.

Opponents of the gold standard claim that the markets did not regulate the gold supply. Gold miners usually mine gold as fast as they can. Smart miners do not necessarily mine all that they can as fast as they can. They mine at a rate that maximizes their return. Furthermore, the consumer is the final determinant in the quantity of gold mined by his consumption of gold and gold products.

Under the gold standard, the markets regulated the quantity of gold coins and gold bullion used as money. If the markets demand more coins, jewelry, flatware, and other items of gold are converted to coins. Gold dealers and others melt gold products into bullion bars and present this gold to the mint for coinage. If the markets decide that too much gold is being used for money, people melt the excess gold coins and use the gold for other purposes, such as gold teeth and jewelry.

One feature of the gold standard is that it is self-regulating and automatically adjusts to meet the demand for metallic money. Some opponents of the gold standard are convinced that gold miners regulate the supply of gold by how much gold they mine. Gold miners do add to the supply of gold by the amount that they mine. However, unless they are coining their gold, they are not adding to the monetary stock. (The exception is the Rothbard school, which claims that all gold regardless of form — the weight of the metal and not its form makes the money — is part of the monetary stock.)

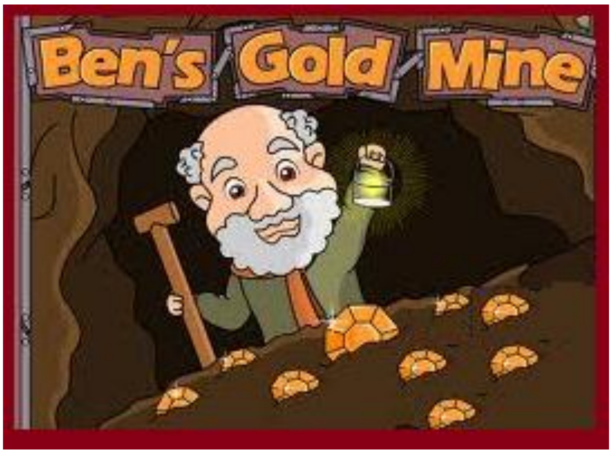
The markets decide how much gold is being used as money. They decide that by the quantity of gold brought to the mint for coinage and by how many coins are melted for other uses. If the value of gold in jewelry, for example, begins to rise in relationship to the value of gold in coins, people will melt the coins and convert them to the more valuable jewelry until the value of the two are brought back in line. If the value of gold in coins begins to rise in relationship to gold in jewelry, people will convert the gold in jewelry into coins until the value of the two are brought back in line. Gold miners may influence the quantity of gold available, but they do not decide how much of the available gold is used as money.

Some opponents seem to believe that the gold standard operates like the current fiat-paper-monetary standard where bankers lend new money into circulation. They fear gold miners lending new gold money into circulation. Gold miners could do this, but it is highly unlikely. They would only be lending about 2 percent of the world gold stock. The other 98 percent is available for monetary use without borrowing or lending. Are people really going to borrow that 2 percent?

Gold miners do not lend newly mined gold into circulation. They spend newly mined gold into circulation by paying their employees, stockholders, bondholders, creditors, and suppliers and also by paying their taxes and utilities.

Contrary to the claims of opponents of the gold standard, gold miners do not control the quantity of gold available for monetary use. They merely add a small percent to the global gold supply each year. The markets decide how much gold is to be used as money in the form of gold coins and monetary bullion.

Thomas Allen



The Slippery Slope Steepens

The very latest piece of insanity emanating from the pathocrats running the show is the blatant theft of Cyprus bank deposits. No longer content to steal from 'the rich', or to simply print more 'money', the pathocrats are now showing the iron fist in the velvet glove; steal from everyone, in plain sight.

Oh yes, it's called a 'one time levy' or a 'wealth tax' or any other euphemism; but a theft by any other name is just as much a theft. And theft is… is WHAT? Odious? Criminal? Ultimately destructive to civilization? Or, perhaps theft is just 'well at least it's not me that's being robbed' or 'it can't happen here'.

For anyone burdened with this attitude, recall the famous quote about Nazi atrocities;

First they came for the communists, and I did not speak out: because I was not a communist;
Then they came for the socialists, and I did not speak out: because I was not a socialist;
Then they came for the trade unionists, and I did not speak out: because I was not a trade unionist;
Then they came for the Jews, and I did not speak out: because I was not a Jew;
Then they came for me: and there was no one left to speak out for me.

The last great public theft was seen during the MF Global bankruptcy. About 1.6 Billion US dollars of customer's money 'disappeared' in the MF global rip-off; but this was money of rich speculators, and I am not a rich speculator, so who am I to speak up?

Now more billions disappear into the bankster's insatiable maw in Cyprus… but 'this is money of rich Cypriots' and 'I am not a rich Cypriot'… so who am I to speak up? Dangerous attitude. If Cypriots are robbed in broad daylight and nobody speaks up, who will be robbed next? Because you can be as sure as 'death and taxes' that someone will be next… and none of us are far down the line. Our turn is coming.

You may be starting to wonder exactly what is going on and exactly where the world is heading. These are good questions, but to answer then we need more than a sound bite, we need to examine a particular bit of world history… the history of the destruction of the Classical Gold Standard.

