The Gold Standard
The journal of The Gold Standard Institute

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The Gold Standard Institute

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

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Editorial

In any sphere of activity, those without a good understanding of what is going on around them are easily rattled. Put another way, equanimity (above the level of apathy) is directly proportional to understanding. This applies just as much to the area of gold as any other.

The current fear of many gold (and silver) holders is that they are losing money. They count up their ounces or kilos and then translate the result into paper terms – so many dollars, pounds or euros etc.

The central tenet of The Gold Standard Institute is that gold is money. Only those who have failed to clear this elementary intellectual hurdle would make the error of using paper as the measure of gold's value.

Such people will succumb to the pressure and swap their gold for paper – if they have not already done so. They will race to give up their ounces and kilos for fear of the 'price of gold' going down. This is the ignorance that gives succour to the current systemised monetary corruption that, in its breadth and depth, is beyond anything witnessed in history.

The understanding that gold is the one and only money will come to everyone eventually, but for many, the price to be paid for that understanding will be denominated in the ounces or kilos that they used to own.

Philip Barton

News

London Evening Standard: 'Beyond El Dorado' – must see gold exhibition beginning in October at the British Museum.

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Trustnet.com: Probably the best encapsulation of the views of the utterly clueless that it has ever been my displeasure to read.

Arizona Central: Gold bill's demise was a betrayal of liberty, sound money.

Gov. Jan Brewer's veto of a bill to exempt gold and silver from taxes is a rejection of individual liberty and of honest money. The measure would have been an important step toward replacing the failing dollar. AP FILE PHOTO

Veto of gold and silver bill was a betrayal of liberty, sound money

MY TURN
KEITH WEINER

Arizona recently had a historic opportunity to lead the nation in replacing the failing dollar, but the governor, citing her desire for higher tax revenue, killed it.

Her veto is a mark of shame for the Grand Canyon State.

The bill Gov. Jan Brewer vetoed, Senate Bill 1439, was an important step forward, exempting gold and silver from taxes.

We could have made real progress in eliminating a barrier to circulation.

Imagine if, every time you bought something using silver, you had to show the IRS the receipt to prove what you paid for that particular bit of metal.

The government currently considers the act of paying in silver to be a sale of silver at the current market price and collects a tax on the gain in price.

Silver cannot circulate under such conditions.

The bill, which passed Arizona's House and Senate, would have removed this obstacle.

The legislation advanced along party lines; other than a few abstentions, every Republican voted in favor, and every Democrat voted against.

One might have expected the governor, a Republican who claims to support freedom and capitalism, to sign it.

Instead, she vetoed it, asserting that the bill would compromise big-government tax and spending, though of course she didn't put it that way.

Arizona's big-government governor is consistent. She enthusiastically promoted a Medicaid scheme that, according to her statistics, subsidizes 1 percent of the Arizona population.

Her veto of the gold and silver bill was based on the same big-government idea.

She does not want to lose revenue from taxing old coins (insignificant in the estimate of the Gold Standard Institute).

Jan Brewer's veto of the gold bill is a rejection of individual liberty and honest money.

The governor likes to portray herself as a fiscal conservative, but she is merely another welfare-state Republican like Richard Nixon, George H.W. Bush and George W. Bush.

Gold will not fix everything, but it stands in the way of government deficits.

The welfare state impoverishes us, so the government masks it by stimulating the economy. Stimulus is really just capital consumption. Like methamphetamines, it gives the economic body a temporary shot of energy — at a devastating cost to one's health.

Gov. Brewer positions herself as a supporter of free markets and capitalism, so she may have assumed that, under this cover, few would notice or care she vetoed this gold bill.

But this Arizonan does care, and so should everyone else who wants liberty, fiscal responsibility and sound money.

Richard Nixon infamously declared: "I am not a crook." George H. W. Bush similarly lied when he said: "Read my lips — no new taxes."

Arizona Gov. Jan Brewer has this shameful veto of gold and silver on the heels of her promotion of Medicaid.

