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

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Editorial

As every man and his dog have expressed a view on gold manipulation schemes at some point, so shall this edition of The Gold Standard. The discussion, both for and against, involves a misunderstanding.

Gold is money, the measure of value. That is its principal virtue. As such it cannot be manipulated; that is the beauty of measures. No matter what is spoken or written about metre rules, no matter whether they are secreted away or sprayed about like confetti, they persistently continue to measure one metre.

While gold cannot be manipulated, other things can – particularly perceptions. This is evidenced by the great majority of people who still sincerely believe that the pieces of paper and junk metal in their wallets and purses are money.

While that fantasy persists, then paper will continue to be acceptable in commercial exchanges. The stronger that fantasy has hold, the less paper it will take to exchange for gold. The weaker the fantasy has hold, the more paper it will take to exchange for gold.

One of the most effective manipulations of perception is the demand by the state that taxes are paid in paper money. The importance of this is sometimes underestimated. It is a brilliant strategy. Surely if taxes have to be paid with pieces of paper, then pieces of paper must have value? The tax creates a demand; the demand must be met with a supply. Voila, paper begins to circulate.

Today we all labour under the fact that the unit of account in our daily lives is paper money. How could it be otherwise when its use is required for every day-to-day purchase? The problem is when we try to use it to measure the value of gold.

The manipulation can only work if people choose to believe it. It is true that the price of our bread, milk and mortgage is measured in paper money; it does not follow that gold is measured in paper money.

In recent months, gold is stating that the value of most paper money is on the rise. Paper money is in high demand (more valuable) because it is desperately needed to service debts that are denominated in paper money. Ironically, as the debt collapse gathers steam, the perception of paper's value may well continue to stay high, or even rise further, for some period of time.

The wild fluctuations in the perceived value of paper money are not of interest to The Gold Standard Institute. What is of interest is that gold is the measure of value and nothing else can serve that function – no matter the machinations and confusions of both those who manipulate and those who are manipulated.

Philip Barton

News

Keith Weiner interview.

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Mining.com: Russia's central bank increases gold holdings for the ninth successive month.

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Business Standard: X-rays could help detect gold. Beware other uses!

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Pune Mirror: US returns Saddam Hussein's gold ceremonial sword to Iraq.

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Fox News: Mediaeval Spanish gold seeker's fort found in North Carolina.

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The News.com: Pakistan joins the doomed fight against money. The intensity with which politicians plaster their faces with eggs is delightful to behold.

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Thai Visa: The unusual case of the Buddhist monk with 8 tonnes of gold. If true, it seems safe to predict that the authorities will never find it.

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Business Standard: Chinese gold demand could hit 1000 tonnes this year – WGC.

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Yahoo: Maybe gold is not the product of supernovas!

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Daily News Egypt: As disorder increases so gold disappears.

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YouTube: As the economy collapses, gold becomes a target for thieves.

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Iraq Business News: 50 tonnes of gold imported into Iraq in six months as the banking system collapses.

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News.com.au: Yet more curbs on Indians importing gold. A minimum of 20% of all gold imports must now be for manufacture of exports.

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NDTV: Indian government now reduced to "imploring" people not to buy gold as smuggling soars.

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Daily Times: Gold imports surge more than 100% in Pakistan.

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NY Times: All movement of gold in or out of Iran now halted – in theory.

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The Onion: "The economy is just one great speech short of a full recovery." :-0)

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Business Standard: Bank of England helped sell Nazi gold.

Clearly Declining Marginal Utility of Additional Debt

"The utility resulting from any small increase in wealth will be inversely proportionate to the quantity of goods previously possessed."

