THE GOLD WARS

Gary North

www.garynorth.com

Copyright, Gary North, 2005

The author reserves all rights to this book.

The author runs a Web site, **www.garynorth.com**. It covers numerous investment topics.

The author also publishes a twice-weekly free e-letter, *Gary North's* ***Reality Check***. It alternates with Bill Bonner's ***Daily Reckoning***. To subscribe, go here:

http://rcsub.notlong.com

Table of Contents

1. Gold at $10,000? 1
2. Gold's Tremendous Leverage 3
3. Greenspan, the Gold Bug 11
4. Government Gold Standard: Bait and Switch 17
5. Two Kinds of Gold Standard 22
6. If Gold Goes to $3,000 28
7. Gold at $3,500 by 2010? 35
8. Gold Is a Political Metal 43
9. Gold Sales Threatened (Again) 51
10. Is America's Gold Gone? 58
11. Cliche: "Gold Is Just Another Commodity" 69
12. Cliche: "There Isn't Enough Gold" 74
13. Exchange Rates and Gold 99
14. The Re-Monetization of Gold 96
15. Gold's Dust and Dusty Gold 104

Chapter 1

GOLD AT $10,000?

There is a war against gold. Politicians hate a rising price of gold. So do central bankers. A rising price of gold testifies against the politicians, who spend more money than they collect in taxes or borrow at interest, and it also testifies against central bankers, whose promises to stop rising prices is a lie that has not come true since about 1939.

So, these people do whatever they can to ridicule gold and gold buyers. They do whatever they can to drive down the price of gold – everything except the one thing that would drive it down: cease inflating.

Gold has risen to match price inflation. But has not risen slowly and steadily. Because gold has moves in spurts for a few years, then stagnates or falls (1980-2001), people hear about gold in the tail end of the bull phase. They buy. Then they look for reasons why they bought. This is true of most markets. Gold and silver are no exceptions.

The people who bought after one of the bull moves tend to become true believers in gold. There are good reasons to become a true believer in gold, but the most popular one is a bad reason: "I just bought gold."

Gold's purchasing power today is close to what it was in 1933, after Roosevelt hiked gold's price from $20 an ounce to $35 -- after the government had confiscated the public's gold. Thus, in the broadest sense, gold is an inflation hedge. On this point, read the article by Dr. Michael Rozeff, who is a recently retired professor of finance. He is a proponent of buying gold.

http://www.lewrockwell.com/rozeff/rozeff72.html

His message: gold in the mid-$600's is pretty much what we should expect. Thus, from this point on, we should not expect major moves upward, unless there is a war or some major unexpected event. Gold played catch-up, 2001 to 2006. If you bought gold in 2001, you're a winner. If you bought later, you should be realistic about what to expect.

You will hear hype about gold at $10,000, just as in 1999 there was hype about "Dow 36,000." If you are tempted to believe these headlines, remember Prof. Rozeff's warning:

Looked at this way, it is evident that gold in the portfolio is equivalent to

> insurance against some devastating contingencies. Complete or partial insurance are possible. The more gold you have, the more insurance you are buying. Over-insuring is costly because the overall rate of return of the portfolio goes down if nothing happens. ThatÆs because gold historically provides no real return. Everyone has to decide for himself what the odds of these scenarios or ones like them are, how to insure against them as with gold or some other real assets, how high gold will go when other assets decline, and how much to insure against these events. There are no pat answers to these decisions, but they are within the realm of understanding and even sensible computation.

http://www.lewrockwell.com/rozeff/rozeff16.html

I am providing this introduction in order to save you from grief. In the lessons that follow, I present the case for gold as money. I also present the case for gold as a long-term hedge against inflation. I own gold. But I am not naive about gold. I used to sell gold and silver coins. It was the right time to buy: 1973. But I understand that people get married to their investments. Gold is a good long-term investment. It is a good disaster hedge. But it moves up fast and then stagnates. So does silver. Be aware of this before you buy gold or silver.

Chapter 2

GOLD'S TREMENDOUS LEVERAGE

The term "leverage" is used in several ways. Gold applies to all of them.

The word usually refers to influence. When someone says of a politician, "he's got a lot of leverage," it means influence.

Consider a U.S. Senator. He has one vote out of 100. But if he is the chairman of a major committee, he has more influence than his single vote indicates. If his committee is important for generating pork barrel spending projects for the voters in other Senators' states, he has even greater leverage. Same person; different leverage.

A preacher has leverage in his congregation. But if he is a satellite TV preacher, he has a lot more leverage. He has leverage in other preachers' congregations.

The term "leverage" also applies to the world of investing. It usually refers to certain debt contracts, but not always.

LEVERAGING GOLD

Consider gold. Say that you own a one-ounce gold coin. (I hope this is true several times over.) Gold's price in dollars then doubles. Your gold coin is worth twice as much in dollars. Of course, if the price of everything else has doubled, your gold coin is worth twice as much in dollars, not twice as much in goods. But that's still much better than having held dollars instead of gold.

But what if your gold investment was leveraged? What if you had borrowed half of the dollars to buy the gold coin? The gold price doubles from (say) $400/oz to $800/oz. You had $200 of your own money in the deal. Your investment is now worth $800. Your profit is $400 ($800 minus the original $400). You sell the gold coin for $800, pay off the $200 loan, and pocket $600, of which $200 was your original investment. It cost you $200 (plus interest) to make $400 free and clear. You made close to 200% (after interest), meaning you made two to one on your money. That's sure a lot better than 100%.

But what if gold's price had fallen to $200? You would now owe $200, and your original $200 would be gone -- "NASDAQed," so to speak. Worse; the lender might have

been in a legal position to "call the loan" by selling the gold coin and getting his $200 back before gold went to $100. This arrangement called buying on margin, and forced sell-outs happen all the time. The broker sells out the client's account. The client loses his ownership completely. If the asset's price rebounds, he is out of the market.

I assume that you want a safer kind of leveraged gold, a kind where you can't be sold out for this good reason: you never borrowed any money. You don't have a margin account. It's as safe as owning a gold coin -- you can't be sold out against your will -- but it still offers leverage upward. Of course, it is risky on the downward side, too, but you can't be sold out because you aren't in debt. You want debt-free leverage. You can get it.

This is what North American gold mining shares offer. Sam Parks described this feature in an interview with me in 2003.

> Marginal producers offer the most leverage to gold. Say that a mining company can show a profit of $5.00 per ounce of production when gold is $350 per ounce. If we up the gold price by $50 per ounce, and the company's profit increases to $55 per ounce of production. This leverage of course works both ways. If gold goes down $50, the company's profit per ounce will go from $5.00 per ounce to a loss of $45 per ounce.

The potential for North American gold shares today is that gold's price has been down for so long that investors have forgotten about gold, or are still scared of buying it.

They have heard of gold coins, but hardly anyone buys them. The number of dealers who make a living by selling bullion coins like American eagles or Canadian maple leafs can be counted on the fingers of two hands. The general public isn't in this market.

Another gold market is the commodity futures market: mostly debt-based, highly speculative, and very risky unless you put down a high margin. The contracts are so large that hardly anyone can afford to invest without a lot of margin debt. Also, investors are personally at risk for every cent borrowed.

This leaves gold mining stocks, which are mostly South African mines -- two miles deep, operated by Africans with AIDS, and supervised by a socialist government. The few other mines that stick brokers know about are the larger North American mines. The most famous is Barrick. But Barrick has a problem: it is sold short. That is, it has promised to deliver gold in the future at a fixed price. Parks comments:

In the past, hedging was profitable for the gold producers. In its 2001 annual report, Barrick stated that over the preceding 14 years, it had made $2 billion from its hedging activities.

GN:
Two billion?

SP:
Yes, two billion. For several years, Barrick was the most popular gold stock. Much of its popularity came from its profitable gold-hedging activities. But, as the gold market began to improve in mid-2001, the effect on Barrick turned negative. Gold stock investors shunned the company because it had so many ounces sold forward.

GN:
Quantify that -- how many ounces?

SP:
At year end, 2002, Barrick had 18 million ounces sold forward at an average price of $341 per ounce.

GN:
What effect has Barrick's hedging had on its share price since the bear market in gold ended in 2001?

SP:
At the beginning of the 2001, two companies were trading around $17 or $18. Newmont, the big major known for its disdain for hedging, is currently about $28 and Barrick is stuck at $17.

Sadly, I got stuck with Barrick. It bought out Homestake, which I owned.

What Parks did for ***Remnant Review*** subscribers in 2001 and early 2002 was to identify smaller gold mines that most stock brokers had never heard of. (They still haven't.) These are marginal mines, i.e., they are high-cost producers. But they are well positioned for highly leveraged returns. They get "more bang for the buck" when gold rises above their production cost per ounce. These mines are still the Rodney Dangerfields of mining. They get no respect. Brokers still are unaware of them. ***Remnant Review*** readers who took Parks' advice are up by 100% or 200%, depending on a mine's

leverage.

But enough about how to make money. Let's get back to the other meaning of leverage: influence.

PERSONAL LEVERAGE

My initial example of leverage was a U.S. Senator with a committee chairmanship. In a sense, I want to put you in a similar position within your circle of influence. That's what ***The Gold Wars*** is really all about.

The number of people who are willing to read a newsletter like this is so small as to constitute a Remnant. I'm using the word in the biblical sense. God told the prophet Elijah, who believed himself to be alone in Israel,

> Yet I have left me seven thousand in Israel, all the knees which have not bowed unto Baal, and every mouth which hath not kissed him (1 Kings 19:18).

You have decided to subscribe to this report. You have designated yourself as someone who is interested in gold. This is not the equivalent of being interested in pork bellies or even copper.

Gold used to be the industrial world's money. Then World War I broke out in 1914. The banks suspended redemption of gold for paper money. This broke all contracts, but the governments all ratified this action. Then the governments had their central banks confiscate the gold that had been stored in the vaults of the commercial banks. The public has never returned to a full gold coin standard. Instead, the world went on a fiat money standard.

The governments' confiscation of the public's gold transferred enormous leverage to central banks, which can now issue credit money without the restraining factor of a threat of a gold run. The last gold run ended on Sunday, August 15, 1971, when President Richard Nixon unilaterally "closed the gold window." He announced that the U.S. Treasury would no longer honor the IOU's to gold (T-bills) in the possession of foreign governments and their central banks. In the first half of 1971, there had been a run by central banks on U.S. gold (meaning gold which was held in the vault of the Federal Reserve Bank of New York) at $35 an ounce. Nixon ended this run on gold, which was a

run against the dollar, in the same way that the world's commercial banks ended a similar run in 1914, after the war broke out. He broke the contract.

> If you go to the home page of the Bureau of Labor Statistics (**www.bls.gov**), you can use the Inflation Calculator (under "Inflation and Consumer Spending") to see what has happened to the dollar as a result of Nixon's action. Select 1971 as the base year (or "debased" year). Enter $100. Then click the CALCULATE button. See how much after-tax money it would take today to match the $100 in purchasing power in 1971.

The day after World War I broke out in July, 1914, a wise investor with money in the bank would have gone to the bank and demanded gold. The handful of people who did this got their gold. But hardly anyone will do this, even when war breaks out. The masses lose. They trust their banks, they trust their governments, and they get their gold confiscated.

He who trusts the government to honor its contracts in a major national crisis is a fool. Most voters are fools. Most investors are fools. They trust professional liars -- the same politicians who keep promising the moon in election years but who don't deliver after the election. They pay a heavy price for their misplaced trust.