She chose the welfare state instead of going for gold. This ought to be remembered by those of us in the great state of Barry Goldwater. The governor betrayed her professed principles and the interest of her constituents.

Keith Weiner is president of Scottsdale-based Gold Standard Institute USA.

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YouTube: Boerse Stuttgart interview with Thomas Bachheimer - President of The Gold Standard Institute Europe.

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Bloomberg: Gold beats cocaine in Colombia

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Caixin.com: Estimated 10,000 Chinese queue outside a gold shop to buy gold.

24hgold.com: A classic example of the fox being put in charge of the henhouse

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Mining.com: Australia's insects provide clues to new gold deposits.

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Mining Australia: Mega mines – the end?

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Mineweb.com: New Indian gold restrictions to cripple traders, but only the legal, tax-paying ones – see next item.

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Mineweb.com: India - "massive spurt in smuggling activities".

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Fox News: The Chinese and gold mining have been synonymous since at least 1859.

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BBC & Fox News: Spain steals same gold twice.

A Strong Dollar Is Not A Healthy Dollar!

When observing the global monetary system one is acutely aware of the resilience and continuing strength of the USD despite all attempts to undermine its foundation. Even when compared to the monetary anchor which was and very much still is gold, the USD appears to have strengthened its reign as monetary supreme. The Bernankes and Yellens of this world, despite all their efforts, including but not limited to QE1/2/3, Operation Twist, ZIRP et cetera seem impudent in halting the strength of the powerful dollar. Despite the thoughts (and disgraceful wishes) of some members of the gold community, the dollar isn't going off the board anytime soon. The clearest evidence of the dollar's strength and overall health is the gold basis[1] which isn't indicating an imminent collapse.

A common misconception which is held by many commentators within the gold community is that the dollar standard will be replaced (any minute now) with the Yuan standard or any other variant proposed by the powers that be. The hypothesis states that via bilateral or multilateral trade agreements, various nations will choose to establish and settle their trades in currencies other that the USD as a means of escaping it. The recent China-Japan bilateral trade agreement is held up as an example which will lead to the dollars demise. The problem with such a hypothesis is that it is undermined by the very nature and structure of the current monetary system. On an aggregated basis there is no exit from the dollar standard. It is true that in private action one can minimise their dollar dependency by becoming one's own "central bank" and acquire in gold and silver, but on a macro scale the system does not and cannot allow one to escape the dollar standard as the system is a closed loop.

When one purchases another currency, by say purchasing the Chinese Yuan or Japanese Yen, one may believe that they have diversified away from the USD but they have in fact merely varied the theme, as all currencies are variants of the USD. In a more technical sense they are USD derivatives as it is the USD which forms the asset side of foreign central bank balance sheets. In the event of the USD collapsing, every central bank around the world would find that they are staring into the insolvency abyss. Such an event would effectively be the default of every other currency on earth. To diversify to another currency believing that one is buying security from the precarious plight of irredeemable currency is the equivalent of changing deck chairs on the Titanic.

The considerate individual or the "Fringe Lunatic" (as Ayn Rand said would be used to describe the modern defenders of Capitalism by the cynics) who purchase gold and contribute to backwardation cannot escape the dollar standard entirely. All dollars are recycled. By purchasing gold one is attempting to exit the system but for every sale of gold the demand of dollars remain constant as the transaction rests upon the seller buying dollars (with the notable exception of trading commodity futures contracts in the event of gold permanent backwardation). In the absence of permanent backwardation, the dollar standard will remain in place.

Those who are claiming that we will see $50,000/oz. gold prices, and champion this as a cause for the dollars downfall are incorrectly assuming that there is a correlation between a high gold price and an unstable dollar. The reality is that the dollar price of gold is irrelevant to the health of the dollar. Permanent backwardation is the dollars undoing not the dollar price of gold. Permanent backwardation can occur at any moment no matter the price of gold and even in the face of a strengthening dollar which was witnessed in 2008 when Professor Antal Fekete issued his "Red Alert" essay[1].