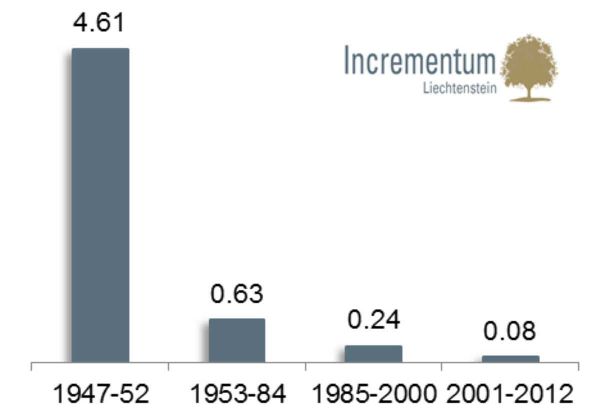
Daniel Bernoulli

Gossen's first law states: *"The amount of one and the same enjoyment decreases continually if we carry on continuously with consuming the enjoyment, until finally satiation sets in."* This means that the consumption of a good provides a successively declining marginal utility as the amount consumed increases. Moreover, factors of production can sometimes even be destroyed.[1] **This law is universally valid, and can be applied to a multitude of different spheres.[2]**

The strongly declining marginal utility of additional units of debt can be seen in the following chart. While from 1947 to 1952, every additional dollar of debt still created $4.61 in GDP growth, this has declined to 8 cents since 2001. This also explains why stimulus programs can by now only produce anemic growth. **As soon as the doses of debt are no longer progressively increased, and even reduced, the withdrawal symptoms will be painful.**

The insight that debt-financed stimuli only provide short term relief is also confirmed by numerous academic studies. According to Paul Vreymans[3], the expansion of the money supply affects the growth of GDP at a statistically barely significant magnitude of 0.1102. The effect is primarily limited to the first quarter after the injection, while the short term growth effect later on dissipates quickly and begins to be counterproductive in subsequent quarters.

Increase in Real GDP per Dollar of Incremental Debt



Expansion of money supply has very limited impact on economic growth

Robert Lucas stated something similar in his Nobel Prize acceptance speech.[4] Monetary expansion has practically no influence on economic growth; it is a causal illusion. Lucas rather regards it as a deception of all market participants, since the most important price in the market economy is falsified and the function of money as a store of value is destroyed. This leads to misallocations of capital. Monetary policy – regardless of whether it is expansive or restrictive – is according to Lucas unable to influence the level of economic output.[5]

"The decline of the value of each dollar is in exact proportion to the gain in the number of them." Keith Weiner

That also explains why the current real problems cannot be solved by means of monetary stimulus. That a strong increase of the monetary base has historically been a surefire recipe for higher rates of price increases, is even stated by the Federal Reserve.[6] According to a Fed study, expansionary monetary policy is only to be

1) Wikipedia, "Gossen's Law": a typical example is the consumption of foodstuffs, which typically leads to satiation (and where the marginal utility can consequently even turn negative). Thus the consumption of a glass of water creates very high utility for a thirsty person, while the second glass creates less utility, the third glass again somewhat less additional utility, and the fourth may already create a feeling of satiation or even nausea, i.e., the marginal utility turns negative. In the most extreme case, one may even drown in water if there is too much of it.
2) an analogy from nature: it is possible to increase the fertility of soil by means of fertilizer. However, if one overdoes it, overfertilization takes place and every additional unit of fertilizer becomes useless, the soil is destroyed.
[3] "The Monetary Stimulus Myth – An Evidence based Analysis", Paul Vreymans

4) http://www.nobelprize.org/nobel_prizes/economics/laureates/1995/lucas-lecture.pdf
5) see "Transmissionsprozess: Die Rolle von Erwartungen und imperfekter Information" (Transmission process: the role of expectations and imperfect information), Daniel Niedermayer
6) see: "Doubling Your Monetary Base and Surviving: Some International Experience", Fed St. Louis, Richard G. Anderson, Charles S. Gascon, and Yang Liu

recommended if the public is aware that the increase is only temporary and the central bank is able to firmly anchor credibility with respect to low, stable rates of price inflation.

Ronald Stoeferle

Biography:

Ronald-Peter Stoeferle, born October 27, 1980 in Vienna, Austria, is a Chartered Market Technician (CMT) and a Certified Financial Technician (CFTe). During his studies in business administration and finance at the Vienna University of Economics and the University of Illinois at Urbana-Champaign, he worked for Raiffeisen Zentralbank (RZB) in the field of Fixed Income/Credit Investments. After graduating from university, Stoeferle joined Vienna based Erste Group Bank, covering International Equities, especially Asia. In 2006 he began writing reports on gold and gained media attention when he expected the price of gold to rise to USD 2,300/ounce when the current price was only at USD 500. His seven benchmark reports called "In GOLD we TRUST" drew international coverage on CNBC, Bloomberg, the Wall Street Journal, Economist and the Financial Times. He was awarded "2nd most accurate gold analyst" by Bloomberg in 2011and is frequently invited to serve as a keynote speaker for major industry gatherings all over the world. He also writes reports on crude oil, his last report was entitled "Nothing to Spare. Stoeferle managed two goldmining-baskets and one basket for silvermining-equities while working at Erste Group.