The Classical Gold Standard as practiced during the nineteenth century, while less than perfect, was a thousand times better than the 'system' of fraud and theft that we are seemingly stuck with. The Classical Gold Standard helped to propel the world economy to unimagined heights, bringing unprecedented prosperity to millions, and helped to make the nineteenth century the most peaceful century mankind has ever experienced. It has taken the best part of a century to destroy this Gold Standard.

The most devastating blow… but not the first… was delivered on the eve of WWI… the Great War. As war clouds gathered, the future combatants called their loans, to fill their vaults with Gold… but even vaults bulging with Gold would not be enough to fund a protracted war. Indeed, pundits of the day were predicting that any possible war could not last more than a few months at worst, as the combatants would run out of money.

All governments knew this and their choices were limited; raise funds through war taxes, borrow by issuing war bonds, or what? At the time, Gold was money, and bank notes were clearly recognized as just that; 'notes', that is IOUs redeemable into Gold money. They came up with a truly insidious plan.

New 'legal tender' laws were passed, decreeing that henceforth the IOUs themselves were money, legal for all payments. Think about this for a minute. Gold is a present good, just like an apple, or sugar, or oil, or any other real, physical commodity… with the only difference being that Gold is a monetary commodity, not a commodity that is directly consumed. Imagine passing a law that decrees that an IOU for an apple, an IOU for sugar, or an IOU for oil is now the apple itself, or the sugar itself, or the oil itself. Is this insane or what?

Insane or not, the laws were were passed, first in France then quickly thereafter in England and Germany. To help mislead people of this grand larceny, Gold remained in circulation along with the new Bank Notes, the so called Legal Tender paper… but not for long.

To top this off, Real Bill circulation was shut down. There is no space here to give justice to the vital importance of the circulation of Real Bills to the viability of a Gold Standard, but appreciate that multilateral trade underpinned by Real Bills circulation is so efficient and productive that total volume of world trade before WWI was not surpassed until the nineteen seventies, nearly sixty five years later, three human generations; this in spite of enormous growth in the world economy. Simply, Real Bills are the commercial clearing system of the Gold Standard, and no Gold Standard can possible survive without a fully developed Bills market.

This double whammy was to prove to be fatal to the Classical Gold Standard. After the Great War ended, Britain 'tried' to get 'back on Gold'… but without resuscitating the Real Bills market. Furthermore, the attempt at going 'back on Gold' was made without devaluing the Pound… to account for the enormous number of Pound notes printed to finance the war.

Returning to the pre-war ratio was considered highly deflationary. This is more of a red herring than anything else, designed to draw attention away from the real cause; the failure to allow Real Bills circulation to resume.

The effort was doomed to failure, and indeed it did fail. Great Britain went 'Off Gold". Soon the US followed… and to rub salt into the wound, President Roosevelt confiscated all the Gold held by US citizens, then a few months later devalued the Dollar from $22 per once to $35 per ounce.

This was the death knell of the Gold Coin Standard, the Classical Gold standard of the nineteenth century. The world retreated to the so called Gold Bullion standard, where only large entities were entitled to hold or trade Gold. No ordinary citizen was allowed to do so. The power of Gold was concentrated into the hands of an 'elite' minority, while the large majority had to be content with irredeemable paper… IOU nothing bank notes.

After WWII, the carnage continued. The Bretton Woods system was brought into play, whereby only the US Treasury was entitled to hold Gold, supposedly to 'back' the US Dollar… and the US Dollar was used as a reserve to 'back' local currencies, such as the British Pound and the French Franck. Gold was still in the system, but farther and farther away from the people. The concentration of Gold, and of monetary power, continued unchecked.

The last nail in the coffin of the Classical Gold Standard was delivered in nineteen seventy three, by President Nixon. By 'closing the Gold window', or more accurately by reneging on the international Gold obligations of the US just as Roosevelt had defaulted on the national Gold obligations of the US government, the last official link to Gold was cut. The whole world was now officially 'off Gold'… and 'on Fiat'.

Mind you, WWI was not the first attack on the Gold Standard by any means. The demonetization of Silver, the change from a bimetallic standard to a Gold only standard was such an attack… although at first glance this seems contradictory. After all, should not removing 'competition' to Gold not make Gold supreme? The answer is not by any means. Demonetizing Silver meant that about half the money in circulation was suddenly removed.

Half the money removed did not mean the Silver disappeared; rather, the purchasing power of the people's Silver was destroyed. Savings of the middle class, largely in the form of Silver, was devastated. In the meantime, the elites… who held mostly Gold… were enriched, as the relative purchase power of their Gold increased. A devious, illicit transfer of wealth… thus the cry "The Crime of 1873"

This blow to the monetary system was far more devastating than the attempt by Britain to return to Gold at pre-war Pound parity… yet the system survived, although not without unnecessary stress.

The only reason it survived is that Real Bills circulation was not destroyed when Silver was demonetized. Real Bills continued to function unimpaired, fulfilling their role as the clearing system of the Gold Standard… and after a brief deflationary episode, the Gold standard continued to soldier on.

But this 'crime of 1873'… the year that Silver was demonetized… was by no means the very first blow to the Gold Standard, the very first blow delivered against honest money. The first blow came early, before the Gold Standard was even fully established. The first blow was a legally sanctioned violation of money ownership; a violation of property rights.

Judgments were made in British jurisprudence, and legal precedents set, that money 'deposited' in a bank account was no longer the property of the depositor, but somehow became the property of the bank. This is another incredible farce of law; it is as if the furniture you take to a warehouse for safe keeping is deemed to suddenly become the property of the warehouse!