The only objective measure to determine the health of the USD is to understand the gold basis. Observing the health of the USD via the gold priced dollar sphere will not tell the viewer anything in particular about the underlining health of the dollar.

Sebastian Younan
President – The Gold Standard Institute Australia

[1] See Keith Weiner's basis report at monetary-metals.com/basisletter/

The American Corner: How Do They Force People to Participate in the Dollar Scheme?

This is a topic where most Americans have only a vague understanding. It is practically an urban legend that if a storeowner set prices in gold or silver, that he could be sent to prison. Even people with advanced degrees in finance believe this.

The dollar is called a fiat currency. Fiat means force. It is true that we are forced to use the government's paper scrip for our money. But the mechanism is not to threaten merchants with prison.

Statists will say that no one is forced to accept dollars, or to hold them. Storeowners can demand payment in gold, and savers are free to buy gold if they wish. These are facts, but they do not support the statist's conclusion that people use the dollar freely. Force, and only force is the reason.

The Legal Tender Laws don't target vendors or consumers. They target lenders. Each dollar bill says, "This note is legal tender for all debts public and private." Creditors have no right to demand repayment in gold. No matter what a lender and a borrower agree to in advance, the borrower can pay in dollars if he wishes. The creditor must accept it (or not be repaid at all). The economy depends on lending to productive business, and the legal tender laws ensure that this is only possible in dollars.

The Accounting Laws force all taxpayers to keep their books in dollars. Anyone can keep other sets of books for internal use. But this is expensive and complicated, especially if the other set of books has a different unit of account, such as ounces of silver or grams of gold. Keeping the books in dollars encourages everyone to think that a gain in dollars is a profit. This is subtle but profound. How can the mind simultaneously grasp (1) "we made money" and (2) "we destroyed wealth"? I frequently try to explain this. Intelligent people, many who have studied economics, balk. If your books are kept in dollars, then you must operate your business to gain dollars.

The Tax Code provides another coercive mechanism. Picture a business that bought inventory for 10 ounces of gold and sold it for 11 ounces. In gold terms, that's a 1-ounce profit. The business would be (relatively) happy to pay an income tax on that ounce. But what if the gold price in dollars has doubled in between buying inventory and selling it? In dollar terms, the company bought inventory for $14,000 and sold it for $30,800. It made a profit of $16,800 and must pay a tax on that. After tax, it will have less than 10 ounces of gold. In gold terms, it will lose money.

The Capital Gains Tax forces anyone using gold or silver to keep track of the price they paid when they bought their metal. Any use of the metal in trade is considered a sale of the metal at the current market price. Even if there were no other obstacles, this one would stop the use of gold and silver coins dead.

The Schools train young minds to think that the dollar is money, and money means the dollar. This is what Ayn Rand called a *frozen abstraction*. This error consists of substituting one particular concrete for the wider class to which it belongs. The concrete is the dollar, and the class is unit of account (or *numeraire*). The dollar is one possible numeraire, and of course gold and silver are others. There is no force of law (after one graduates from school) to make people think this way. Yet they do, and this may be the strongest force that keeps people inside the dollar scheme. Even gold standard advocates often get stuck on what is the right "price" of gold, as if value cannot be possible unless it is measured in dollars.

There is No Interest Rate in Gold. The only way to save in gold today is to hoard it. There is nothing else one can do. However, storing pieces of metal creates no wealth, and this is obvious to most people. Only an interest rate will encourage people to take gold out from under the mattress and put it to productive use in financing new business.

I prefer to end on an upbeat note, but the above is a sober look at some of the challenges that we must face. If we understand them, then we have a chance to defeat them.

Dr. Keith Weiner

But there is not enough Gold… is there?

One of the 'Big Lies' about Gold is that there is not enough Gold around; after all, Gold is valuable because it is scarce, so Gold cannot be used as 'money'… right? Well, no, not right at all. In reality, this particular 'Big Lie' is three 'Big Lies' rolled into one.