If you want a classic pair of examples of those who trust the government and those who don't, watch "Gone With the Wind." Rhett Butler uses his ship to run guns -- illegal, the North says. He also gets paid in gold -- unpatriotic, the South says. When he is caught, he deliberately loses at cards in the yankee prison, so he knows that the commander won't hang him. He is in a position to settle his bets in yankee dollars. He has gold hidden somewhere. In contrast is Scarlett's father, driven mad, sitting in poverty and holding bonds -- "good Confederate bonds" -- as his only form of liquid capital.

No, gold is not like pork bellies. Central banks still settle their accounts at the end of the day by means of dollars and gold. Gold is not just another commodity.

THE THREAT TO THE DOLLAR

The economic problem facing the whole world today is that the means of settling payments -- the dollar -- is the world's reserve currency. But there are no technical limits on its creation. The Federal Reserve is pumping dollars into the economy in order to hold domestic interest rates down, so as to stimulate the American economy. Americans are

running a trade deficit of well over a billion dollars a day, 365 days a year. This deficit is now in the range of 5% of our economy. To this, add the growing Federal debt, which is also growing at well in excess of a billion dollars a day.

As Senator Everett Dirksen said a generation ago: "A billion here, a billion there, and pretty soon we're talking big money."

Will the world keep trading in dollars? Not if our policies don't change. But our policies won't change without the outside pressure of an international monetary crisis. Greenspan has made this clear -- well, at least as clear as he makes anything. So have other members of the Board of Governors of the Federal Reserve System. They are going to continue to inflate the dollar.

The reason why the dollar is the world's reserve currency is two-fold: (1) central bankers refuse to rely exclusively on gold, for gold imposes too many constraints on them; (2) the U.S. economy is the largest on earth. But the U.S. economy is now dependent on capital injections from foreigners equal to our balance of payments deficit. Asia is catching up economically. Asians are supplying Americans with goods in the form of loans and purchases of capital assets owned by Americans. Americans are mortgaging their future to buy Asian goods; they are going into hock to Asian lenders.

THE WAR ON GOLD

The war on gold has led to the leveraging of government power over the public. Governments can run huge budget deficits, central banks can crank out credit money to stimulate the economy, and politicians can spend and spend to buy votes because we, the public, have no way to restrain them directly. Prior to 1914, our great grandparents could and did. One by one, with no one telling them what to do, they could walk into a bank, hand over paper money, and say to the teller, "I want gold coins at $20 per ounce."

Today, hardly anyone knows this story. It isn't found in history textbooks. Only a handful of people know about the role that gold has played in the war of governments on the public. What I call "the gold wars" are in fact a series of wars by governments on the voters. The most powerful means of voting in 1913 was not in an election booth. It was in a bank.

Your neighbors are oblivious. Your friends don't know and don't care. They may think you're a bit nutty to worry about gold's price. Ignore this. To the extent that you

understand today what the role of gold was long ago, has been in our day, and will be in the future, you have leverage. You have information about the past and the most probable future that most people don't have.

You may also own gold in various forms, from coins to gold mining shares.

In THE GOLD WARS, I will do my best to explain the gold wars. I will try to show why gold is not copper or lead, why gold is at the very heart of the conflict between the expansion of government and the ability of the victims to fight back.

We are in the midst of a war on gold because we are in the midst of a war on our liberties.

YOUR FULL SCHOLARSHIP TO OFFICERS' CANDIDATE SCHOOL

We have the military academies to train our generals and admirals. We have Officers' Candidate School to train our officers in the field.

THE GOLD WARS is correspondence course version of Officers' Candidate School for a handful of dedicated people who want to know about the nature of the war against honest money by dishonest politicians and their beneficiaries.

There are not many volunteers. The army is small. You are part of the Remnant.

But if you will stick with me, I'll offer my thoughts after 40 years of study on this issue. I'll talk straight on gold, and I'll also send you the best examples of other people who have talked straight on gold. That's because talking straight on gold is talking straight on freedom: how we lost it and how we can get it back. And make a few bucks, too.

As the recruiting poster used to say: "Uncle Sam Wants You." He also wanted our gold, and he got it.

I'm going to show you how we can get it back, and the liberties that came with it.

I'm glad you signed up. I hope you stick with the program.

Chapter 3

GREENSPAN, THE GOLD BUG (1966)

You may already have read Alan Greenspan's essay, "Gold and Economic Freedom," which was published in Ayn Rand's *Objectivist* newsletter in 1966, and reprinted in her book, *Capitalism: The Unknown Ideal*, in 1967.

Greenspan has never publicly retracted a word of this essay.

This essay is a good introduction to the government's war on gold. It summarizes the basic issue: the comparative liberty that a government-guaranteed gold coin standard offers to a society. A gold coin standard places a restraint on the government's ability to defraud the public through monetary inflation.

The problem is, a government-guaranteed gold standard is guaranteed by the government. As I like to say, a government-guaranteed gold standard isn't worth the paper it's written on. But, for as long as the government redeems its paper money or its credit money on demand -- in gold coins of a fixed weight and fineness, at a fixed exchange rate with the government's money -- the public does possess a lever of power against the government: the threat of a "bank run" against the biggest bank, the government's central bank. In the case of the United States, this is the Federal Reserve System. How ironic that Alan Greenspan is the chairman of the FED's Board of Governors.

GOLD AND ECONOMIC FREEDOM

Alan Greenspan

An almost hysterical antagonism toward the gold standard is one issue which unites statists of all persuasions. They seem to sense - perhaps more clearly and subtly than many consistent defenders of laissez-faire - that gold and economic freedom are inseparable, that the gold standard is an instrument of laissez-faire and that each implies and requires the other.

In order to understand the source of their antagonism, it is necessary first to understand the specific role of gold in a free society.

Money is the common denominator of all economic transactions. It is that

commodity which serves as a medium of exchange, is universally acceptable to all participants in an exchange economy as payment for their goods or services, and can, therefore, be used as a standard of market value and as a store of value, i.e., as a means of saving.

The existence of such a commodity is a precondition of a division of labor economy. If men did not have some commodity of objective value which was generally acceptable as money, they would have to resort to primitive barter or be forced to live on self-sufficient farms and forgo the inestimable advantages of specialization. If men had no means to store value, i.e., to save, neither long-range planning nor exchange would be possible.

What medium of exchange will be acceptable to all participants in an economy is not determined arbitrarily. First, the medium of exchange should be durable. In a primitive society of meager wealth, wheat might be sufficiently durable to serve as a medium, since all exchanges would occur only during and immediately after the harvest, leaving no value-surplus to store. But where store-of-value considerations are important, as they are in richer, more civilized societies, the medium of exchange must be a durable commodity, usually a metal. A metal is generally chosen because it is homogeneous and divisible: every unit is the same as every other and it can be blended or formed in any quantity. Precious jewels, for example, are neither homogeneous nor divisible. More important, the commodity chosen as a medium must be a luxury. Human desires for luxuries are unlimited and, therefore, luxury goods are always in demand and will always be acceptable. Wheat is a luxury in underfed civilizations, but not in a prosperous society. Cigarettes ordinarily would not serve as money, but they did in post-World War II Europe where they were considered a luxury. The term “luxury good” implies scarcity and high unit value. Having a high unit value, such a good is easily portable; for instance, an ounce of gold is worth a half-ton of pig iron.

In the early stages of a developing money economy, several media of exchange might be used, since a wide variety of commodities would fulfill the foregoing conditions. However, one of the commodities will gradually displace all others, by being more widely acceptable. Preferences on what to hold as a store of value, will shift to the most widely acceptable commodity, which, in turn, will make it still more acceptable. The shift is progressive until that commodity becomes the sole medium of exchange. The use of a single medium is highly advantageous for the same reasons that a money economy is superior to a barter economy: it makes exchanges possible on an incalculably wider scale.

Whether the single medium is gold, silver, seashells, cattle, or tobacco is optional, depending on the context and development of a given economy. In fact, all have been employed, at various times, as media of exchange. Even in the present century, two major commodities, gold and silver, have been used as international media of exchange, with gold becoming the predominant one. Gold, having both artistic and functional uses and being relatively scarce, has significant advantages over all other media of exchange. Since the beginning of World War I, it has been virtually the sole international standard of exchange. If all goods and services were to be paid for in gold, large payments would be difficult to execute and this would tend to limit the extent of a society's divisions of labor and specialization. Thus a logical extension of the creation of a medium of exchange is the development of a banking system and credit instruments (bank notes and deposits) which act as a substitute for, but are convertible into, gold.

A free banking system based on gold is able to extend credit and thus to create bank notes (currency) and deposits, according to the production requirements of the economy. Individual owners of gold are induced, by payments of interest, to deposit their gold in a bank (against which they can draw checks). But since it is rarely the case that all depositors want to withdraw all their gold at the same time, the banker need keep only a fraction of his total deposits in gold as reserves. This enables the banker to loan out more than the amount of his gold deposits (which means that he holds claims to gold rather than gold as security of his deposits). But the amount of loans which he can afford to make is not arbitrary: he has to gauge it in relation to his reserves and to the status of his investments.

When banks loan money to finance productive and profitable endeavors, the loans are paid off rapidly and bank credit continues to be generally available. But when the business ventures financed by bank credit are less profitable and slow to pay off, bankers soon find that their loans outstanding are excessive relative to their gold reserves, and they begin to curtail new lending, usually by charging higher interest rates. This tends to restrict the financing of new ventures and requires the existing borrowers to improve their profitability before they can obtain credit for further expansion. Thus, under the gold standard, a free banking system stands as the protector of an economy's stability and balanced growth. When gold is accepted as the medium of exchange by most or all nations, an unhampered free international gold standard serves to foster a world-wide division of labor and the broadest international trade. Even though the units of exchange (the dollar, the pound, the franc, etc.) differ from country to country, when all are defined in terms of gold the economies of the different countries act as one-so long as there are no restraints on trade or on the movement of capital. Credit, interest rates, and prices tend to follow similar patterns in all countries. For example, if banks in one country extend credit

too liberally, interest rates in that country will tend to fall, inducing depositors to shift their gold to higher-interest paying banks in other countries. This will immediately cause a shortage of bank reserves in the "easy money" country, inducing tighter credit standards and a return to competitively higher interest rates again.

A fully free banking system and fully consistent gold standard have not as yet been achieved. But prior to World War I, the banking system in the United States (and in most of the world) was based on gold and even though governments intervened occasionally, banking was more free than controlled. Periodically, as a result of overly rapid credit expansion, banks became loaned up to the limit of their gold reserves, interest rates rose sharply, new credit was cut off, and the economy went into a sharp, but short-lived recession. (Compared with the depressions of 1920 and 1932, the pre-World War I business declines were mild indeed.) It was limited gold reserves that stopped the unbalanced expansions of business activity, before they could develop into the post-World Was I type of disaster. The readjustment periods were short and the economies quickly reestablished a sound basis to resume expansion.

But the process of cure was misdiagnosed as the disease: if shortage of bank reserves was causing a business decline-argued economic interventionists-why not find a way of supplying increased reserves to the banks so they never need be short! If banks can continue to loan money indefinitely-it was claimed-there need never be any slumps in business. And so the Federal Reserve System was organized in 1913. It consisted of twelve regional Federal Reserve banks nominally owned by private bankers, but in fact government sponsored, controlled, and supported. Credit extended by these banks is in practice (though not legally) backed by the taxing power of the federal government. Technically, we remained on the gold standard; individuals were still free to own gold, and gold continued to be used as bank reserves. But now, in addition to gold, credit extended by the Federal Reserve banks ("paper reserves") could serve as legal tender to pay depositors.