Of course, once the bank acquires ownership of the money, IT decides what to do with it… like using demand deposits to buy high yielding long term bonds… the notorious practice of borrowing short to lend long. As if the warehouse owner decides to lend out your furniture for his own profit, or trade it for some other stuff.

This is where the very first cracks appeared, the vulnerable spot where the shenanigans begin. The customer is disempowered, and the power over his money… and the power inherent in his Gold… is transferred to the banking system. The so called business cycle, in reality a credit cycle, is put into motion by the fraudulent credit thus made possible. If the depositor decides to withdraw his money, the money is simply not there… having been used to buy a high yielding long term bond… and the run on the bank begins.

So where are we today? The cancer of property rights invasion that first disturbed the inherent stability of an unadulterated Gold standard, a Gold standard where property rights and contract law are sacrosanct, is metastizing.

First came the perversion of declaring that the Bank owns and has rights to dispose of deposits as it sees fit, not as the rightful owner wishes. Next, the abomination of decreeing that an IOU for something is the thing itself… followed by outlawing citizens from even holding Gold…. and then, taking Gold completely out of the system.

Today, the speed of slippage down the slippery slope towards Hades is increasing rapidly. MF Global, the large international futures clearing house recently went bankrupt, and about 1.6 Billion dollars of customer property accounts in the form of futures contracts from 'segregated' customer accounts simply 'disappeared'. The 'furniture' you took to the warehouse for safekeeping was not returned to you when the warehouse went bankrupt… but given to creditors, along with the warehouse itself. The creditor in this atrocity was… surprise… a 'too big to fail' bank, namely J.P Morgan.

Moreover, a US federal judge ruled that 'yes, the value disappeared, but there was no criminal intent, just chaos'… and so Mr. Corzine, the CEO of JP Morgan, is innocent. Right. In a world of computerized audit trails, where every penny transaction is tracked with Argus eyes, $1,600,000,000 simply 'disappears between the cracks'! If you believe that the 'honorable judge' made a fair and honest judgment, then I suggest you go out and make a fair and honest offer to buy the Brooklyn Bridge.

So what is next? Could it be that the rumors of the upcoming demise of Morgan Stanley are more than just rumors? Could Morgan Stanley be the next Mf Global? Is it be possible that after the violation of property rights to money, after the violation of property rights to futures contracts the violation of property rights to equities is next? Would anyone be shocked if this rumor comes true?

It turns out that Morgan Stanly is not the next hit on property rights; rather, the hit is taking place in a far more egregious, in your face fashion. As of March 18, 2013, the news that the government of Cyprus is stealing about 10% of all bank deposits is hitting the news like a nuclear bomb.

This Cyprus move is nothing but more theft… but no more so than all the theft that came before. The only difference is that theft is getting ever more blatant, ever more visible. Indeed, the root of the problem is not the theft per se… but the concentration of power that makes such theft possible. Is this blatant act enough to wake up the sleeping majority?

Before any honest money system becomes possible, before the world economy can be set to rights, the destruction of property rights must be reversed. Only then will it become possible to resolve the Global Financial (Money) Crisis, instead of constantly making it worse.

Rudy J. Fritsch
Editor in Chief

The American Corner: Arizona Gold and Silver Legislation Update

Last month, I wrote about a bill in the Arizona state legislature, SB 1439, that recognizes that gold and silver are money. Its two key clauses eliminate tax on "gains" in gold and silver at the state level (Federal taxes would still apply), and allow people and businesses to operate in gold or silver, and pay taxes based on the gain in gold or silver.

These are the clauses:

> *A. Notwithstanding any other law, the exchange of one form of legal tender for another does not give rise to liability for any type of tax.*
>
> *B. Any tax that is due as a consequence of a transaction that involves specie legal tender shall be paid proportionally in the same legal tender.*

This bill, if enacted, could be an important early step towards the realization of the gold standard in the United States. Many people are watching Arizona right now.

On Monday, March 18, I went to the House of Representatives Financial Institutions committee hearing which discussed and voted on the bill. I gave testimony, along with several other people, all of whom favored the bill. The other speakers focused on the US Constitution and price stability. I talked about that day's hot news from Cyprus.

I reminded the committee that the island state is bankrupt, and the first to consider imposing losses on bank deposits. I pointed out that paper money is leading the whole world down the path toward bankruptcy, including the United States. I emphasized that the bill, if enacted, will attract more financial industry to Arizona and help provide leadership in a national dialogue about gold, money, and capitalism.

My testimony generated many questions from the committee. I think I spent more time answering these wide-ranging questions than I did in my original comments. Today, people know little about gold, and it is interesting that these legislators wanted to know more about so many aspects.

I explained that trading with gold is not barter, because gold is the most marketable good with the narrowest bid-ask spread. I spoke about security in a precious metals vault, to assure one Representative that the gold standard cannot be hijacked by a crook who works at a depository. I presented my view that, according to proper banking law, shareholders take losses first, then junior creditors, then senior secured creditors—and only when these capital classes are wiped out do depositors lose a penny. Because of this, the people who run the bank (and who own its shares) have an interest in being honest; they stand to lose first and most if there is a run on the bank. Members of the committee seemed to understand and favorably respond to what I said.

At the end of the hearing, they took a vote. SB1439 passed.

The next step for the bill was to go to the House Rules committee. This committee decides if a bill is constitutional. They do not allow members of the public to testify. They voted yes.