The first lie is that the quantity of money in circulation is crucial to the state of the economy, and determines recessions, booms, etc. After all, we hear about 'money supply' and 'fine tuning' the economy practically every day. Rest assured Mr. Bankster and Mr. G'man want our attention on this… not on the truth.

The bland truth is that the quantity of money in circulation has NO effect whatsoever on the economy…! Read the last statement again, carefully, because it probably goes against everything you have ever heard… from Mr. Bankster, from Mr. G'man, and their bought and paid for 'economists'. Once again; the quantity of money in circulation has no effect whatsoever on the economy… zero, nada.

Ok, may you find this hard to believe… trust me, it took me a long time and a lot of study to understand how and why this is true. It is vital to understand that the quantity of money is irrelevant if we expect to understand what really goes on. History is full of examples that show beyond a shadow of a doubt that the quantity of 'money' in circulation is absolutely irrelevant… if we have eyes to see.

Surely you have heard of the cases of 'New Pesos' replacing 'Old Pesos'… or 'New Lira' replacing 'Old Lira'? This happens every time a currency is so debased that million, billion, and even trillion unit bills must be printed. A cup of coffee may cost three billion Lira… and it becomes impossible to add more zeros to the bills… lest the bills become the size of bed sheets.

At this time the G'man decides to issue a new currency… and in the process lops six zeros from the 'old' currency. That is, a billion Old Lira note is replaced directly by a new one Lira note. Think about this; every billion Old Lira is replaced by ONE Lira… and there were millions of the old Billion Lira notes in circulation… they are all gone, all replaced by One Lira notes.

The money supply just shrank, overnight, by a factor of one billion. Not by a percent or two as usually claimed by the 'fine tuning' money supply 'experts'… but by a factor of one hundred billion percent. Yet, the next day, life goes on as usual… incredible, yes? Of course, it is easy to see why.

The price of a cup of coffee was three billion Old Lira; the price of a cup of coffee is now three New Lira. Meanwhile, the average wage was thirty billion Old Lira per hour… and is now thirty New Lira. One hour's pay in Old Lira bought ten cups of coffee. Surprise, surprise… one hour's pay in New Lira will also buy ten cups of coffee.

Nothing has changed… in relative prices that is. Clearly the quantity of money is irrelevant… only relative prices count. Or, to be more precise, only the purchasing power of money vs wages counts.

The second big lie is based on the first big lie… if money supply is crucial (lie # one) then the G'man must carefully manage it… (lie # two). Let's take an economy with 300,000,000 people… like the USA. If we add $1,000,000,000.00 (one billion Dollars) to the money supply that sounds like a big number… but it only comes to $3.33, that is three Dollars and thirty three cents, per US citizen… now honestly, would it make any significant difference to your 'economy' if someone gave you three Dollars and thirty three cents? Methinks not….

On the other hand, suppose that the $1,000,000,000.00 (one billion Dollars) were given to ONE person… now that would surely make some difference to that person. But this is exactly what happens when a billion of new 'money' is printed… one person gets the whole billion; Mr. G'man gets the billion, and gets to spend it any way he chooses. This is called seignorage… profit made by the money issuing agent. It is more accurately called 'legalized counterfeiting'.

Contrast this to that 'barbarous relic', the Gold Standard. Gold cannot be counterfeited, but has to be earned (or stolen openly). Gold is earned by either trading value for value, or by digging it out of the earth at full cost and with much sweat. Just like you and I earn our living… not like Mr. G'man, who makes us take his freely printed paper, at gunpoint, calls it 'Legal Tender', taxes us, and makes us sweat to pay him back.

Not like Mr. Bankster, who prints paper freely, and then has the audacity to not only demand that we pay his 'money' back in full, but demands that we pay him interest for the privilege of using his 'money'. This is my definition of usury; create paper chits, pretend they are money, then charge real interest for the use of it… and if you or I try to print the chits, guess what happens? Only Mr. Bankster has the privilege of counterfeiting legally. His bedfellow Mr. G'man sees to that.