When business in the United States underwent a mild contraction in 1927, the Federal Reserve created more paper reserves in the hope of forestalling any possible bank reserve shortage. More disastrous, however, was the Federal Reserve's attempt to assist Great Britain who had been losing gold to us because the Bank of England refused to allow interest rates to rise when market forces dictated (it was politically unpalatable). The reasoning of the authorities involved was as follows: if the Federal Reserve pumped excessive paper reserves into American banks, interest rates in the United States would fall to a level comparable with those in Great Britain; this would act to stop Britain's gold loss and avoid the political embarrassment of having to raise interest rates. The "Fed"

succeeded; it stopped the gold loss, but it nearly destroyed the economies of the world, in the process. The excess credit which the Fed pumped into the economy spilled over into the stock market-triggering a fantastic speculative boom. Belatedly, Federal Reserve officials attempted to sop up the excess reserves and finally succeeded in braking the boom. But it was too late: by 1929 the speculative imbalances had become so overwhelming that the attempt precipitated a sharp retrenching and a consequent demoralizing of business confidence. As a result, the American economy collapsed. Great Britain fared even worse, and rather than absorb the full consequences of her previous folly, she abandoned the gold standard completely in 1931, tearing asunder what remained of the fabric of confidence and inducing a world-wide series of bank failures. The world economies plunged into the Great Depression of the 1930's.

With a logic reminiscent of a generation earlier, statists argued that the gold standard was largely to blame for the credit debacle which led to the Great Depression. If the gold standard had not existed, they argued, Britain's abandonment of gold payments in 1931 would not have caused the failure of banks all over the world. (The irony was that since 1913, we had been, not on a gold standard, but on what may be termed "a mixed gold standard"; yet it is gold that took the blame.) But the opposition to the gold standard in any form-from a growing number of welfare-state advocates-was prompted by a much subtler insight: the realization that the gold standard is incompatible with chronic deficit spending (the hallmark of the welfare state). Stripped of its academic jargon, the welfare state is nothing more than a mechanism by which governments confiscate the wealth of the productive members of a society to support a wide variety of welfare schemes. A substantial part of the confiscation is effected by taxation. But the welfare statists were quick to recognize that if they wished to retain political power, the amount of taxation had to be limited and they had to resort to programs of massive deficit spending, i.e., they had to borrow money, by issuing government bonds, to finance welfare expenditures on a large scale.

Under a gold standard, the amount of credit that an economy can support is determined by the economy's tangible assets, since every credit instrument is ultimately a claim on some tangible asset. But government bonds are not backed by tangible wealth, only by the government's promise to pay out of future tax revenues, and cannot easily be absorbed by the financial markets. A large volume of new government bonds can be sold to the public only at progressively higher interest rates. Thus, government deficit spending under a gold standard is severely limited. The abandonment of the gold standard made it possible for the welfare statists to use the banking system as a means to an unlimited expansion of credit. They have created paper reserves in the form of government bonds which-through a complex series of steps-the banks accept in place of

tangible assets and treat as if they were an actual deposit, i.e., as the equivalent of what was formerly a deposit of gold. The holder of a government bond or of a bank deposit created by paper reserves believes that he has a valid claim on a real asset. But the fact is that there are now more claims outstanding than real assets. The law of supply and demand is not to be conned. As the supply of money (of claims) increases relative to the supply of tangible assets in the economy, prices must eventually rise. Thus the earnings saved by the productive members of the society lose value in terms of goods. When the economy's books are finally balanced, one finds that this loss in value represents the goods purchased by the government for welfare or other purposes with the money proceeds of the government bonds financed by bank credit expansion.

In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. There is no safe store of value. If there were, the government would have to make its holding illegal, as was done in the case of gold. If everyone decided, for example, to convert all his bank deposits to silver or copper or any other good, and thereafter declined to accept checks as payment for goods, bank deposits would lose their purchasing power and government-created bank credit would be worthless as a claim on goods. The financial policy of the welfare state requires that there be no way for the owners of wealth to protect themselves.

This is the shabby secret of the welfare statists' tirades against gold. Deficit spending is simply a scheme for the confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights. If one grasps this, one has no difficulty in understanding the statists' antagonism toward the gold standard.

http://www.321gold.com/fed/greenspan/1966.html

Chapter 4

GOVERNMENT GOLD STANDARD: BAIT AND SWITCH

"A gold standard isn't worth the paper it's written on." -- Yogi Berra

Actually, Yogi didn't say that. I said it. But if people believed that Yogi said it, the aphorism would gain greater currency.

One of the litmus tests of a person's conservatism is his commitment to the ideal of the gold standard. This is an appropriate test for conservatives. It shows a person's commitment to one of the movement's least understood and most futile political causes. It also identifies the adherent as a card-carrying member of the movement's cognoscenti. The listener thinks, "Maybe this person even understand's Gresham's law." Most important, it defends big government in the name of limited government. And, just like almost everything else in the conservative movement, it eventually backfires. It backfires for the same reason the other conservative programs backfire whenever inaugurated: it calls on the State to limit the State.

THE THEOLOGY OF THE GOLD STANDARD

The person who calls for the re-establishment of "the" gold standard -- nobody agrees as to exactly what "the" gold standard should be -- begins with an unstated judicial presupposition: "The State has a legitimate legal right to control the issue of money." This is another way of saying: "Monetary policy is an example of market failure." More than this, it implies the following: "Because money is the central economic institution in a high division of labor economy, the State has a legal right and a moral obligation to control money, so as to retain influence over every area of the market."

It goes far beyond this, however. One of the greatest little-known books in recent history is Ethelbert Stauffer's *Christ and the Caesars* (Westminster Press, 1955). Stauffer was both a theologian and a historian of numismatics: coinage. His book traces the moral, theological, and political confrontations between the early church and the Roman Empire. He does this by means of a survey of the coinage. He shows, coin by coin, how the messianic claims of the emperors as the source of salvation paralleled the debasement of the coins.

The coins were implements of political and religious propaganda. The images of the emperors and the slogans on the coins were important devices in promoting faith in the Roman Empire. Stauffer shows that the inscriptions on the coins were challenges to all rival gods with universal claims. There was an inescapable war between Christ and the Caesars.

There was a war against the Jews, too. During Bar Kochba's revolt (133-35 A.D.), Jews issued their own coinage. These coins did not have any person's image on them.

Most of the world's currencies and coins today have images of politicians, either dead or alive. By law, American coins and bills may not have the image of anyone living. (In this instance, I am strongly in favor this law. If I must daily look at pictures of politicians, I prefer the dead ones.)

Kings and governments have long asserted an authority, if not an absolute monopoly, over the coinage. It has to do with control over the images. It has to do with the ability of the state to extract wealth from the public by means of currency debasement: taxation by stealth, whose negative effects can be blamed on private speculators. But, from the standpoint of economic theory, this monopoly over money has to do with a theory of market failure.

The next time you hear someone waxing eloquent -- and, in all likelihood, incoherent -- about the marvels of the gold standard, ask him this: "Why don't you trust the free market?" This question is intended to elicit what I like to call a jude awakening. (I refer the late Jude Wanniski, for whose education I wrote *Mises on Money*. I failed completely to educate him. Jude never did have a clue about Austrian monetary theory. Yet he thought he was Mises' intellectual disciple.)

Be prepared for a blank stare, followed by "Huh?"

"AS GOOD AS GOLD"

This phrase is well chosen. It presents gold as the standard of comparison. It usually is applied to something that isn't as good as gold.

In monetary affairs, it applies to a substitute for gold, or what is called a fiduciary instrument. It is a piece of paper that is offered in lieu of gold.

Gold has its flaws. Its flaws are extensions of its unique benefits. Let me list three.

First, gold is heavy. Paper is lighter. Digits are lighter still. A person can carry pieces of paper with lots of zeroes rather than gold coins.

Second, gold is universally in demand, despite its impersonal nature. This means that, when stolen, it is easy for the thief to find buyers. In the era of the gold standard, a fence liked gold coins so much that he offered a reduced discount to the thief. So, people with a lot of money adopted checks and other less universal means of payment. You can stop payment on a stolen check.

Third, gold is highly transportable. This means that it is easy to lose. Lose a check, and you have not lost much. You can stop payment on a lost check.

But to retain their status as being as good as gold -- and a little better under most circumstances -- fiduciary instruments had to preserve the greatest benefit of gold -- its scarcity due to the high cost of mining -- despite the low cost of printing. It is easier to counterfeit paper than to counterfeit gold. It is easier to sign a promise to pay gold than to pay gold.

All of the defenders of the gold standard believe -- I am not making this up -- that the best way to reduce the practice of counterfeiting is to hand over a legal monopoly over money creation to the most accomplished and universally recognized counterfeiters in history: civil governments.

THE STING

A gold standard is a promise made by a self-licensed professional counterfeiter that he will always stand ready to redeem his pieces of paper and official digits in exchange for gold at a fixed ratio. As the mid-1950's comedian George Goebel used to say, "Suuuuuuure he will."

The gold standard became universal in the nineteenth century. Because the public had the right of redemption for a century, 1815 to 1914, the price level remained relatively stable for a century. This right of gold redemption was invariably suspended during major wars, but it was restored a few years after the war ended.

This was the era of free market economic theory and the politics of limited

government. We speak of "nineteenth-century liberalism": free markets, low taxes, and the gold standard.

The nineteenth century was the first stage of an international sting operation. As in the case of every con game, the con man must create a sense of trust on the part of his mark. Whether it is a Ponzi scheme or a more traditional scam, if the targeted sucker distrusts the con artist, he won't surrender his money. For the con game to work, the con man must create an illusion of reliability. In short, he must present himself, economically speaking, as if he were "as good as gold."

The era of limited government led to enormous economic expansion. It also led to the mass production of high-tech weapons. Governments had to get their hands on these weapons in order to defeat other governments. There were few Third World nations in 1880 that could afford fifteen minutes of ammo for a Maxim machine gun. The big governments, in the words of nineteenth-century New York City politician George Washington Plunkett, "seen their opportunities and took them." The age of modern empires began in earnest.

The bigger the world's economy got, the bigger the national governments got. The bigger the national governments got, the more they jostled with each other for supremacy. By 1914, they were ready for mass destruction on an unprecedented scale.

World War I began with the suspension of gold payments by the commercial banks. The was the violation of contract -- a lie from the beginning -- that fractionally reserved banks would redeem bank notes and accounts at any time for gold coins. As soon as the governments all retroactively validated this violation of contract by commercial banks, they used their central banks to extract the gold from the commercial banks. They have yet to give it back.

The big crooks muscled into the territories of the small crooks. The big counterfeiters extracted the loot from the little counterfeiters.

CONCLUSION

The free market created money. Civil government spotted an opportunity and took it. The State granted itself a monopoly over money. It did so in the name of law: the defense of society from unscrupulous cheats and counterfeiters. From the day King Croesus (rhymes with "greases") asserted authority over the new invention of the round

metallic device that we call the coin, the State has muscled into monetary affairs. For 2,600 years, the public has accepted this arrangement. It worked for 1,100 years in Byzantium: 325 to 1453. It has not worked anywhere else for longer than a century or two.

Then came paper and ink. As Ludwig von Mises once supposedly said, but didn't: "Only government can turn valuable items like paper and ink into something utterly worthless."