In 2013 he became managing director and partner of Incrementum AG, based in the Principality of Liechtenstein. The company focusses on asset management and wealth management and is one hundred percent owned by its partners. He will continue to write the annual "In Gold we Trust" as a senior advisor to Erste Group. Moreover he is a lecturer at the Institut für Wertewirtschaft (Institute for value-based economics) and at the academy of the Austrian Stock Exchange.

His favourite books are "*The World of Yesterday*" by Stefan Zweig, "*Human Action*", by Ludwig von Mises and „*The Raven of Zurich: The Memoirs of Felix Somary*" by Felix Somary. His favourite quote is "*Whatever you are, be a good one*" (Abraham Lincoln).

How do we get there??

If you have read my last three articles, you are starting to understand the true value of Honest Money to society and to you and ME… but we have barely scratched the surface. The well hidden 'magic' of Gold money emerges only once Gold is in free circulation.

However, we do have a slight problem… namely, how in heck do we transition from a paper world, in hock up to its ears, to a world of honest money… to a world of modest, honest debt… to a world where power lies with the people, not with banksters and G'men?

A tough question indeed… and another place where a Big Lie sneaks in… like 'there is no way' to go 'back on Gold'… so don't even try. If we believe this lie, we are damned to continue with the Chinese paper torture… and nature will take its own course… we will be dragged kicking and screaming back to honest money. Better we disbelieve the Big Lie, and find a rational, reasonable way out of our paper dilemma. I quote Hans Sennholz, well known Austrian economist;

"Sound money and free banking are not impossible, they are merely illegal. That is why money must be deregulated. The Gold standard will return as soon as people realize that honesty is the best policy.
As hope of ill gain is the beginning of the fiat standard, so is honesty the mother of the Gold standard. The Gold standard is as old as civilization. Throughout the ages, the Gold standard has emerged again and again because man needed a dependable medium of exchange."

To find our way back, we must understand that a Gold Standard has more than one component; sure honest, real money, Gold and Silver, must be in circulation and in the hands of the people; but this is just the foundation. Once the stable, earthquake resistant Golden foundation is built, we must then build the rest of the edifice.

To create the Unadulterated Gold Standard that is our ultimate goal, we need to build an honest credit system. Credit breaks down into two distinct components; credit (in the form of debt) created by borrowing, and commercial credit, created by clearing urgently needed consumer goods… credit created without borrowing.

The idea of credit and debt are well understood… indeed too well! All the trillions of debt in existence today reflect this emphasis on borrowing… the very stuff we use as 'money', the Dollar bills, the Euros… all paper… are borrowed into existence.

Unfortunately, the other vital component, credit created WITHOUT borrowing, is pretty much unknown. I will be writing another article on this very issue… the third leg of the Gold Standard. The first leg is Gold (and Silver) in circulation. The second leg is Gold-bonded debt; the third leg is commercial credit created by clearing, not borrowing.

For now, we talk about Gold Bonds… the second component of the Unadulterated Gold Standard. Gold bonds will work to absorb and extinguish the enormous debt tower that is presently tottering, and threatening to take the world economy down with it. The situation here is simple; 'if you have dug yourself into a deep hole, first stop digging'.

Even a child knows the truth of this; yet seemingly our 'fearless leaders' have no clue… the hole dug so far is approximately sixteen trillion Dollars deep… and instead of stopping the digging, they are encouraging, indeed forcing us to Dig Deeper! What total insanity is this?

We can stop the digging by turning to Gold and Silver as our currency… no more borrowing endless quantities of paper into existence. Then, once we have stopped digging, once we have stabilized the situation, we can think of how to repair the problem… how to fill up that sixteen trillion Dollar hole.