Under the Barbarous Relic, money supply took care of itself. If it cost 11 Gold coins to mine and refine 10 Gold coins, no one would do it…. On the other hand, if Gold was really scarce and valuable, and it cost only 9 Gold coins to mine and refine 10 new Gold coins, miners would get to work, and balance would be restored… in the long term. Short terms fluctuations are impossible.

The third big lie is a bit of a paradox, and we need to see both sides of this paradox in order to understand Gold. First, Gold is indeed a precious metal; to mine Gold today, tons of rubble must be dug up and sifted to find grams of Gold… indeed, this is why rubble cannot be money; it is far too easy to get new supplies… new gravel money would be almost as easy to create as new paper money.

The paradox kicks in when we look at the supply of Gold on hand… remember, Gold has been money for thousands of years, and Gold was recognized as being precious and valuable far longer than its use as money in circulation… so Gold has been mined and hoarded since time immemorial… long before written history.

Thus, even though new Gold is very difficult and expensive to extract, there is an enormous supply of mined and refined Gold around. It would take about 80 years of mining at current rates to dig up as much new Gold as already is known to exist. This is called the 'stock to flow' ratio… and it means that the supply of Gold is steady, not subject to disruption on a new mine discovery.

As supply is steady, so value is also steady… and by steady I mean steady over centuries, not just over a few weeks or months. By comparison, all non-monetary commodities like copper, crude oil, grains etc. have stock to flows measured in weeks, not decades.

This is logical if you think about it; if there was a glut of zinc, like a year's supply, the price would collapse. The value of all commodities except Gold and Silver… the monetary metals… declines rapidly with excess supply. Guess what the value of freely printed paper does.

The demand for the monetary metals Gold and Silver is endless. There is never a 'glut' of Gold or Silver. Indeed, only real interest paid in real Gold or Silver can lure hoarded monetary metals out of their hoards.

Today, we get no real interest… and so most Gold and Silver is in hiding, awaiting the day of freedom… the day it will once again be safe and legal to earn, to hoard, and to spend Gold and Silver instead of counterfeit paper; real money instead of Bankster's debt notes masquerading as money.

Rudy J. Fritsch
Editor in Chief

Theory of Interest and Prices in Paper Currency Part IV (Rising Cycle)

In Part I, we looked at the concepts of nonlinearity, dynamics, multivariate, state, and contiguity. We showed that whatever the relationship may be between prices and the money supply in irredeemable paper currency, it is not a simple matter of rising money supply → rising prices.

In Part II, we discussed the mechanics of the formation of the bid price and ask price, the concepts of stocks and flows, and the central concept of arbitrage. We showed how arbitrage is the key to the money supply in the gold standard; miners add to the aboveground stocks of gold when the cost of producing an ounce of gold is less than the value of one ounce.

In Part III, we looked at how credit comes into existence via arbitrage with legitimate entrepreneur borrowers. We also looked at the counterfeit credit of the central banks, which is not arbitrage. We introduced the concept of *speculation* in markets for government promises, compared to legitimate trading of commodities. We also discussed the prerequisite concepts of *Marginal time preference* and *marginal productivity*, and *resonance*.

Part III ended with a question: "What happens if the central bank pushes the rate of interest below the marginal time preference?"

To my knowledge, Antal Fekete was the first to ask this question[2]. It is now time to explore the answer. We are dealing with a cycle. It is not a simple or linear relationship between quantity X and quantity Y, much to the frustration of students of economics (and central planners).

The cycle begins when the central bank pushes the rate of interest down, below the rate of marginal time preference. Unlike in the gold standard, under a paper currency, the disenfranchised savers cannot turn to gold. Perhaps it has been made illegal as it was in the U.S. from 1933 to 1975. Or it could merely be taxed and creditors placed under duress to accept repayment in irredeemable paper. Whatever the reason, the saver cannot perform arbitrage between the gold coin and the bond[3], as he could in the gold standard. He is trapped. The irredeemable paper currency is a closed loop system. The saver is not entirely without options, however.