The next step was the Committee of the Whole. The bill passed, but unfortunately it was amended. They removed clause B, the part that allows one to pay tax on specie gains in specie. In so doing, they may have shut off a potential gold income for the state before it began and keep in place one more obstacle to the circulation of gold and silver.

The bill as it now stands is still good. It repeals the tax on "gains" in gold and silver. It still places the issue of gold money, and ultimately the gold standard in the national spotlight. For example, the Associated Press wrote an article based on the House Financial Institutions committee hearing (and they quoted my testimony). Yahoo, Businessweek, and many other sites picked up the article.

By the next issue of The Gold Standard, this bill will likely either be law or be dead for another year. Let's hope it passes.

Dr. Keith Weiner
President of the Gold Standard Institute USA

An Open Letter to a 'Heretic'

We have just finished the first Madrid session of the New Austrian School of Economics (NASOE) held in Spain. The NASOE, now under the presidency of Professor Juan Rallo, is bringing the wisdom and knowledge of the Gold Standard to an ever expanding audience. As the global monetary system rushes headlong towards collapse, this knowledge is becoming ever more timely and essential.

We did our best to compress the fundamentals of a sound monetary system into the intense three day session; Gold money, as the ultimate extinguisher of debt, the only financial asset that is no one's liability. Gold as a present good, unlike all debt and credit, which are promises of money sometime in the future.

We showed how credit must necessarily be divided into two categorically different components; conventional borrowing and lending, represented by the bond market, and credit created by the clearing of highly desired, rapidly moving consumer goods on their way to the consumer, represented by the bill market.

The bill market has not existed since before WWI… and is the most important and most obscure component of the classical Gold standard; a Gold standard cannot survive without its clearing system, the bill market. We pointed out the structural differences between bills and bonds; bonds involve borrowing, collateral, payment schedule… and are paid off by the earnings of the borrower.

We pointed out that Bills involve no borrowing, no collateral, no payment schedule… and are paid off by the sale of the highly liquid consumer goods they are drawn against; that is, they are self liquidating. Furthermore, we made it very clear that bills are limited to a 91 day maturity, are never rolled over, and must mature into Gold.

Finally, we showed how multilateral world trade funded by Real Bill circulation is the most efficient means of funding trade, and presented solid facts to prove this; world trade without Real Bill funding took over 75 years to recover to pre WWI levels in spite of population growth. The destruction of the bill market led to the Great Depression, and to structural unemployment hounding the world to this day… and most tellingly, that during the existence of the British Empire, the Bank of England ran Bill funded world trade on only 150-200 Tons of Gold in its vaults.

In spite of this, one of the attendees, claiming status as a 'heretic', went on to conflate discount and interest, to claim that bills are merely a form of short term commercial debt, and that consequently our presentation was without real merit.

Well, the fact is that the whole Austrian school is (still) considered heretical by mainstream (Keynesian) economists, and the New Austrians are considered somewhat heretical even by the majority of Austrians; thus our 'heretic' is actually presenting conventional, confused views of the Real Bills Doctrine of Adam Smith.

Now I have no intention of pounding the table in favor of Real Bill circulation, or of repeating or refining the arguments already presented. All this is available in my previous articles, such as Bills vs. Bonds, as well as in greater depth in my book Beyond Mises. The story of Real Bills told in Professor Fekete's inimitable style is also available on his web site, in 'The Second Greatest Story Ever Told' series.

Instead, I propose to apply a figurative 'acid test' to bonds and to bills; and determine if they are truly different or not. The term 'acid test' comes from Gold; in cases of doubt as to the purity of a Gold sample, acid is applied. Gold, being a noble metal, will not react with the acid; thus Gold passes the acid test. If Gold is adulterated, if it is alloyed with base metals, the sample will react, and thus fail the test.

Here is the 'figurative' acid test, applied to bonds (borrowing) under a pure Fiat monetary system. To keep the numbers simple, let us take a 1,000 monetary unit (MU) bond, with a five year term, carrying a five percent per annum interest rate as our example. For monetary unit, you may substitute any Fiat currency; Dollar, Euro, whatever.

Such a bond will command a yearly payment of 50 MU plus the repayment of the principle at the end of five years; the total payment the borrower needs to make for the use of 1,000 MU's for five years is 1,000 MU principle + 250 MU interest… 1,250 MU.

It is not necessary to use an annual payment schedule; there are such things as zero coupon bonds, that instead of paying interest, are sold at a discount (this is where some of the confusion between interest rate and discount rate may come from)… but the situation is the same.

A lender who buys a 1,250 MU bond for a discount at 1,000 MU, will pay 1,000 MU and receive 250 MU income for the privilege of the borrower (bond seller) getting to use the lender's currency for the term of the bond... as well as getting his principle of 1,000 MU back. Total lent 1,000 MU, total paid back 1,250 MU. No difference, and it is easy to compare conventional and zero coupon bonds by annualizing the discount of the zero coupon bond.

Now, here is the acid test; where does the currency to pay the interest come from? Or if you like, where does the 250 MU earned by the zero coupon bond holder come from? Notice I do not ask HOW the bond is paid back… presumably a commercial loan is paid from the earnings of the commercial enterprise, by rental payments in case of mortgages, etc. A consumer loan is paid by other income earned by the borrower.