The thought of filling this hole is daunting; it is bigger than the Grand Canyon, and will take an awful lot of filling to heal… but given a stable situation, that is no more digging, even a slow and methodical method will eventually fill the hole; instead of digging, start filling.

Bit by bit, day by day, the wound can be healed… and the economic situation also improve day by day instead of staggering from crisis to ever deeper crisis. After all, it took more than a century of digging to make the debt hole as big as it is… don't expect to fill it overnight.

So how do we start? The plan is simple… start to issue Gold Bonds, instead of paper bonds. Gold bonds are the second major component of a Gold Standard; Gold Bonds are denominated in Gold units, are payable in Gold units at maturity, and pay interest in Gold units... actual, physical Gold, not paper promises.

The key difference between current bonds and Gold bonds is that no paper is involved… only physical Gold. This means that once a Gold Bond is paid, the debt it represents is extinguished… whereas this is not true of paper bonds. Paper bonds issued by the Treasury are never paid off, cannot be paid off… else the Dollars they 'back' are themselves extinguished.

Simply put, by issuing Gold bonds we separate money (Gold coin) from debt… (Gold bond). Once this is done, once Gold bonds are issued, the holders of paper bonds will face a choice; continue to hold paper bonds that mature into worthless paper currency… if they ever mature at all… or trade their paper bonds for Gold Bonds, bonds that not only mature into Gold… but pay interest in the form of Gold.

The choice will be a no brainer… and paper bonds will be gradually replaced by Gold bonds. The Gold bonds will eventually mature, and the debt they represent will be extinguished. Gold income, needed to pay interest on the Gold bond, is assured by the circulation of Gold coin.

As paper bonds are retired, the deep hole will continue to be filled… and financial sanity will return to the planet. It may take years if not decades to make this transition… but that is incomparably better than an outright debt default… see Greece or Cyprus for examples of the destruction caused by default. Imagine a default by a major nation, rather than economically invisible entities like Greece or Cyprus.

The idea of 'inflating away' the debt is another Big Lie; not only is inflation just as destructive as an outright default, inflating the debt away is actually impossible. The idea that inflation is the consequence of 'more money chasing less goods' is false.

In order to create more 'money' to chase the goods, more debt must be created to back the new 'money'… indeed, for every new Dollar created, new debt of exactly one Dollar must also be created. On the other hand, no debt new or old is needed for Gold; Gold IS money, Gold stands on its own, Gold is not 'backed' by anything.

Let's get started. The sooner we stop digging and start filling the better. If we don't stop soon, the tower of debt will indubitably collapse, and take the world economy… and you and 'ME' with it.

Rudy J. Fritsch
Editor in Chief

Theory of Interest and Prices in Paper Currency Part V (Falling 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*.

In Part IV, we discussed the rising cycle. The central planners push the rate of interest down, below the marginal time preference and unleash a storm whose ferocious dynamics are more than they bargained for. The hapless subjects of the regime have little recourse but they do have one seeming way out. They can buy commodities. The cycle is a positive feedback loop of rising prices and rising interest rates. Ironically, their clumsy attempt to get lower interest results in rising interest. Alas, the cycle eventually ends. The interest rate and inventory hoards have reached the point where no one can issue more bonds or increase their hoards.

In this Part V, we discuss the end of the rising cycle and the start of the falling cycle. We examine its dynamics and its mode of capital destruction. Lastly we look at the response of the central bank.

It is not possible to pay debts with inventories of completed or partially completed product, nor even with raw commodities. In order to circulate as money, a good must have an extremely narrow bid-ask spread. Commodities have a wide spread, especially in the environment of the late stages of the rising cycle. Liquidations are pushing the bid down. The ask side is still being pushed up, by those businesses which are still buying. Work in progress of course could not be sold, except to another company in the same industry.

Recall that the rising cycle is driven by selling bonds to build inventories. This creates a conflict: the desire to accumulate more inventories because prices are rising rapidly vs. the need for cash to service the debt. In any conflict between want and need, between speculation and leverage, the latter must win in the end. At the same time that the marginal utility of the unit of hoarded goods is falling, the amount owed is rising.