He can buy commodities or finished goods.

I can distinctly recall as a boy in the late 1970's, when my parents would buy cans of tuna fish, they would buy 50 or 100 cans (we ate tuna on Sunday, two cans). Prices were rising very rapidly, and so it made sense to them to hold capital in the form of food stocks rather than dollars. Indeed, prices rose so frequently that grocery stores were going to the expense of manually applying new price stickers on top of the old ones on inventory on the shelves. This is extraordinary, because grocers sell through inventory quickly. Some benighted people began agitating for a law to prohibit this practice (perhaps descendants of King Canute, reputed to have ordered the tide to recede?).

Consumers are not the only ones to play the game, and they don't have a direct impact on the rate of interest. Corporations also play. When the rate of interest is below the rate of marginal time preference, we know that it is also below the rate of marginal productivity. Corporations can sell bonds in order to buy commodities. They can also accumulate inventory buffers of each input, partially completed items at each state of production, and finished products.

What happens if corporations are selling bonds in order to expand holdings of commodities and goods made from commodities? If this trade occurs at large

[2] Fekete wrote about the connection between interest rates and prices at least as early as 2003, in "The Ratchet and the Linkage" and "Between Scylla and Charybdis". He published Monetary Economics 102: Gold and Interest. The idea he proposed in those three pages has been fleshed out and extended by myself, and incorporated into this series of papers on the theory of interest and prices, principally in parts IV and V. I would like to note that Fekete regards the flow of money from the bond market to the commodity market as inflation and the reverse flow as deflation. I agree with his description of these pathologies, but prefer to reserve the term inflation to refer to counterfeit credit. I call it the rising cycle and falling cycle instead.

[3] http://keithweinereconomics.com/2012/06/06/in-a-gold-standard-how-are-interest-rates-set/

enough scale, it will push **up** the rate of interest as well as prices. Let the irony sink in. The cycle begins as an attempt to push interest rates **down**. The result is the opposite.

Analysts of this phenomenon must be aware that the government or its central bank cannot change the primary trend. They can exaggerate it and fuel it. In this case, the trend goes opposite to their intent and there is nothing they can do about it. King Canute could not do anything about the waves, either.

Wait. The problem was caused when interest was pushed below time preference. Now interest has risen. Are we out of the woods yet?

No. Unfortunately, marginal time preference rises. Everyone can see that prices are rising rapidly, and in such an environment, are no longer satisfied with the rate of interest that they had previously wanted. The time preference to interest spread remains inverted.

This is a positive feedback loop. Prices and interest move up. And then this encourages another iteration of the same cycle. Prices and interest move up again.

Positive feedback is very dangerous, because it runs away very quickly. Think of holding an electric guitar up to a loudspeaker with the amplifier turned up to 10. The slightest sound is amplified and fed back and amplified until there is a horrible squeal. Electrical systems contain circuits to prevent self-destruction, but alas there is no such thing in the economy.

There are, however, other factors that begin to come into play. The regime of irredeemable currency forces actors in the economy to make a choice between two bad alternatives. One option is to earn a lower rate of interest than one's preference. Meanwhile, prices are rising, perhaps at a rate faster than the rate of interest. Adding insult to injury, as the interest rate rises, it imposes capital losses on bondholders. Bonds were once called "certificates of confiscation". There is but one way to avoid the losses meted out to bondholders.

One can hold commodities and inventory. There is a problem with this alternative too. The marginal utility of commodities and inventory is rapidly falling. This means that the more one accumulates, the lower the value of the next unit of the good. This is negative feedback. Another problem is that it is not an efficient allocation of capital to lock it up in illiquid inventory. Sooner or later, errors in capital allocation accumulate to the harm of the enterprise.

There is another problem with commodity hoarding. Unlike gold hoarding, which harms no one, hoarding of goods that people and businesses depend on hurts people. As we shall see below, growth in hoarding is not sustainable. What the economy needed was an increase in the interest rate. An unstable dynamic that causes prices to rise along with interest rates is no substitute.