No, I ask WHERE does this currency come from? Presumably, from the 'pool' of currency existing in the global economy… at least, this is the assumption. But now, let's pour on the acid; multiply the bond… and the number of bonds… go from 1,000 to a Million… to a Billion… to a Trillion in bonds… and the question 'where does the currency to pay interest come from' assumes greater and greater weight.

Indeed, it seems that we must reach a limit at some point, a point where ALL currency is in bonds, and no further currency is available to pay interest! This is the crunch. In our 'system' of Fiat currency, the reality is that ALL currency, whether Dollar, Euro, or other, is borrowed into existence. We live every day at this very 'crunch' point. There is no (Gold) money in circulation… it is all Fiat currency, all borrowed into existence, all debt… with no debt extinguisher.

Suppose the total quantity of MU in the global economy corresponds to twenty Trillion MU of bonds, maturity five years, and interest rate five percent; then, every year, five percent of twenty Trillion of new money will have to be 'created' to pay this interest; the tidy sum of one trillion monetary units per annum.

So, how is this new currency to be 'created'? Why, just like all Fiat currency; it is borrowed into existence. The treasury writes a new, one trillion MU bond, and sells it to the Bank of Issue (called 'Central Bank' for camouflage purposes) and the Bank of Issue will create new currency -out of 'thin air'- to buy the bond.

As a result, the next year's quota of interest must now include interest on this new bond as well as outstanding bonds; instead of five percent of twenty trillion, the due amount is five percent of twenty one trillion… thus, interest due at the same five percent rate is now one trillion, ten billion…. 1.01 Trillion annually. The burden grows.

This is a geometric progression, the interest due grows ever faster, as the quantity of currency in existence must also grow ever faster. There is no way to terminate this progression… outstanding debt can never be repaid, indeed the debt outstanding must grow without limit. The only defense the Bank of Issue has, is to work hard to keep interest rates low. Lower interest rates slow down the progression, but by no means stop it. Systemic breakdown is inevitable. Fiat currency and bonds (Sovereign debt) fail the acid test dismally.

Now let's apply the same acid test to Real Bills; a 1,000 MU bill is drawn against urgently needed consumer goods arriving at the retail outlet. Remember, MU here is Gold units; ounces, grams, whatever you like. The term cannot be more than 91 days, by definition… and the discount rate is always less than the going interest rate. Let's assume the discount rate on the 1,000 MU Real Bill is four percent.

Now four percent is the annualized rate; the discount must be reduced to 91 days, the term of a Real Bill. A four percent annual rate is about one percent over 91 days. The actual discount on this newly drawn Real Bill is therefore about 10 MU… (if the bill were to be pre-paid in full on the day of acceptance, the cost would be 990 MU. The merchant will have received 1,000 MU worth of goods, at a 10 MU discount, for 990 MU cash Gold).

If the bill is held for thirty days, the discount decreases; now, the bill would command about 993.3 MU. After sixty days, that is thirty days before maturity, it would command 996.6 MU… and on maturity day, it will be paid at face value, 1,000 MU.

The bill commands 990 MU at signing, 993.3 after 30 days, 996.6 after 60 days, and 1,000 at maturity.

Now for the acid; how much more money (Gold) than face value must be pulled from the 'pool' of circulating Gold to repay the bill? Why, in the worst case scenario, if the bill is paid on maturity, the answer is zero… 1,000 MU of goods is paid in full with 1,000 MU… full stop. If prepaid, that is paid in full before maturity, less MU's are needed; the term 'discount' carries real meaning… something purchased at less than full price.

Now, pour on the acid; multiply the 1,000 MU bill to a million, a billion, or a gazillion; elementary mathematics tells us that any number multiplied by zero is zero… not one single penny of new money has to be 'created' to pay bills due, no matter what quantity of bills is in circulation. I suggest that the Real Bill Doctrine, like Gold itself, passes the acid test with flying colors.

Dear Heretic; the only salvation for the world's monetary crisis is the return of Gold money into circulation, accompanied by unhindered Real Bills circulation… and the return of bonds to their original, legitimate purposes; accumulation of real capital for long term, capital intensive projects, like investments in factories, infrastructure, etc… bonds are not to be used fraudulently as 'backing' for illegitimate Fiat currencies. Debt must stop masquerading as money.

Rudy J. Fritsch
Editor in Chief

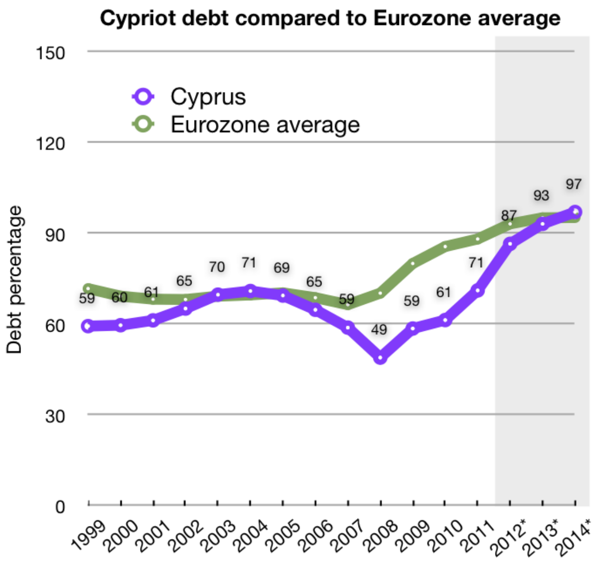
Cyprus – Test bed template

The small island of Cyprus has a population of approximately 800,000 people. Its economy, if measured using GDP, is one of the smallest of the civilised world at $24.7 billion. This small island has been making global headlines which are remarkable considering its insignificant size. After all the market capitalisation of many companies, take Apple as an example, are many factors greater than the entire GDP of Cyprus. In the whole scheme of irredeemable currency, a bailout of €10 billion is about three days' work for Ben Bernanke.