There are conservatives who still present this 2,600 year-old con job as a philosophy of limited government. Whenever I hear this assertion, I always hear the faint sound of a piano playing Scott Joplin's "The Entertainer." My mind becomes clouded by an image of Paul Newman and Robert Redford, arm in arm, walking away with my money. Fade to black.

Chapter 5

TWO KINDS OF GOLD STANDARD

The British economist, John Maynard Keynes, is famous for one aphorism, "In the long run, we are all dead," which he applied to the operations of the price system, and one phrase: "barbarous relic," which he applied the phrase to the gold standard. He believed that the free market needed to be policed by bureaucrats to be made efficient. He also believed that the gold standard's restriction of State power is a great evil.

Keynes' hostility to the traditional gold standard is shared by all inflationists and statists. It places temporary limits on the government's ability to create fiat money and thereby spend without taxing directly. I say "temporary," because the traditional gold standard is a promise made by a government. It is made to be broken later, during an emergency that is declared by the government. It is ultimately paper gold. It is a misuse of the people's trust.

The gold standard made possible much of the civilization of the ancient world, until gold was abandoned by the in the third-century government of Rome. Then classical civilization disappeared in the West. But in the Eastern Roman Empire (Byzantium), a reliable gold coinage lasted for over a thousand years.

Even in the Alexandrian and Roman empires, the government needed gold to pay its troops. When the costs of maintaining Rome's war machine and its bread and circuses at home grew too great for direct taxation to fund them, the government began to debase its coins. This debasement parallelled the decay of the Roman Empire.

Is the traditional gold standard really a relic? Yes. It becomes a relic in every empire, as surely as there was gold at the beginning of that empire. No nation honors the requirements of a State-run gold standard: the free convertibility of the State's money into gold.

TWO VIEWS OF GOLD'S ROLE

The first view is that of the free market. The gold standard is seen as the product of voluntary exchange. The Stare's enforcement of the laws of contract leads to the development of a commodity money. The commodity usually is gold or silver. Whatever commodity is portable, widely recognized, divisible, and has a high value in terms of weight and volume can function as money. But gold and silver are the common winners

in the competition for money. Money is therefore initially not the product of State action. It is the product of voluntary exchange. This is the view of Austrian School economists: Mises, Rothbard, Hayek. See my eBook, “Mises on Money.”

http://www.lewrockwell.com/north/mom2.html

The other view of gold argues that money is the product of State declaration, i.e., fiat announcement. Money is anything that the State says it is. This has been the view of all governments from the beginning of coinage in the sixth century B.C. The State’s gold standard can be extended as a result of military conquest. The victorious nation steals the gold hoard of the defeated nation. While the empire is expanding, the gold standard is possible. When the empire shrinks, gold is abandoned. The costs of empire lead to the debasement of the currency.

Keynes’ statement on gold came in the early 1920's, which was when the British Empire had begun to fade. World War I had nearly bankrupted the British government. World War II would end the British empire.

Lenin’s famous quote on gold was that gold would someday be used for public urinals. But that would be later. Under Communism, torture was common to get men to surrender their gold to the state.

Barbarism began in the twentieth century when World War I broke out in 1914. Within weeks, the commercial banks suspended redeemability in gold. The governments authorized this, and then had their central banks confiscate the confiscated gold from the commercial banks. The degree of barbarism that the war produced could not have been accomplished had a gold standard been in force. The public would have stripped the banks of the public’s gold. The governments would have had to come to terms with the enemy. It was the abandonment of the gold standard that made modern barbarism affordable.

THE STATE INTERVENES

Gold initially becomes the favored money metal because of the decisions of individuals. The division of labor is not the product of State sovereignty over money. It is the product of the rule of law.

Under contract law, if a gold coin’s producer debases his coins, he can be sued in

court by his victims or by his competitors. Debasement is fraud: a violation of contract. The State need only enforce contracts in order for a gold standard to be extended by market participants.

Government officials then see that gold coins circulate. They intervene, mandating that all coins be stamped with the State's seal. The State comes in the name of its own sovereignty to bask in the light of a free market institution: the gold standard. It is like a species of bird that lays its eggs in another species' nests. It has to fool the other birds. So does the State have to fool the public. "Money is an attribute of the state's sovereignty!" Not initially, it isn't.

The State then offers to store coins for free and issues receipts: IOU's. A free service! How wonderful! Something for nothing! But the offer is bogus. The State's goal is to get the public to start using IOU's for gold coins rather than actual coins. The State can then more easily confiscate these coins: nothing for something!

There is no long-run limit on the State when the State controls the coinage. The traditional gold standard is a paper standard, revocable at will by politicians.

Commercial banks can also issue IOU's for depositors' gold. The banks make the same offer: redeemable on demand. The tip-off that there is fraud in the arrangement is when storage fees are not charged for the service. There are no free lunches. You must ask: How can the institution afford to offer a free service? Who pays now? Who will pay later? Someone must pay for storage.

There is a limit on the ability of a bank to issue credit, but only when the government enforces gold contracts. The government can and will change the gold contract law during an emergency.

I suggest this relationship: a government-guaranteed gold standard is to money what government-guaranteed health inspection is to prostitution. Both guarantees are subsidies to the providers. Both guarantees create the illusion of decreased risk. Finally, the operations of both systems are best described by the same verb.

When money fails, legitimacy is lost, too. Gold's price is a test of political legitimacy: the value of a national currency. A rising gold price is a vote of reduced confidence in the State's money. This is why governments since World War I have done everything they could to remove gold coins from circulation. Politicians want no public referendum on the legitimacy of the state. They allow political voting. Political voting can

be controlled. Gold coins cannot be controlled. So, they are abolished by law.

This is why governments sell off gold. It de-legitimizes gold and legitimizes government currency. But this can go only for as long as central banks sell their confiscated gold.

THE PROBLEMS WITH GOLD COINS

Most of the problems are obvious. Coins are bulky. They must be carried with you, which increases the risk of robbery and loss. There are problems with making small change.

The solution is an IOU redeemable in gold. The IOU must be signed over by the existing owner to a new owner. The IOU, if trusted, results in wide acceptance. It is “as good as gold.” It may even be better than gold: less risky.

But then comes default on the IOU contract. If the agency that stores the gold and issues the IOU is protected by the government, as banks are, or if the issuer is an arm of the government, then the risk of default in wartime is high.

We see an extension of trust: by the public to the banks, by the banks to the central bank; by the central bans to the State. The transfer of trust moves from economics to political sovereignty. But a system based on political sovereignty is not trustworthy. It has the ability to cheat, and no agency can bring charges. No agency of appeal exists.

During World War II, the Bank for International Settlements (Basle) was created so that agents of the various central banks of warring nations could clear their accounts. It was a neutral third-party agency that enforced the rules. This made a gold exchange standard possible among central bankers. What they did not allow to the masses whose gold had been stolen by the commercial banks they demanded from each other: settlement in gold. This allowed the national war machines to continue their bloody efforts.

MONETIZATION

In the republican phase of government, the State monetizes gold. It places its stamp of approval on gold coins. It asserts sovereignty over money in the name of preserving the value of money by guaranteeing the fineness and weight of the coins.

Then, in the empire phase, debasement begins. The State de-monetizes gold. It substitutes base metals and calls the new coins equally valuable. The free market assesses the truth of this claim, exchange by exchange.

The result of the de-monetization of gold is the de-capitalization of the State. The de-monetized IOU's become IOU nothings. The State finds it more difficult to get the masses to accept its money.

In the twentieth century, the State persuaded the masses to accept its IOU nothings. The result has been a vast expansion of state power and state debt, coupled with a vast depreciation of money's purchasing power. This will not be reversed until the debt system overwhelms the monetary system (deflation), or the state's official money is abandoned by the public (inflation).

CONCLUSION

The State's gold standard is a preliminary to eventual confiscation or debasement. The State's promise of redemption on demand should not be trusted.

A gold coin standard by profit-seeking storage organizations can be trusted with less risk, but not if the storage is offered for free. There are no free lunches. Someone will eventually pay for free services. When it comes to fractional reserve banking, that someone is always the late-coming depositors.

This is why any call by conservatives for the State to adopt a gold standard is futile. No one will listen. Even if voters understood the case for a limited State, they would not be able to limit the State by a State-run gold standard. A State-run monetary system, with the exception only of Byzantium, becomes a debased standard.

This is why the free market is the only reliable source for the re-establishment of a gold standard. Honest money begins with these steps: (1) the revocation of legal tender laws that require people to accept the State's money; (2) the enforcement of contracts; (3) laws against fraud, which fractional reserve banking is. The free market can do the rest.

For a free copy of my book, "Honest Money," click here.

http://www.freebooks.com/docs/2156_47e.htm

Chapter 6

IF GOLD GOES TO $3,000

Sam Parks, the gold mining specialist, thinks that gold is going to $5,000 an ounce. For this to happen, there would have to be a disaster in the international currency markets. The dollar would have to lose its reserve currency status. Is this possible? With an annual deficit in the balance of payments of more than $500 billion a year, of course it's possible. The dollar cannot maintain its reserve currency status with this level of imbalance of trade.

Less radical but still off today's radar screens is Richard Russell's prediction of Dow 3,000, gold $3,000. Russell is a master investor. His letter is close to half a century old. I have tracked his advice for two decades. I know of no one any better.

Back in the early 1980s, Russell went into print with a prediction: gold might suffer a two-decade bear market. It fell for 21 years. So, for Russell to become an overwhelming bull on gold and a bear on the stock market is a two-fold reversal. He is not a gold bug. He is not philosophically committed to gold. But he sees a disaster coming for the Federal Reserve System. He has said for as long as I've read him that the FED has only two options: inflate or die. He has always said the FED will inflate.

To dismiss Russell's predictions as the nightmare of a madman is to dismiss one of the most gifted market watchers of the second half of the 20th century.

LEVERAGE

I have covered the story of leverage, why North American gold mining shares will outperform the appreciation of rise in the dollar price value of gold, at least in the early stages of the move upward. This is because the mines are marginal producers. A $50 rise in the price of gold has an enormous "kick" effect for the share price.

Now think about a $2,600 rise in gold's price.

Of course, that high an increase would reflect (not create) havoc in the currency markets and all markets related to the currency markets. But if you're going to go through havoc, it would be better to be sitting on profits of twenty to one in dollars than sitting on dollars that are stuck in a bank account at 1% interest before income taxes.

It's not that I want to see the disruption of markets that gold at $3,000 would reflect. I much prefer stability. But I am not in a position to manufacture stability. But I am in a position to hedge myself against havoc more profitably by being in gold and gold-related assets.

WILL YOU RIDE GOLD'S WAVE?

I wish every subscriber to this newsletter make money from the information that I have already published, let alone from the information I will publish. But I have been in this business too long to believe that this wish will come true. Pareto's 20-80 law teaches otherwise.

I would settle for 80 gainers, 20 losers. But even that is too much to hope for.

When I decided to begin publishing this newsletter, I had misgivings. My goal is to help readers make money -- or at least not lose money. But because of the way human nature works, I may wind up losing a lot of money for most of my readers. Here's why.

One group of readers will be old time gold investors. They own gold coins. They keep gold as a reserve against the disaster of monetary inflation, which eventually will turn into price inflation. They subscribe in order to keep up on gold, which includes the logic of gold. For them, this is an ideal newsletter: not only free but written by a long-term gold bug. It will confirm them in what they decided to do years ago.

There are not many of these people.

The next group, even smaller, is made up of newcomers who have only recently heard about gold as an investment. They have read that the price bottomed in 2001 at under $260. "Maybe there is money to be made here."