The choice between losing money in bonds, vs. buying more goods that one needs less and less, is a bitter choice. This choice is imposed on people as an "unintended" (like all the negative effects of central planning) consequence of the central bank's attempt to drive interest rates lower. I propose that this should be called *Fekete's Dilemma* in the vein of the Triffin Dilemma and Gibson's Paradox.

Another negative feedback factor is that rising interest rates destroy productive enterprises. Consider the example of a company that manufactures TVs. When they built the factory, they borrowed money at 6%. With this cost of capital, they are profitable. Eventually, the equipment becomes worn out and/or obsolete. Black and white TVs are no longer in demand by consumers, who want color. Making color TVs requires new equipment. Unfortunately, at 12% interest, there is no way to make a profit. Unable to continue making a profit on black and white, and unable to profitably start making color, the company folds.

The more the interest rate rises, and the longer it remains high, the more companies go bankrupt. This of course destroys the wealth of shareholders and bondholders, and causes many workers to be laid off. Its effect on interest rates is to pull in both directions. When bondholders begin taking losses, bonds tend to sell off. A falling bond price is the flip side of a rising interest rate (bond price and yield are inverse). On the other hand, with each bankruptcy there is now one less bidder pushing up prices. Additionally, the inventories of the bankrupt company must be liquidated; creditors need to be paid in currency, not in half-finished goods, or even in stockpiles of iron ingots.

A third factor is that a rising interest rate causes a reduced burden of debt for those who have previously borrowed at a fixed rate, such as corporations who have sold bonds. They could buy back their own bonds, and realize a capital gain. Or, especially if the price of their own product is rising, they have additional capacity to borrow more to finance further expansion of their inventory buffers. This will tend to be a positive feedback.

These three phenomena are by no means the only forces set in motion by the initial suppression of interest rates. The take-away from this discussion should be that one must begin one's analysis with the individual actors in the economy, and pay attention to their balance sheets as well as their profit and loss.

The above depiction of a rising cycle, where rising interest rates drive rising prices, and rising prices drive rising interest rates is not merely hypothetical. It is a picture of what happened in the U.S. from 1947 to 1981.

Many people predicted that the monetary system was going to collapse in the 1970's. It may have come very close to that point. The Tacoma Narrows Bridge swung to one side before moving even more violently to the other. The dollar might have ended with prices and interest rates rising faster and faster, until it was no longer accepted in trade for goods.

But this is not what, in fact, occurred. Things abruptly turned around. Fed Chairman Paul Volcker is now credited with "breaking the back of inflation". Interest rates did indeed spike up briefly to about 16% on the 10-year Treasury in 1981. After that, they fell, rose once more in 1984, and then settled into a falling trend (with some volatility) that continues through today. But remember what we said above, that a central bank can exaggerate the trend but it cannot reverse it.

Interest rates and prices had peaked. When the marginal utility of each additional unit of accumulated goods falls without bound, it eventually crosses the threshold of zero marginal utility. Then it can no longer be justified. Meanwhile, bankruptcies, with their forced liquidations, increase. A final upwards spike of interest rates discourages any further borrowing. What company can borrow at such an extreme interest rate and still make a profit?

At last, the time preference to interest spread is back to normal; interest is above the time preference. Unfortunately, there is another problem that causes the cycle to slam into reverse. The cycle continues its dynamic of destroying wealth, confounding central planners and economists.

The central planning fools think that they can magically gin up some more credit-money, or extract liquidity somehow to rectify matters. Surely, they think, they just have to find the right money supply value. Their own theory acknowledges that there are "leads and lags" so they work their equations to try to figure out how to get ahead of the cycle.

A blind man would sooner hit the bulls-eye of an archery target.

In Part V, we will examine the mechanics of the cycle reversal, and the other side of the unstable oscillation. Without spoiling it, let's just say that a different dynamic occurs which drives both interest and prices down.

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.