Undoubtedly most of the financial community, including our astute readers, are aware of the circumstances surrounding Cyprus. The €10 billion bailout from the ECB is conditional with the most blatant condition being the levy assigned to depositors throughout Cyprus guaranteeing the loan. It was this condition which sparked so much outrage which led to the banks closing for almost a fortnight with account holders frozen out. Only now have the banks re-opened with capital controls limiting withdrawals to approximately €300 per account per day. This is a blatant infringement upon property rights, the corner stone of free markets and a civilised society, but this is a crisis where everyone must sacrifice (except the perpetrators of this mess being government bureaucrats).

The cold fact of this debacle is that whether the banks remained open with the accounts accessible or not is irrelevant. The deposits, invested in failed government bonds throughout the European periphery, have long evaporated along with the bond valuations. The Cypriot banking sector was insolvent and remains insolvent whether you have access to your account or not. Furthermore just like the FDIC in the US, the DPS (Deposit Protection Scheme) of Cyprus has no ability to cover depositors in the event of a bank run which was precisely the reason for its establishment in accordance with Article 34 of the Cypriot Banking Law of 1997. The reason, quite simply, is that the "risk free assets" which the Cypriot Banks were "encouraged" to invest in happen to be the same "risk free assets" which the DPS holds. The Cypriot banking system, both public and private, is on life support.

What has startled most around the world has not been the failing of the Cypriot banking system as that has been making headlines for at least six months but rather the blatancy involved. For those monitoring the state of affairs sympathetic to gold and freedom, Cyprus is hardly a surprise but still concerning. Of course the talking heads on CNBC and Bloomberg have raised Cyprus as a "black swan" event sighting its poor fiscal policies over the last ten years. What is to note about the Cyprus coverage is what is not being reported. Cyprus is guilty as charged and its fiscal situation deserves to be condemned, yet that condemnation should not stop only at the Cypriot parliament.



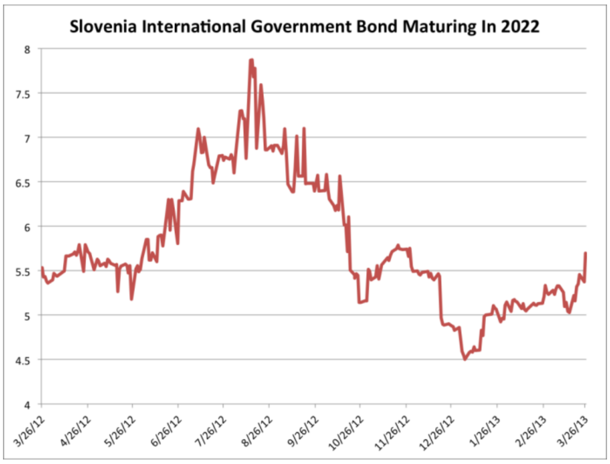
Source: Eurostat (1/2013)
*estimates

As illustrated in the above graph which indicates sovereign debt to GDP, Cyprus has been performing rather well on a relative basis. The charge that Cyprus is a basket case must be leveled at the Euro zone as well as just about every other western nation. That said, the pressing question now is why Cyprus? Such a measure could have easily been applied to Greece since their situation is somewhat worse, so what drew the powers that be to the small island?

Various theories around the world say it was an orchastrated effort to attack Russian ex-KGB money. That may be the case but this author is in not privy to such knowledge. It would be more plausable that Cyprus was selected as a test bed template to determine whether this could be applied to larger economies. The geographical remotenest of Cyprus is ideal to conduct such a trial. Being an island it would contain its inhabitants from fleeing the country to make witdrawals from other banks. Having a small population of 800,000 people makes it relatively easy to manage in the case of social unrest. Of course this is all conjecture but it is worth noting that many governments are looking on with great interest.

Recently the Canadian government launched its 2013-14 budget proposal which included Cyprus style "bail-ins". This should be a cause of alarm. Canada is no Cyprus. The events which have transpired in Cyprus could mark the acceleration point of capital controls around the globe. Whether one believes or cares about capital controls is immaterial as its consequence will be far reaching and cannot be avoided.

Already Cyprus-style measures have been called upon by Slovenian President Borut Pahor as bond yields begin to break out, depressing bond valuations. The graph below indicates the breakout and, if it continues, capital controls will be likely on the cards.



It has been well expressed in this journal by various authors regarding the merit of an unadulterated gold standard and the need to hold physical bullion outside the banking system. What one should consider as well is physical cash holdings, preferably USD as well as your local currency, outside the banking system. Anywhere between three to six months of physical cash reserves is a prudent move. Understandably one many lose out if the environment turns hyperinflationary but, cash is currently king in Cyprus.

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Theory of Interest and Prices in Paper Currency Part I (Linearity)

Under gold in a free market, the theory of the formation of the rate of interest is straightforward.[1] The rate varies in the narrow range between the floor at the marginal time preference, and the ceiling at the marginal productivity. There is no positive feedback loop that causes it to skyrocket (as it did up until 1981) and subsequently to spiral into the black hole of zero (as it is doing now). It is stable.