I assure you, there are very few cutting edge investors in any market. These are the people who tend to make big money in stocks. They spot a trend early and put their money -- not too much, but some -- on the trend. Then they sit back and let late-comers make money for them.

The largest group on my mailing list -- Pareto's 80% -- will provide the largest number of people who lose big: the "NASDAQ, 1999" people. Why? Because they found

out too early for them to take action, psychologically speaking. They want to wait and see. They want confirmation from others who are more innovative and who will make the most money. They think, "I'll look at this for a while." They look. They read. They ponder. Then they read some more.

If gold's price falls, they will not get hurt. But what if gold's price rises? When it does, these "wait and see" readers will think, "I should have acted. If gold ever goes back down, I'll buy." They are asking for the improbable. They are waiting for confirmation. The whole idea of confirmation is that confirmation must confirm upward. Procrastinators don't respond to setbacks, i.e., unconfirmations downward. It's confirmation that drives the price up.

If gold rises, they'll say to themselves, "It's a good thing I didn't buy. Gold is going even lower." If it reverses and goes back up, they will say, "I knew it! If it goes back down again, I'll buy."

They prefer life on the see-saw's axis. They are in the middle so that they see the price go up and down, but they don't actually participate in the ride.

The key is their refusal to take action. It is possible to buy any investment asset by placing an order to buy at any price. This order is placed in advance. A person can specify a purchase at a price 20% lower or above the current market price. He can place a pair of orders: at a lower and higher price. So, of the price falls, he buys, but if it never falls, but instead rises, he buys. Only if it doesn't hit the trigger price does he not become an owner.

Both approaches are economically rational. Both offer a prospective investor a logical reason not to act now. He thinks it may go lower, but he fears that he might miss out if it doesn't, so he places an emergency "don't let it get away" order at a higher price.

SELF-DECEPTION FIRST, FRENZY LATER

Few people ever place buy specific advance orders with a broker. They prefer to deceive themselves into believing that they really do intend to take action "one of these days." Their opposite arguments -- "I'll buy if it ever goes lower" and "I'll buy if it starts to move upward" -- are in fact illusions. People are really saying, "I don't intend to buy at all, but I'll pretend to myself that I can predict the future. I'll pretend that I won't put off making a decision, no matter whether the price falls or rises."

The problem with self-deception comes when the emotionally paralyzed person stumbles onto an investment that is poised to go sky-high. He refuses to buy. He thinks, "If it ever goes lower, I'll buy." But he won't. The proof of this is that he refuses to place a buy order with his broker at the specified lower price. He is justifying his own inaction. He pretends that he will buy when it goes lower, but the fact that he refuses to place a buy order testifies against him.

In falling markets, it doesn't matter. He never buys. But in booming markets, it does matter, because he had fair warning in advance that this asset's price would rise. So, he sits in awe as it rises. He kicks himself all the way up. "I knew! I knew! If only I had bought!" He plays another round of "if it ever goes back to [$x], I'll buy." But it doesn't. It just keeps going up.

At some point, he will be unable to stand the self-recrimination. He will buy. That is the point at which the experienced investors, who bought when it was low, start unloading. The self-recrimination buyers get in at the top of the market.

The pain of having missed the opportunity of a lifetime is what drives the procrastinators to their final, desperation move. In contrast, those many millions of people who never heard about the particular investment until it made 80% of its move don't pay much attention. They heard about it too late. They don't get into self-recrimination mode.

This is not true of the handful of people who found out early, pretended that they would buy "if it ever drops again," and watch in agony when it keeps rising. They are the people who come in at the top of the market because of the pain of having known early, having done nothing all the way up, and deciding at last to get in.

NOT JUST GOLD

What I'm describing here applies to every investment that becomes the focus of a mania. As the mania increases, the early comers who did nothing become the most frenzied buyers at the end of the bull run.

I believe that gold mining shares will become mania-driven as the dollar falls and gold bullion rises. The North American gold mining market is a very thin market. When the mutual fund industry finally spots the opportunity and moves into this thinly

capitalized market in a small way, the leverage will be spectacular.

At the same time, I also believe that it's better to buy gold coins than gold shares if you are unwilling to own both. There is less leverage with the coins, but there is a steady market. The U.S. government mints gold coins. There is stability here, though less leverage.

But it is not the gold coin market that will drive early comers/procrastinators into their final, top-of-the-market buying frenzy. That will happen to the people who found out early about North American gold mining shares.

KNOW THYSELF

There are good reasons and bad reasons for subscribing to this newsletter. If you're interested in learning more about gold for philosophical reasons, you've come to the right place. If you subscribed to find out how to make money, you have come to the right place. But if you subscribed as a bystander who wants to see other people get rich by taking action, while you sit on the sidelines and watch, it is best that you click the link at the bottom and get off the list.

I know: no editor is ever supposed to ask subscribers to unsubscribe. But that's what I'm asking you to do. Otherwise, you'll get hurt. The mania will hit you, no matter what you think. You will kick yourself all the way up. Those horrifying words, "I knew!" will lure you into a late investment.

As long as you don't really care when other people will make a lot of money from information that you knew about, then this newsletter will be safe for you. There are good reasons to learn more about gold other than making money with this knowledge. There is more to gold than making money. Gold serves as one of the pillars of our economic liberty. It's good to know about gold even if you never invest in it. It's like the Second Amendment: you don't have to own a gun in order to benefit from the Second Amendment. (But it helps if you do.) So, some of my reports will be so informative about gold and monetary theory that they will positively boring to thousands of subscribers.

As an editor, I want subscribers. It's as easy to send out a newsletter to 10,000 people as 1,000 or 100, thanks to new software that I use. But, as someone who wants to help people, I don't want subscribers on this mailing list who are likely candidates for the

"I knew! I knew!" syndrome.

Here is the deal: if you want to make money from gold, you must own gold or gold-related assets. I know that it sounds silly to say this. I mean, I would not bother to tell a person who dreams of winning the lottery that he has to buy a ticket. He knows. But with gold, people really don't know. They say they know better, but they don't. They think they can make more money later by buying in later. They don't recognize the fact that they won't buy on the way down. They will always wait for another dip -- like the one that took gold from $380 to $321 earlier this year. They will buy only on the way up -- way, way up.

I spoke to Franklin Sanders in early June about his gold coin business. He said things were slow. He could not get clients to buy when gold fell into the $321 area in April, and now they were paralyzed with gold at $370 because they had missed the boat . . . again. "It's human nature," he said. He was right. It is.

The logic of gold stays the same. The supply may change, due to government dumping (called gold-leasing). Or demand may change. But the logic of gold stays the same. I will cover the logic of gold in this newsletter.

I want subscribers calmly to decide to buy gold coins and hold them, and also to buy gold shares and eventually sell them. I just don't want my readers who refused to buy to wind up buying from my readers who did buy and who are now selling into the mania.

You must know yourself. You must assess the effects of a gold mania on your future investment decisions. You must take steps now to head off any mania-induced investment strategy. I don't want you to get hurt because of this newsletter.

CONCLUSION

Your action steps today include these:

1. Decide why you want to read this newsletter.

2. If you want to make money, distrust fiat money.

3. If you want to learn more about the economics

of gold, stay on the list.

4. If you aren't ready to buy gold or gold shares, decide a buy price -- below today's market or above -- and place an order with a broker.

5. If you are not convinced yet, but you want to learn more, stay on the list.

6. Finally, if you want to make money in the gold market, but you are not willing to buy until the price goes back down to [$xxx], and you are also unwilling to place an automatic purchase order with a broker at this price, then it really would be best if you click the unsubscribe button. I don't want you to get hurt in the mania. Trust me: you are playing with emotional fire.

I don't want to lose you as a reader, but I'd rather lose you than hurt you. Know your limitations. If tremendous profits that you almost had -- "coulda, woulda, shoulda" -- will drive you to buy when you should stay on the sidelines, don't stay on this list.

Chapter 7

GOLD AT $3,500 BY 2010?

When we think of gold's price at $850, we think of 1980. That was a bad year. There had been reckless expansion of money under the Federal Reserve Chairmanship of G. William Miller, who everyone in 1980 wanted to forget, and generally the public has. He is remembered, if at all, mainly by his appearance at a Washington costume party, dressed in a Batman suit. Paul Volcker replaced him in August, 1979, and the FED then slammed on the money breaks. The flame-out of gold and silver took place in January, 1980. Then, down, down, down for over two decades.

The FED under Volcker brought monetary inflation under control long enough for price inflation to recede. It took back-to-back recessions, 1980/1981 to accomplish this. It also took Ronald Reagan's reduction in top marginal income tax rates. We forget about his desperation hike in Social Security taxes in 1983, when SSI technically went bankrupt, and the large tax hike in 1986, known as TEFRA.

We have seen the triumph of the dollar and the collapse of Communism. We have seen the rise of America as the only superpower. All of this looks like it's forever. But nothing is forever. The futures markets being what they are, forever is about as secure as the NASDAQ was in early 2000.

I have been watching the gold wars since about 1963. That is 40 years. It's my entire adult life. Old men lament, "What I have seen!" Well, I don't think I've seen much yet.

What one generation saw, 1910-1950, was something to be seen. In the America of 1910, there was no Federal Reserve System, no income tax, and a full gold coin standard was in operation. There had been neither World War I nor World War II. The following names were unknown: Lenin, Hitler, Mao.

My teacher Robert Nisbet put it best. In 1913, the year of his birth, the only contact that the average American had with the Federal government was the Post Office.

That was then. This is now.

THE AMERICAN EMPIRE: EASY COME, EASY GO

We live in what appears to be era of the American empire. Three events have made this era visible: the fall of the Soviet Union (August 19-21, 1991), September 11, 2001, and the fall of Iraq (March, 2003). The question is: How long will it last?

If Europe were still the main competition, the answer would be simple: a long time. Europe is in decline. Its population statistics reveal this. Muslims are replacing the original inhabitants. Europe is no longer where the challenge will come from. Asia is. I think the Europeans know this.

Empires are noted for military strength at the beginning and fiscal weakness at the end. The military budget grows as a percentage of the total budget.

This will not be true of the American empire. The expenses of the welfare system for the aged will swamp the military budget long before there is a significant military threat to the United States. The fall of the American empire will be fiscal, as the fall of every empire is. But foreign occupation costs, military recruitment costs, and weapons costs will not be the collective cause. The unfunded liabilities of actuarially unfulfillable political promises will be. It will not be enemies at the gates who overwhelm the American empire. It will be the army of politically armed economic dependents inside the gates. Granny will bring it down. If you want a mental picture image of the end of American empire, imagine a man dressed in uniform, holding an automatic rifle, being pelted mercilessly by an old lady who is beating him over the head with her handbag.

SAME OLD, SAME OLD

In *The Asia Times* (July 15, 2003), John Berthelsen begins with a conventional survey of the Asian economy and America's role in it. The numbers are nevertheless astonishing. American investors have become inoculated to
these numbers -- a bad sign.

The problem is Asia's build-up of dollar reserves. Private Asian investors and central banks have been buying dollar-denominated assets in order to keep their currencies from rising against the dollar. The decision-makers don't want their export markets to fade. But, in effect, when governments and their central banks follow a policy of debasing their currencies for the sake of their export
markets, they have adopted a foreign aid program for America. I call it the Marshall-san

Plan. Berthelsen writes:

> At a time when the United States remains tightly focused on its domestic economic problems and its international military adventures of the past two years, Asia has been quietly running up an absolutely staggering surplus of US dollars.
>
> By the end of 2003, according to JP Morgan Chase economists in Hong Kong, the combined countries of Asia are expected to hold an astonishing 70 percent of the world's currency reserves. In the past decade, they estimate, Asia has added US$1.2 trillion to its US dollar reserves as it runs up whopping trade surpluses with the rest of the world -- principally the United States, whose annual trade deficit is expected to reach US$500 billion. Credit Lyonnais Securities Asia (CLSA) in Hong Kong put the Asian reserves even higher, at perhaps $1.5 trillion.