The backdrop is layoffs and liquidations, as each time a company's capital and plant must be renewed, it is harder and harder to make a business case. If it is profitable to borrow at 7% to buy machines to manufacture cameras, it may not be profitable at 14%. So factories are closed, resulting in liquidations. People lose their jobs, resulting in increasing softness in the consumer bid for goods.

Eventually, as it must, the trend comes to its ignominious end. The interest rate spikes up one final step higher as banks are taking capital losses and become even more reluctant (or able) to lend. The rate of interest is now, finally, above marginal time preference. That spread is reverted to normalcy. Unfortunately, the other spread discussed in Part III inverts.

That other spread is marginal productivity to the rate of interest; the latter is now above the former. I mentioned in Part IV that many people credit Paul Volcker for "breaking the back of inflation" in 1981. The central planners cannot change the primary trend, and in any case the problem was not caused by the quantity of money, so the solution could not have been reducing the money supply. At best, if he pushed up the rate of interest he accentuated the trend and helped get to the absolute top. The 10-year Treasury bond traded at a yield around 16%.

The rising cycle was driven by rising time preference that caused rising interest as businesses borrowed to finance inventories which caused time preference to rise further. During this process, at first one by one and then two by two, enterprises were forced to close and liquidate their inventories, as their businesses could not earn the cost of capital. This force opposed the rising cycle.

Now it fuels the falling cycle. The only good thing to be said is that interest rates are not rising and therefore viable companies are not squeezed out due to rising cost of capital. The wrecking ball of rising rates has finished on that side of the street. It is done destroying capital by rendering it sub-marginal, when it cannot produce enough to justify borrowing at the higher rate of interest.

As we shall see, that wrecking ball will not repair the damage it has done when it swings to the other side. A falling rate destroys capital also, though by a different mechanism. It causes the *Net Present Value* (NPV) of every bond to rise. This is because the NPV of a stream of future payments is calculated by discounting each future payment by the interest rate. The lower the interest, the lower the discount for all future payments. This is why the bond price rises.

Falling interest rates benefit one group. The bond speculators get rich. They can buy bonds, wait a little while, and sell them for a profit. The bond bull market starts off slowly but becomes ferocious over time. In nature, if a source of readily usable energy exists then a specialized organism will evolve to exploit it and feed off it. This is true for plants and animals in every niche on dry land, and it is for strange sea creatures near volcanic vents on the icy sea floor. Plants convert sunlight into sugars and animals eat plants, etc. The same is true for free profits being offered in the bond market. A whole parasitic class develops to feed off the free capital being offered there.

Savers and pension funds cannot profit from falling rates because they hold until maturity. The more the interest rate falls, the more they are harmed. The lack of savings is another blow to the economy, as it is savings that are the prerequisite to investment and investment is the prerequisite to jobs and rising wages.

By contrast, the speculators are not in the game for the interest payments. They are in for capital gains.

Where does their free profit come from? It comes from the capital accounts—from the balance sheets—of bond issuers. Anyone who has sold a bond or borrowed money with a fixed-rate loan should mark up the liability, to market value. I have written previously on the topic of falling interest rates and the destruction of capital.[7]

On the way up, businesses could seemingly dictate whatever prices they felt like charging. Recall my example of cans of tuna fish in the 1970's; stores were re-stickering them with higher prices even in the short time they sat on the shelves. My theory predicts that gross margins must have been rising everywhere, especially if companies managed their inventory to move from input to final sales over a long period of time (this would be worth researching in further papers).

But today, they have not this power. Even in industries where prices have been rising, the consumer is reluctant and sluggish to pay and there are many competing alternatives. In other industries (recall my example of Levis jeans, which applies to clothing in general) there seems to be no pricing power. Many stores in the mall have permanent signs offering big discounts; I regularly see 60% off.

What is it about rising interest rates that allows for aggressively expanding prices and margins, and falling rates that compresses margins and prices?