In irredeemable paper currency, it is much more complicated. In this first part of a multipart paper presenting my theory, we consider and discuss some of the key concepts and ideas that are prerequisite to building a theory of interest and prices. We begin by looking at the quantity theory of money. In our dissection, we will identify some key concepts that should be part of any economist's toolbox.

This theory proposes a causal relationship between the quantity of money and consumer prices. It seems intuitive that if the quantity of money[2] is doubled, then prices will double. I do not think it is hyperbole to say that this premise is one of the cornerstones of the Monetarist School of economics. It is also widely accepted among many who identify themselves as adherents of the Austrian School and who write in critique of the Fed and other central banks today.

The methodology is invalid, the theory is untrue, and what it has predicted has not come to pass. I am offering not an apology for the present regime—which is collapsing under the weight of its debts—but the preamble to the introduction of a new theory.

Economists, investors, traders, and speculators want to understand the course of our monetary disease. As we shall discuss below, the quantity of money in the system is rising, but consumer prices are not rising proportionally. Central bankers assert this as proof that their quackery is actually wise currency management.

Everyone else observing the Fed knows that there is something wrong. However, they often misplace their focus on consumer prices. Or, they obsess about the price of gold, which they insist should be rising in lockstep with the money supply. The fact that the price of gold hasn't risen in two years must be prima facie proof that there is a conspiracy to suppress it. Gold **would** have risen, except it's "manipulated". I have written many articles to debunk various aspects of the manipulation theory.[3]

The simple linear theory fails to explain what has already occurred, much less predict what will happen next. Faced with the fact that some prices are rising slowly and others have fallen or remained flat, proponents insist, "Well, prices will explode soon."

Will the price of broccoli rise by the same amount as the price of a building in Manhattan (and the same as a modest home in rural Michigan)? We shall see. In the meantime, let's look a little closer at the assumptions underlying this model.

Professor Antal Fekete has written that the Quantity Theory of Money (QTM) is false, on grounds that it is a linear theory and also a scalar theory looking only at one variable (i.e. quantity) while ignoring others (e.g. the rate of interest and the rate of change in the rate of interest).[4] I have also written about other variables (e.g. the change in the burden of a dollar of debt).[5]

It is worth noting that money does not go out of existence when one person pays another. The recipient of money in one trade could use it to pay someone else in another. Proponents of the linear QTM would have to explain why prices would rise only if the money supply increases. This is not a trivial question. Prices rise whenever a buyer takes the offer, so no particular quantity of money is necessary for a given price (or all prices) to rise to any particular level.

In any market, buyers and sellers meet, and the end result is the formation of the bid price and ask price.

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[1] http://monetary-metals.com/in-a-gold-standard-how-are-interest-rates-set-3/

[2] We do not distinguish herein between money (i.e. gold) and credit (i.e. paper)

[3] Full disclosure: when I am not working for Gold Standard Institute, I am the CEO of Monetary Metals, which publishes a weekly picture and analysis of the gold basis. One can see through the conspiracy theories using the basis: http://monetary-metals.com/basisletter/

[4] http://www.safehaven.com/article/13063/a-critique-of-the-quantity-theory-of-money

[5] http://monetary-metals.com/irredeemable-paper-money-feature-451-3/

To a casual observer, it looks like a single "price" has been set for every good. It is important to make the distinction between bid and ask, because different forces operate on each.

These processes and forces are nonlinear. They are also not static, not scalar, not stateless, and not contiguous.

Nonlinear

First let's consider linearity with the simple proposal to increase the tax rate by 2%. It is convenient to think it will increase government tax revenues by 2%. Art Laffer made famous a curve[6] that debunked this assumption. He showed that the maximum tax take is somewhere between 0 and 100% tax rate. The relationship between tax rate and tax take is not linear.

Another presumed linear relationship is between the value of a unit of currency and the quantity of the currency outstanding. If this were truly linear, then the US dollar would have to be by far the least valuable currency, as it has by far the greatest quantity. Yet the dollar is one of the most valuable currencies.

"M0" money supply has roughly tripled from 2007, "M1" has roughly doubled, and even "M2" has risen by 50%.[7] We don't want to join the debate about how to measure the money supply, nor do we want to weigh in on how to measure consumer prices. We simply need to acknowledge that by no measure have prices tripled, doubled, or even increased by 50%.[8] It's worth noting an anomaly: on the Shadowstats inflation[9] chart, the inflation numbers drop to the negative precisely where M0 and M1 rise quite sharply.

Consider another example, the stock price of Bear Stearns. On March 10, 2008 it was $70. Six days later, it was $2 (it had been $170 a year prior). As Bear collapsed, market participants went through a non-linear (and discontiguous) transition from valuing Bear as a going concern to the realization that it was bankrupt.

Dynamic

Some people today argue that if the government changed the tax code back to what it was in the 1950's then the economy would grow as it did then. This belief flies in the face of changes that have occurred in the economy in the last 60 years. We are now in the early stages of a massive Bust, following decades of false Boom. Another difference was that they still had an extinguisher of debt in the monetary system back then. I wrote a paper comparing the tax rate during the false Boom the Bust that follows[10]. The economy is not static.