These numbers are gargantuan. Updating Senator Dirkson's apocryphal comment, "a trillion here, a trillion there, and pretty soon we're talking big money." Think about a $1.5 trillion reserve. This is about 70% of the U.S. government's budget for one year.

> Is this a danger to the world economy? For many years, America's strong-dollar policy served the world and chiefly the United States very well. Their currencies cheap against the US dollar, Asian manufacturers profited by making relatively inexpensive exports and selling them in the United States at a healthy profit. In a kind cat-and-rat-farm analogy, in which the cats eat the rats, are skinned for their fur, and then are fed back to new rats, the Americans benefited by getting cheap goods that kept their consumer-led economy roaring. The financial communities benefited from the repatriation of those profits as the funds flowed back in a ceaseless waterfall into US stock markets, treasury and corporate bonds, money-market funds and other financial instruments.

Well, as Pearl Bailey sang five decades ago, it takes two to tango. It takes two to contango, too. America's strong-dollar policy has been matched step for step by Asia's weak-currency policies. When no currency offers unrestricted redeemability in gold coins, it's all a matter of comparison.

America's supposedly strong-dollar policy is simply an extension of the weak-dollar policy imposed overnight by the Federal Reserve and other central bankers in 1985: the

Plaza Accord. There has been no significant reduction in the rate of American monetary expansion since 1985, except for two years, 1994-95. You can see the statistics for money narrowly defined, 1990-2002, which reveals Federal Reserve policy better than the broader definition of money. You can compare FED policy with policies of the other major nations. Check the figures for China, especially. Don't call this a strong-dollar policy. Call it a weak yuan policy.

http://research.stlouisfed.org/publications/aiet/page3.pdf

This is an Asian-subsidized program of accumulating reserves. The original "Asian tiger" strategy of export-led growth, which is widely understood as the cause of the enormous growth of Asia, 1950-90, is being imitated. The problem is, this understanding was incorrect. That there were large numbers of exports is unquestionable. But these exports were made possible because of the low-taxation policies of the governments, which freed up their economies as never before. Also, the import of entrepreneurship -- "made in the U.S.A." -- helped transform non-Communist East Asia. But government policy-makers misunderstood the cause of their nations' economic success. They adopted mercantilism as their explanatory methodology: export-led balance of payments surpluses. China has especially been guilty of this faulty economic analysis, which now dominates central bank policy.

> China, whose share of exports in total gross domestic product (GDP) averaged 10.8 percent in 1985-89, now is producing exports at 28.4 percent of GDP. South Korea's exports were at 23 percent during the same period and now are at 54 percent of GDP. Hong Kong, then at 77.8 percent, is now at 153.5 percent of GDP. These figures are being repeated across virtually every economy in Asia. These exports continue to flow into the United States despite a three-year economic downturn that, if rationality were to prevail, should have slowed consumer purchases. The US Federal Reserve's easy-money policy and record cuts in interest rates, however, have kept consumers buying at a feverish pace, far too often on credit.

In contrast to European mercantilists of the 17th century, who sought the expansion of their governments' gold reserves, Asian central have sought dollars.

> The currencies of Asia, however, have almost all remained firmly tied to the dollar, either through currency pegs, reserve boards or, as in the case of Japan, as governments have bought dollars to keep their currencies static and thus to preserve their terms of trade.

> Despite the US attempts to talk the dollar down, Asian governments regard any negative changes in their trade balances as inimical to their economies. While supposedly loosening restrictions so that their consumers can participate in a demand-led consumer revolution, Asia in fact is more dependent on exports today than at any time over the past two decades.

Now, as always, Asian mercantilist policy must face the monetary results described in the mid-eighteenth century by David Hume: a build-up of foreign exchange. A free market would raise the exchange rate of the exporting countries. This would make Asian imports more expensive for Americans, who would have to pay more dollars to obtain Asian currencies. Asian the central banks refuse to allow this market-produced development. They insist on subsidizing exports to Americans. This policy comes at the expense of domestic consumers in Asia and American manufacturers. It cannot go on indefinitely. In the immortal words of the late Herb Stein, the chairman of Nixon's Council of Economic Advisers, when something cannot go on, it has a tendency to stop.

> But perpetual-motion machines don't work. The monumental scale of Asia's dollar reserves and the size of America's deficit are starting to make economists and strategists nervous. Wayne Godley, an economist at the Levy Economics Institute in New York, writes: "If the balance of trade does not improve, there is a danger that over a period of time the United States will find itself in a 'debt trap', with an accelerating deterioration both in its net foreign-asset position and in its overall current balance of payments (as net income paid abroad starts to explode). Such a trap would call imperatively for corrective action if it is not at some stage to unravel chaotically."
>
> It has been widely reported that the US must take in about $1.3 billion a day -- about $55 million an hour -- in foreign investment to finance its overseas debt. If that river of money falters or dries up, the difference must be made up by an inexorable fall in the value of the US currency. Indeed, if it had stopped already, the fall in the US stock markets since equities began to lose their luster in 2000 would have been catastrophic.

The American economy is growing ever-more dependent on Asian investments here. Berthelsen is correct: this is the result of central bank policy, not free market entrepreneurship.

> Certainly, Asia has been on a buying spree in US securities of all types.

> Despite a three-year economic pause in the United States, Asians bought a record $201 billion worth of long-term US paper in 2002. That includes another record $97 billion in US government securities. Asian central banks, with their enormous overhangs of US dollars, are increasingly doing the buying.

AN APOCALYPTIC FORECAST

Berthelsen also reported on an in-house report by Christopher Wood, an economist for Credit Lyonnais Securities Asia.

I had not previously heard of Mr. Wood. I am familiar with Credit Lyonnais, but not its Asian branch. What impressed me about the report is that it came from a company that makes money by advising clients. It does not make its money selling newsletters. This means that its recommendations are aimed at conventional people with a lot of money to invest. Therefore, reports generated by such large retail organizations in the financial world tend to be reserved. Wood's report was not reserved.

> "So long as America continues to secure easy funding, there is no pressure on policymakers in Washington to do anything other than run super-easy policies to try to keep their own consumer credit cycle going," says Christopher Wood, global emerging-markets equities strategist for CLSA Hong Kong. "Like any profligate debtor, market discipline will only be imposed on America when foreign investorsdemand an interest-rate premium for owning dollars."
>
> Wood tends to grow apocalyptic. "The current trend can continue for a while," he writes in his 110-page first-half 2003 overview of the world economy, published last month. "But the longer American excesses are financed, the more inevitable will be the ultimate collapse of the US paper-dollar standard that has been in place ever since Richard Nixon broke with Bretton Woods by ending the dollar's link with gold in 1971. The result will be a massive devaluation against gold of Asia's hoard of dollar-exchange reserves."

The statistics are really quite remarkable. Berthelsen summarizes the concentration of reserves in the central banks of a handful of countries.

> Japan's foreign reserves currently total $496 billion, followed by China at $310 billion and Taiwan at US$170 billion, according to figures compiled in April by the Hong Kong Monetary Authority. Hong Kong, with 7.5 million people, has reserves of $114 billion, nearly seven times the total money in circulation in the territory. Other Asian treasuries are similarly bulging with dollars.

To his credit, Wood calls a spade a spade: mercantilism. This is one reason why I am impressed with his overall analysis.

> "Asian central banks could abandon their mercantilist policies. They could let their currencies rise, which is what would happen given Asia's high savings rates if market forces were allowed to prevail. This would in turn boost Asia's consumer demand cycle. This is also what should be happening from a theoretical standpoint, as satiated American consumers have already borrowed a lot and need to rebuild their balance sheets."

American consumers have no realization about what is happening, nor should they. They go into Wal-Mart, and they buy imports from China. It is not their responsibility to assess the impact of their purchases on the balance of payments, the build-up of Asian central bank reserves, or anything else that economists love to chatter about. They buy their items and walk out of the store. Before they start their cars' engines, Wal-Mart has re-ordered the items they bought. Why not? Wal-Mart is being subsidized by Asian central bankers. This is why the price of real estate goes up, up, up in Northwest Arkansas.

In the old *Saturday Evening Post*, there used to be a regular column modeled after a baseball pitching analogy, "The Long, Slow Curve . . . and Then the Fast Break." Here comes Wood's fast break.

> Then, turning truly apocalyptic, Wood predicts that by the end of the decade there will no longer be a possibility that the world's central banks can control the situation, and there will be a truly massive devaluation of the US dollar. "The view here is that the US dollar will have disintegrated by the end of this decade. By then, the target price of gold bullion is US$3,400 an ounce." That is roughly 10 times gold's current level. If that were to happen, Asia's holders of dollars would be forced to start selling them or see their own reserves collapse. If they start to sell them, the price of America's paper will fall even faster.

Think about this estimate: gold in the mid-$3,000 range. Those of you who follow Richard Russell's newsletter will recognize the figure. Russell thinks the Dow Jones Industrial Average and the price of gold will meet at 3,000. Berthelsen summarizes:

> That is truly apocalypse now, or in 2010. Is it possible? The policymakers in the administration of President George W Bush in Washington are far more sanguine. They regard economists, often said to be the only field in which two individuals have shared the Nobel Prize for saying exactly the opposite things, to be basically irrelevant, and presumably by extension strategists. The administration, facing an election in a year and a half, and the Federal Reserve intend to keep the party going if they can.

http://www.atimes.com/atimes/Asian_Economy/EG15Dk01.html

CONCLUSION

On the fringes of opinion from the fringes of Asia has come a remarkable prognostication. If it turns out to be correct, then the world of international commerce is going to hit a brick wall sometime in the next ten years, a brick wall so thick that it might even affect the price of real estate in Northwest Arkansas.

Chapter 8

GOLD IS A POLITICAL METAL

If I were to start a newsletter called *The Copper Wars*, it would not attract many subscribers, even for free. *The Silver Wars* might attract a few more, but not many. But *The Gold Wars* has attracted thousands. Why?

When I imply that there is a war against gold, gold bugs with silver hair nod in agreement. When I say that the government is opposed to the public's using gold coins in exchange, gold bugs understand exactly. They see that the war on gold is a war of government officials against private owners of gold.

When I say that gold is a political metal, I mean more than the obvious fact that gold has political ramifications. I mean something more significant. I mean that gold has always been intertwined with politics, that gold, alone among metals until the success of the Manhattan Project added uranium to the list, has been the uniquely political metal.

In some societies, we can speak of "the silver wars." China used a silver standard for generations. The same was true in the colonial United States. "Pieces of eight" were Spanish silver coins that served as America's primary currency until the mid-nineteenth century. (The most detailed and accurate Constitutional history of American money is *Pieces of Eight*, by Edwin Viera. The older, shorter edition is more suitable for normal people. The two-volume edition is not aimed at normal people; it's aimed at legal historians.)