We said in Part III:

> *What is the bond seller—the entrepreneur—doing with the money raised by selling the bond? He is buying real estate, buildings, plant, equipment, trucks, etc. He is producing something that will make a profit that, net of all costs, is greater than the interest he must pay. He is doing arbitrage between the* ***rate of interest*** *and the* ***rate of profit****.*

[7] Falling Interest Rates Destroy Capital

As the interest rate ticks upwards, every producer in every business must adapt his business model to the higher cost of capital. They must earn a higher gross margin, in order to pay the higher interest rate. Higher rates must necessarily drive higher gross margins. We have discussed two ways to get a higher margin: (1) a long lag between purchase of inputs and sale of outputs and (2) higher prices. Strategy #1 is the reaction to the inverted interest to time preference spread. Strategy #2 is the reaction to higher interest rates and thinning competition.

The burden of debt is falling when the interest rate is rising, and we can see it in the reduced competitive pressures on margins. Of course, we are now in the falling cycle and the opposite applies. If one wants to track the "money supply", one can think of the money going, not into consumer goods or commodities, but into productive capacity. I propose that one should think of inflation not in terms of the "money supply" but in terms of counterfeit credit.[8] In the rising cycle, counterfeit credit is going into commodities. In the falling cycle, by contrast, it is going into bonds that finance government and also productive capacity.

I call it a "ferocious" bull market in bonds because it is gobbling up the capital of businesses that borrow (and they have to borrow in order to keep up with their competitors). The competition is ferocious, because each new business can borrow at lower rates than incumbent competitors. The new entrant has a permanent competitive advantage over the old. Then the rate falls further and the next new entrant enters. The previous new entrant is now squeezed, doubly so because unemployment is rising. The prior incumbent is wiped out, its workforce is laid off, and its plant and inventory is sold off. Unemployed workers are not able to aggressively bid up prices. There is, by the way, another reason why falling rates cause unemployment. There is always a trade-off between capital invested to save labor vs. employing labor. At lower cost of borrowing money, the balance tilts more heavily in favor of investment.

In the falling cycle, a vicious one-two punch is delivered to productive enterprises. Low margins make it necessary, and low interest makes it possible, to use big leverage relative to its equity. There is a term for a company with low and shrinking margins and high leverage - "Brittle".

If you have ever owned one of those impossibly delicate glass figurines with long tendrily tails, whiskers, manes, and tongues, you know that the slightest bump causes it to break. The same is true for many businesses in the falling cycle. In any case, it is only a matter of a sufficient drop in the interest rate for many to be wiped out.

Opposite to *Fekete's Dilemma*, the problem now is that the cheaper one finds the cost of borrowing, the more meager are the opportunities to profit combined with the higher the price of capital goods.

The falling cycle is a cycle of capital churn. Perfectly good capital is wiped out by the dropping interest rate, which gives incentive to a new entrepreneur to borrow to build what is essentially a replacement for the old capital. And then his capital is replaced by churn, and so on.

So long as the interest rate remains above marginal productivity (and marginal time preference), people choose to buy the bond over buying commodities. The burden of debt is rising. As Irving Fisher wrote in 1933, "…the more debtors pay, the more they owe." It is better to be a creditor than a debtor (until the debtor defaults).

[8] Inflation: An Expansion of Counterfeit Credit

Businesses, struggling under this burden, do everything possible to squeeze inventory and fixed capital out of their businesses, and buy back some of their debt. This adds more oil to the fire of rising bond prices and falling interest rates. It is no coincidence that *Lean*, the Toyota Way, began to be widely adopted in the 1980's. It was not well suited to the rising cycle of the post WWII era, but it was demanded by the falling cycle after Volcker.

Meanwhile, the central bank is not idle. What does every central bank in the world say today? They are fighting the monster of "deflation". How? They want to increase the money supply. How? They buy bonds.

The bond bull market is ferocious indeed.

The last falling cycle ended just after World War II. The situation today is unlike that of 1947. One key difference is that credit expansion to fuel the falling cycle was limited by the ties to gold that were still partially in place after FDR's 1933 gold confiscation and kept in place in the Bretton Woods Treaty in 1944. Today, there is no such constraint and so the end of the falling cycle will be quite different, as we explore in Part VI.

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.

The American Corner: Gold Confiscation

It is well known that in 1933, President Roosevelt confiscated the gold of U.S. citizens and made possession of gold illegal. He gave gold owners about $20 an ounce and when he was done, he raised the gold price to $35. The common telling of this story portrays it as a simple case of robbery. It makes people wonder if 1933 is a precedent, if the government might confiscate gold in the not-too-distant future.