By definition and by nature, when a system is in motion then different results will come from the same input at different times. For example, if a car is on the highway at cruising speed and the driver steps on the accelerator pedal, engine power will increase. The result will be acceleration. Later, if the car is parked with no fuel in the tank, stepping on the pedal will not cause any increase in power. Opening the throttle position does something important when the engine is turning at 3000 RPM, and does nothing when the engine is stopped.

Above, we use the word dynamic as an adjective. There is also a separate but related meaning as a noun. A dynamic is a system that is not only changing, but in a process whereby change drives more change. Think of the internal combustion engine from the car, above. The crankshaft is turning, which forces a piston upwards, which compresses the fuel and air in the cylinder, which detonates at the top, forcing the piston downwards again. The self-perpetuating motion of the engine is a dynamic. This is a very important prerequisite concept for the theory of interest and prices that we are developing.

Multivariate

It is seductive to believe that a single variable, for example "money supply", can be used to predict the "general price level". However, it should be obvious that there are many variables that affect pricing, for

[6] http://en.wikipedia.org/wiki/Laffer_curve
[7] http://www.shadowstats.com/charts/monetary-base-money-supply
[8] http://www.shadowstats.com/alternate_data/inflation-charts
[9] I don't define inflation as rising prices, but as an expansion of counterfeit credit: http://monetary-metals.com/inflation-an-expansion-of-counterfeit-credit/
[10] http://monetary-metals.com/the-laffer-curve-and-austrian-school-economics/

example, increasing productive efficiency. Think about the capital, labor, time, and waste saved by the use of computers. Is there any price anywhere in the world that has not been reduced as a consequence? The force acting on a price is not a scalar; there are multiple forces.

It should be easy to list some of the factors that go into the price of a commodity such as copper: labor, oil, truck parts, interest, the price of mineral rights, government fees, smelting, and of course mining technology. One or more of these variables could be moving in the opposite direction of the others, and as a group they could be moving in the opposite direction as the money supply.

Perhaps even more importantly, the bid on copper is made by the marginal copper consumer (the one who is most price-sensitive). At the risk of getting ahead of the discussion slightly, I would like to emphasize that today the price of copper is set by the marginal bid more than by the marginal ask. The price of copper has, in fact, been in a falling trend for two years.

Stateful

Modeling the economy would be much easier if people would respond to the same changes the same way each time—if they didn't have memories, balance sheets, or any other device that changes state as a result of activity. Even Keynesians admit the existence of human memory (ironically, they call this "animal spirits"[11]), which makes someone more cautious to walk into a pit a second time after he has already learned a lesson from breaking his leg. People are not stateless.

Stateless, and its antonym stateful, is a term from computer software development. It is much simpler to write and understand code that produces its output exclusively from its inputs. When there is storage of the current state of the system, and this state is used to calculate the next state, then the system becomes incalculably more complex.

In the economy, a business that carries no debt will respond to a change in the rate of interest differently from one that is struggling to pay interest every month. A company which does not have cash flow problems but which has liabilities greater than its assets would react differently still.

An individual who has borrowed money to buy a house and then lost the house to foreclosure will look at house price combined with the rate of interest quite differently than one who has never had financial problems.

It is important not to ignore the balance sheet or human memory (especially recent memory) when predicting an outcome.

Discontiguous

Markets (and policy outcomes) would be far more predictable, and monetary experiments far less dangerous, if all variables in the economy moved according to a smooth curve.

A run on the bank, as is occurring right now in Cyprus (in slow motion due to capital controls), is a perfect example of a discontiguous phenomenon. One day, people believe the banks are fine. The next day there may not be a measurable change in the quantity of anything, and yet people panic and try to withdraw their money. If the bank is insolvent, they cannot withdraw their money, it has been already lost.

A common theme in my economic theories is asymmetry. In the case of a run on the bank, there is no penalty for being a year early, but one takes total losses if one is an hour late. This adds desperate urgency to runs on the bank, and desperate urgency is one simple cause of an abrupt and large change, i.e. discontiguity.

Ernest Hemingway famously quipped that he went bankrupt, "Two ways. Gradually, then suddenly."[12] It's not a smooth process.

There are many other examples, for instance a scientific breakthrough may enable a whole new industry because it reduces the cost of something by 1000 times. This new industry in turn enables other new activities and highly unpredictable outcomes occur. As an example, the invention of the transistor eventually led to the Internet. The Internet makes it possible for advocates of the gold standard to

[11] http://en.wikipedia.org/wiki/Animal_spirits_(Keynes)

[12] *The Sun Also Rises* by Ernest Hemingway, 1926

organize and coordinate their action into a worldwide movement that demands honest money. The gold standard in this example would be a discontiguous effect caused by the invention of the transistor.

My goal in Part I was to introduce these five key concepts. While not writing directly against the Quantity Theory of Money, I believe that a full grasp of these concepts and related ideas would be sufficient to debunk it.

In Part II, we will discuss the dynamic process whereby the rate of interest puts pressure on prices and vice versa. I promise it will be a non-linear, multivariate, stateful, dynamic, and discontiguous theory.

Dr. Keith Weiner

Dr. Keith Weiner is the president of the Gold Standard Institute USA, and CEO of Monetary Metals where he write on the basis and related topics. Keith is a leading authority in the areas of gold, money, and credit and has made important contributions to the development of trading techniques founded upon the analysis of bid-ask spreads. Keith is a sought after speaker and regularly writes on economics. He is an Objectivist, and has his PhD from the New Austrian School of Economics. He lives with his wife near Phoenix, Arizona.