After the end of the Napoleonic wars in 1815, Western European governments moved to the gold standard for international commerce. This made the gold standard the domestic monetary standard, too. But because governments adopted fixed prices between gold and silver -- price controls -- their laws would drive one or the other metallic coinage out of circulation. The legally overvalued money metal coins stayed in circulation. The legally undervalued money metal coins went into hoards, the black market, or were exported. This, of course, is the inevitable consequence of price controls: shortages of the item whose legal price is below the market price. Gresham's law -- bad money drives out good money -- is merely an application of the law of price controls.

WHY POLITICAL?

Political rulers throughout recorded history have asserted a monopoly over money. They have argued that the State possesses legitimate authority over the creation and distribution of money. Because gold and silver have been widely used as money metals, the State has asserted control over the monetary uses of these two metals.

This is the origin of the war against gold. Gold is widely recognized and desired as an investment. It is a highly marketable commodity. This was far more true in 1913 than it is today. Prior to the de-monetization of gold, which began in 1914, a person could take a gold coin anywhere where international trade was common and buy just about anything. It did not matter which ruler's image was on the coin. The coin was valuable because of its gold content. The image may have helped to convey information about the coin -- so much gold of a certain fineness -- but the face on the coin had merely a brand-name recognition effect. The British gold sovereign was so widely recognized that James Bond carried sovereigns as late as the mid-1960's. In "From Russia With Love," the coins were in the booby-trapped briefcase. The ruler's image verified the quantity of gold in the coin. It did not add value except as a kind of Good Statekeeping Seal of Approval.

Gold's value is not independent of governments. This is because governments buy and sell gold. This activity affects its price. Gold's value is also affected by laws against the circulation of gold coins. The Soviet Union had such laws. So did the United States, 1933-1974. But gold's value as a money metal can exist independently of a government's actions to subsidize or stigmatize gold's use as money. Gold circulates as money precisely because it has a value independent of government policies. Or it did. It no longer does. Gold has been de-monetized by governments and their acolytes, the economists.

As with any scarce resource, gold moves to those holders who bid highest. The more widespread gold's use as money becomes, the more likely that trade will accompany gold. Gold reduces risk by reducing the likelihood of default or fraud on the part of the State or its licensed agents, fractional reserve banks. A government can go bankrupt, but its gold coins will still circulate at gold's market value. The same is true of any coin-issuing agency. The gold may be marginally more or less valuable in a particular form because of the degree of recognition of the producer, but a government that accurately certifies its gold coins will find that its coins circulate at full value even if the government itself faces bankruptcy or extinction.

Gold's independence from the fate of governments points to a political truth that governments despise: governments are not the source of the value of gold. To the extent

that gold is money, gold testifies against the sovereignty of the State in the realm of money. It testifies to the sovereignty of consumers in a free market. The free market, not the State, is the primary source of gold's exchange value.

This means that consumers can escape from the State's anti-consumer policies. They can buy gold. This provides them with international money, black market money, and "hoard it and spend it later" money. It provides one group of citizens with the personal escape hatch from the effects of government power-seeking. Which group? Political skeptics who do not trust the government's money.

In olden days, this escape hatch was an insult to a king, whose face was on the coins that he was debasing by adding metal of lower value. The king wanted to increase his spending, but there was tax resistance. So, he would call in the old coins, melt them, add cheap metal, and try to spend them into circulation at the old rate for coins with higher gold content. The plan never worked. The new coins would always fall in value.

This enraged the government. It made theft through deception less effective. The citizens who spotted the fraud early would buy gold by exchanging the debased new coins for old gold coins, leaving the less perceptive, more trusting citizens holding depreciated new coins. Private citizens did what the king was trying to do, and this invasion of the king's asserted prerogative to steal enraged kings for centuries.

Today, there are no kings, other than "King" Farouk's famous kings of clubs, diamonds, hearts, and spades. But politicians still play the old games, and play it much better. They want the monopoly of theft that comes from passing the new, counterfeit money to the suckers (citizens) at yesterday's lower prices. So, when a few of the recipients of the new, phony bills and credit money start unloading them to buy gold, the politicians take action. They do not want to share the benefits of being able to buy at yesterday's prices with today's more plentiful money.

When gold's price rises steadily when there seems to be no war imminent or other international disaster, people start looking for a reason. The main reason is that the government is inflating. If gold's price is rising in one currency but not others, this is additional evidence of policies of monetary inflation.

The government wants people to believe in "something for nothing." It wants people to believe that digital money creates wealth. But if one group seeks to gain a disproportionate share of wealth by exchanging fiat money for gold, only to see gold's price rise, the politicians try to stop this. They cry out against "speculators" who are

"acting against the public interest" by "profiting at the expense of widows and orphans." This is a more acceptable way of saying: "These private amateurs are invading our turf in the ever-profitable business of looting widows and orphans."

A rising price of gold is like a trip-wire alarm that announces: "The politicians are at it again. Bolt down the furniture." It is a signal, published in the newspapers, that there is something untrustworthy about the central bank's monetary policies. It alerts entrepreneurs to start buying goods before prices rise further. So, prices rise even faster. This makes it even more expensive to buy votes with fiat money. The new money buys fewer of the goodies that politicians hand out to buy votes.

The skeptics who say "the government should never be trusted" get rid of the new money and buy at yesterday's prices. The trusting souls who say, "The government is our friend" hang onto the money, only to see it fall in value. The skeptics win; the State-trusting citizens lose. This is an affront to the politicians. It raises the cost of trust. Economic law then takes over: "At a higher cost, less will be supplied." More citizens begin to distrust the government.

The politicians deeply resent this aspect of gold, for the same reason that a burglar resents the widespread installation of burglar alarms.

THE CAMPAIGN AGAINST GOLD

The State has adopted several strategies in undermining the use of gold as coinage. Here are a few of the more common strategies.

1. Issue paper IOU's for gold, called gold certificates.

2. Issue more of these certificates than there is gold to redeem all of them on demand on the same day. "Suckers!"

3. Allow commercial banks to do the same thing. "Suckers!"

4. Create a central bank that stands ready to issue gold to bail out any bank that experiences a gold run.

5. Allow commercial banks to suspend redemption of gold during a national emergency. "Suckers!"

6. Allow the central bank to confiscate the gold of the now-protected commercial banks. "Suckers!"

7. Make the ownership of gold illegal for citizens.

8. Create a gold-exchange system internationally in which foreign central banks buy interest-bearing bonds from one or two countries that back their currencies in gold: IOU's for central bankers.

9. Create a central bank for central banks that will lend gold during a national bank run. Call it something other than a bank, such as the International Monetary Fund.

10. Suspend gold payments to foreign central banks when too many of them catch on that there are more IOU's out there than gold to redeem them. "Suckers!"

11. Persuade all of the other central banks to store their gold in the senior branch of a central bank whose nation used to redeem gold on demand by foreign governments, but which defaulted decades ago. "Suckers!"

12. If the price of gold rises, calling attention to the monetary fraud of legalized counterfeiting, sell some of this gold to the grandchildren of those trusting citizens from whom you stole the gold. But call the sales something else, such as gold leasing. Don't reveal a reduction in the official reserves of gold.

13. Allow central banks make a substitution: written promises to pay gold, issued by private organizations called bullion banks, instead of actual gold.

14. Wait for the price of gold to rise, thereby bankrupting the bullion banks, which will not be able to repay. These are all corporations, and so enjoy limited liability benefits. No one goes to jail.

In this final scenario, who wins? All those people who bought gold while the gold-leasing operations lowered the market price of gold.

Today, the central banks' gold is steadily being repatriated to private owners. The central banks are subsidizing the future net worth of gold buyers.

When there is finally no more gold to lease, or when central bankers at long last figure out that IOU's issued by recently bankrupted gold bullion banks are not really what central bankers need to establish public confidence in their forecasting abilities, the price of gold will skyrocket. At that point, the public will decide it's time to buy -- at high and rising prices.

Those who have already bought will then look at the rest of the population, which failed to buy while the buying was good, and very quietly, in private circles, issue their unofficial assessment: "Suckers!"

THE SHORT RUN

Politicians are guided by the short run. Central bankers take a longer view than politicians, but ultimately, they are the handmaidens -- if that's the correct metaphor -- of the politicians. They do what they are told during a political crisis.

Politicians care nothing about gold today. This is something new. This was not true in 1971 or 1931. The economists care just as little. What gets politicians' attention is the interest rate. The same is true of investors. So, the central bankers can play games with gold, lending it at 0.3% per year, as if this were a wise move. Of course, this arrangement is a whale of a deal for bullion banks, which borrow low, sell the gold, and lend high.

But what about the day of reckoning? What about when gold starts up, and bullion banks cannot afford to buy it back and pay off the central banks in the commodity borrowed? Central bankers don't care. They think that gold will never again be a factor in the monetary affairs of mankind. When they think "never," they mean in their lifetimes.

They may be right. But the lifetime of one generation is short compared to the affairs of mankind.

Events will speed up and opinions will change fast when the public at last figures

out that they have once again been the victims of the government's experts. They will see the price of gold rise. They will once again pay attention to the price of gold. This will focus attention on monetary policies. This will put central bankers in the place they hate to be: the spotlight.

But, in the meantime, central bankers can create short-term losses for the long-term winners. They can sell (lease) more gold and turn gold price increases into spikes. They can scare off most gold investors for a long time: skeptics who don't have deep pockets. They can restrict the speculative gains and increase the set-backs by dumping gold.

They will do this. Count on it. Central bankers do not want to let the public know that "the public's gold" (ha, ha) is gone, that it has been sold to jewelry wearers and industrial manufacturers. The game must go on, but a rising price of gold reveals the corruption and deception of the players who make the rules.

What is happening, unseen, is that what was the public's gold in 1913 is being sold back to them. The whole idea of "the public's gold" was a sham from day one, a way to get the suckers to turn over their gold for IOU's issued by commercial banks or governments. Deposit by deposit, the public's gold was turned over to professional liars and counterfeiters: fractional reserve bankers and politicians. When the gold was confiscated by central bankers in 1914 and 1933, in the name of "the public good," the public ceased to own any gold. The entire notion of "the public's gold" that is held in trust by the government and the central bank is the very reverse of the actual situation. The public's gold ceased to be the public's gold when it became "the public's gold."

CONCLUSION

The common man will lose. He always loses when fraud is legalized by the government. The common man wins only when markets are free, contracts are enforced, and fraud is prosecuted. None of this applies to the gold market because the State asserts a higher law than the law of contracts: the law of State sovereignty over money.

What, then, of the not-so-common man? If he distrusts the promises of the politicians, then he will take advantage of the fraud of gold leasing. He will buy the leased gold, which becomes his, leaving the bullion bankers to worry about repayment.

In the era of the international gold standard, the public trustingly handed over their

gold coins to scam artists in three-piece suits who issued IOU's and then defaulted on the contracts, with the government's approval. Today, the spiritual heirs of the scam artists are selling back the confiscated gold to the biological heirs of those long-dead trusting souls. You and I can buy gold today at lease-subsidized prices in exchange for fiat money. I say, "This is an opportunity not to be missed."

Chapter 9

GOLD SALES THREATENED (AGAIN)

It has long been a standard policy of central banks to sell gold and invest the money gained in interest-bearing securities, which are usually government bonds of their own national treasuries.

These sales are non-inflationary. They do not represent an increase in the monetary base. The increased holdings of Treasury bills are offset by the reduction in gold holdings, which also serve as monetary reserves, i.e., high-powered money. Nothing changes with respect to the money supply.

These sales are applauded by those politicians who believe academic monetary theory, whether Keynesian or monetarist -- a small group, indeed. Nobody else in government pays any attention.