I don't think it was so simple.

Let's look at how the monetary system worked prior to 1933. The U.S. had a central bank, but it did not have the unlimited and arbitrary power that the Fed wields today. Gold performed a vital function in the economy, regulating credit and interest.

At that time, there was not what we think of today as a gold "price". Loans and other credit were made in the form of gold, and repayment or redemption was in gold (even if most of the people did not demand redemption). Credit, including dollar bills, was redeemed at the rate of one ounce for about $20. The dollar at the time was closer to a weight of gold, than to a separate money in its own right.[9]

What does it mean to say that credit is redeemable? One way to look at credit redemption is that it extinguishes debt. If a debt is paid in gold, the debtor gets out of debt. But, also the debt *itself* goes out of existence. Credit contracts, as it should. In the gold standard, even in the centrally planned, centrally banked adulterated gold standard that existed until 1933, credit could contract as well as expand. This is not what the government wanted then (or now). Let's look at one mechanism of credit contraction.

A depositor with a demand deposit account could demand his gold from a bank. If the bank were scrupulous about duration matching, it would own only gold and Real Bills to back it. Redeeming the deposit would cause no harm. However, one factor in the boom of the 1920's was duration mismatch (i.e. borrowing short to lend long). Much can be said about this practice but for now, let's focus on the fact that the bank has extended credit that the owners of the capital—the depositors—did not intend to extend. Depositor withdrawals of gold forced credit to contract, and this contraction caused problems for the bank. A forcible contraction of credit[10] is how I define *deflation*.

When the depositor demands his gold, it pulls precious liquidity out of the bank. In 1933, there

[9] As I show in The Unadulterated Gold Standard Part I, the government made several missteps from the time of the Founding through 1933, and each time the dollar evolved away from its original identity of 371 ¼ grains of silver.
[10] Inflation: An Expansion of Counterfeit Credit

were runs on the banks and many banks defaulted when they could not honor their deposit agreements. Redemption also forces the bank to sell bonds. Selling bonds causes the price to drop. Since the interest rate is the inverse of the bond price, interest rises.

Someone, somewhere in the economy is suddenly starved for credit, perhaps in the middle of a long-term project. We call him the "marginal entrepreneur". He must liquidate assets. He must also lay off workers, because his reduced capital base cannot support the same workforce.

President Roosevelt had a brilliant (if evil) advisor. John Maynard Keynes would certainly have grasped the nature of this mechanism as I describe it above. Roosevelt presided over a wholesale conversion of the economy from free markets, to central planning under regulations, taxes, diktats, price minimums, price caps, control boards, duties, fees, and tariffs. Central planners regard the market as irrational, chaotic, and self-destructive. They see no reason to let the market prevail. It is so easy to order things, as they "ought" to be ordered.

In 1933, they wanted to stop runs on banks and to push down the rate of interest. A secondary goal was to begin the slow process of altering the public's perception of gold as money. President Roosevelt's Executive Order 6102 accomplished all of these goals (at least runs due to a lack of gold liquidity—he had no power to stop runs due to other causes).

Today, by contrast, the dollar is irredeemable, a debt obligation of our central bank. When you pay a debt with another form of debt, you are personally out of the debt loop, but the debt does not go away. It is merely shifted to the Fed. There is no extinguisher of debt. There is no way for debt to be paid and go out of existence, and no way for a depositor to redeem his deposit in gold.

This also means that the saver cannot force credit contraction or the rate of interest to rise. Instead, the interest rate is putty in the hands of the central bank (well, not quite, as I am arguing in my ongoing series on the theory of interest and prices). The saver is totally disenfranchised.

And how about the public perception of gold and money? Even the gold bugs today think of the value of gold in terms of how many dollars it is "worth" per ounce. But for the lonely warriors in the 1970's and 1980's who kept the memory of gold alive through the dark years, and but for more recent gold advocates, and now the Gold Standard Institute, the victory of the central planners would have been complete.

Could the US government grab the gold as they did in 1933? Anything is possible. I make no political predictions. One thing is certain. If they grab gold today it will not be for the reasons they did it in 1933. Those reasons are no longer applicable.

Dr. Keith Weiner