Gold is regarded as a dead asset or an unproductive asset because it doesn't generate interest. (I mean interest as money, not interest as public awareness.) It just sits there, gathering dust.

GOLD LEASING

If a central bank leases gold, this also doesn't change its monetary base, since the central bank pretends that an IOU from a private "bullion bank" -- a bank that sells off all of its borrowed bullion -- is equal to gold bullion in the vault. Therefore, the lease is not treated as a sale. The IOU for gold is as good as gold, legally.

A problem arises when gold's price rises in the nation's currency. This calls into question the ability of the bullion bank to enter the gold market and buy gold, so that it can repay the gold it borrowed from the central bank, which the bullion bank has promised to do one of these days, Real Soon Now. If the bullion bank cannot repay the loan, then its IOU is publicly exposed as not being as good as gold. If the central bank were to press the bullion bank for repayment, rather than rolling over the loan, then the bullion bank could go bankrupt, which would reduce the value of its IOU's to something less than face value. This would create a legal crisis for the central bank, which would lose reserves on its books.

What would a central bank do then? Simple: buy more government bonds to offset

the reduction in gold reserves.

The main problem would not be the lack of repayment but a lot of unwanted public interest. "What did the central bank do with our gold?" A default by bullion banks would be a public relations problem, not a monetary problem.

To forestall this PR problem, central banks are prepared to sell off more gold to keep its price down. This will enable the bullion banks to continue to draw interest from the investments they made with the money they generated by selling the leased gold.

Everyone is happy, except for people who think that government currencies should be backed by gold, something that has not been true ever since Roosevelt issued his executive order to confiscate Americans' gold. The number of people who feel this way are few and far between. I am surely not one of them. For almost three decades, I have called for exactly what is happening: the sale of stolen gold by central banks to the public, in order to get gold back into private hands. I even had an article published in *The Wall Street Journal* in the 1970's that recommended this. The gold should be in private hands. Gold is too important to be left to the discretion of central bankers.

Oddly, there are conservatives who don't believe this. They trust central bankers. They think central bankers are not agents the national government. They think the government can be trusted to fulfill one (and only one) promise: "Bring in an IOU for gold at any time, and your government will give you gold." The more times governments default on this promise, the more strongly certain economists (few in number) assert, "Next time, it will be different."

Fools and their money are soon parted, but economists are always with us. They are there to encourage the next generation of fools. That's the way the world works.

ANOTHER THREAT TO SELL GOLD

An article by the *Financial Times*'s Kevin Morrison appeared on July 23. In it, we read:

> Europe's central banks are expected to extend their four-year-old gold sales agreement when it comes up for renewal next year.
>
> The low returns to be made from lending gold to market participants

> hedging forward sales and the budgetary pressures on Germany and other leading economies will encourage the banks to continue sales of the precious metal.

This seems a bit odd. The low returns made by gold mining firms that have promised to deliver gold at a fixed price should be of no concern to central bankers. Why should central bankers care one way or the other?

Of course, they don't care about gold mining profits. They care about the bullion banks' inability to repay in gold. They care because defaults by bullion banks could create a PR problem for central bankers. Bureaucrats don't like PR problems. So, they don't want gold's price to rise.

> The banks will also want to retain the stability of the gold price created by the restrictions imposed by the sales pact.
>
> The current agreement, which expires in September 2004, allows for 400 tonnes of gold to be sold each year. One central banker told the Financial Times recently that he thought there was room for an increase in gold sales.

Anonymous central bankers tell the media the same story every time gold's price rises. I mean, it's not as though it would be a good idea for a central bank to own an asset whose price is rising. What kind of speculative nonsense is that? "Buy low, sell low" is their motto. Well, sort of. "Buy low, lease low, get stiffed" is closer to it.

> Some analysts expect the new pact to allow the sale of 500 tonnes a year over a five-year period, or 2,500 tonnes in total. This would allow additional banks - from Greece and the European Union accession countries - to join.
>
> The original arrangement was signed in September 1999 in response to increasing concerns that unco-ordinated central bank sales of gold were adding volatility to the market and pushing prices lower.

Are you following this? They worry about a repetition of 1999, when gold sales pushed prices lower. You may also recall Mr. Morrison's explanation, presented in paragraph two, for the need to sell gold next year because of "The low returns to be made from lending gold to market participants hedging forward sales. . . ." So, let's see now: the banks sold gold in 1999, lowering its price, thereby making a potful of money for the

mines that had sold gold forward at a fixed price, which had been higher. But now they worry about a replay of that event, while, simultaneously, they worry about the absence of profits for forward-selling gold mines.

Mr. Morrison dutifully reports all this. No bells went off it his mind. Nothing said, "does not compute!"

> The gold price fell to a 20-year low of $252 a troy ounce when the Bank of England announced its gold sales in the summer of 1999. The current pact has proved successful in adding order to the market.

Order? What exactly is order? A stable price? This is not what we have seen so far.

> Gold rose to about $320 shortly after the agreement was reached. After a brief subsequent fall it has risen steadily for the past two years.

He then added more information.

> Although the gold price has firmed, the rate central banks can charge borrowers such as gold miners -- which use it to hedge forward sales of the metal -- has fallen. The miners have needed less gold as they have unwound their long-term hedge positions.

He is saying that some gold mines have borrowed gold from the central banks at low interest rates, so that they could unwind -- i.e., deliver -- their forward sales obligations. Let me get this clear. The mines had debt positions -- promises to deliver gold at a higher price -- which became less profitable when gold's price rose, so they borrowed gold from central banks to pay off their gold debts. That is, they took on a debt in gold to pay off a debt in gold. This is called "unwinding."

You bet it is! The forward gold contracts were made in a free market, where those who are owed gold on a fixed date can bring gold mining officials into court for payment if the mines don't deliver physical gold. In contrast, gold leasing debts to central banks are assumed to be open-ended, never to be repaid, only rolled over.

> One-month gold deposits rates are zero, against more than 3 per cent at the time of the agreement.

Now, that's a deal. Borrow gold at 0 percent, sell it, take the money received by the sale, lend it to someone at some rate of interest, and pocket the money. Nice work if you can get it. There is only once catch: the price of gold could go up. But bullion bankers don't seem to care. Why not? I suggest this reason: they know they will not have to repay. At worst, the loans will be rolled over at low, low rates. Nice work if you can get it.

> Germany will play a key role in any future agreement. Gold accounts for an estimated two-fifths of its foreign exchange reserves.
>
> It is the largest holder among the 15 signatories to the gold agreement, whose members, all European central banks, hold about 40 per cent of the world's official gold reserves.
>
> The central banks hold 22 per cent of the 147,000 tonnes of the world's gold that is in circulation, in the form of jewelry, in industrial uses and in official or investment holdings.

Morrison quotes Matthew Turner.

> "However, there are also ways that funds can transfer from the central banks to the treasury, such as dividend payments," said Matthew Turner, an analyst at Virtual Metals, a consultancy.
>
> Germany would be motivated to sell gold because it could probably earn a better return from a switch to other investments, he noted.

Well, yes. And if Germany had sold gold at $800 an ounce in 1980, and had bought 30-year U.S. Treasury bonds at 13%, it would be sitting on a huge pile of money. But the central banks did not do this in 1980, when they could have gotten a huge return on their gold. Yet they are now talking anonymously about selling it at $350, when the available return on bonds -- highly risky, as we have seen in recent weeks -- is 4%, and short-term rates are 1%.

Gold earns no interest return. Quite true! It never has. So, Mr. Turner's observation would have been equally true in 1980, 1960, and 1800. "Gold held by the central bank earns no interest return." To invoke this fact as a guide to understanding central banking policy is the equivalent of arguing that a lot of people will go to bed because the sun will go down.

> Mr Pringle said central bank sales were part of a long-term trend which will further reduce the banks' role in the international gold market.
>
> "I think there will be a day when they will be able to conduct buying and selling activity without disrupting the market too much," he said.

How could that ever be? Only because the central banks will have sold their gold to the public.

Well, not quite: to the public and to China's central bank.

CONCLUSION

When you read explanations for anything central bankers have done or plan to do regarding gold, bear the following in mind:

1. The explanation makes no sense.
2. The explanation was never intended to make sense.
3. Central bankers want to avoid PR problems.
4. They have leased out gold that will not be repaid if gold goes over $800/oz.
5. If they try to get their gold back with gold at $800, their debtors will declare bankruptcy.
6. Loans on the books to defunct debtors will reveal the fact that leased gold is not the same as gold in a vault.
7. This is has bad PR implications.
8. The central banks are trapped by their own gold-leasing programs.
9. They must now sell gold in order to create the illusion of bullion banks' solvency.

10. This will act as a depressant on the price of gold for as long as central banks continue to lease gold and sell it.

11. The public will slowly get back that portion of its gold that the China's central bank doesn't buy at these subsidized prices.

12. Indian fathers will continue to receive their gold subsidies from Western central banks.

13. Indian daughters will have dowries in gold, just as they have had for 3,000 years.

14. In exchange, Americans will have Alan Greenspan, who seems to have been around almost as long as Indian dowries -- and is beginning to look like it.

Chapter 10

IS AMERICA'S GOLD GONE?

I sent this report to ***Remnant Review*** subscribers in February, 2002. I want to share it with you, even though the gold market has long since confirmed what I wrote then. I want you to understand why I believed that gold had bottomed in 2001, and what the forces are that will push gold's price higher. I still believe it.

Pay close attention to my discussion of James Turk's reports. Turk believes that the U.S. government has quietly leased out all of its gold. If he is correct, then the government cannot get it back. Gold's borrowers have paid about 1% per year to borrow the gold. Then they sold it, pushing gold's price down. Then they took the money and invested it at market rates -- over 7% when the leasing process accelerated sometime around 1997. It was a sweet deal until gold's price started upward. Now it threatens to bankrupt the so-called gold-bullion banks.

If Turk is correct, the banks that are in debt in gold bullion cannot buy it back to repay their debts. If they try, gold's price will soar.

I warn you, this informationis arcane material. The average Congressman knows nothing about it, let alone the average voter. But gold investors should be aware of these issues.

I begin with an article written by two economists, one of whom worked at the time for the Federal Reserve System. It was published in 1997. You can read it here:

http://www.econ.lsa.umich.edu/~ssalant/hhh.pdf

The authors wrote that if every central bank sold all of its gold in one gigantic auction, the price of gold would decline by about 11%. The price in 1997 was $350. A gigantic, one-shot auction by central banks would drop the price to "about $309" (p. 3). (Only academic economists would be as specific as $309.)

Here is part of what I wrote in 2002. . . .

* * * * * * *

What if the United States were to sell all of its gold in one shot? What price effect

would this have? Gold would fall by $10 an ounce, the report says.

> Up to this point, we have considered actions that might be taken by all governments acting together. Of course, one government may sell even if others do not. As shown in Chart 6, if the United States sells all its gold but other governments do not, the price is estimated to drop only to about $340 [down from $350 -- G.N.]. U.S. receipts are about $89 billion, about 10 percent higher than if all governments sold. A credible announcement by other governments that they intend to sell gold soon has almost the same effect as an immediate sale (p. 5).

Now, I'm not sure they were correct in 1997. No one can be sure. I think such a sale would have dropped the price by more than $10. But this is what the document says.

The report's paragraph ends: "Thus, the U.S. example illustrates the consideration that each government makes more revenue if it sells before other governments either sell or announce a sale." This insight surely isn't going to win its authors a Nobel Prize. Of course it's better to sell before others do. But this assumes that central bankers will take the authors' advice and sell all of their gold at one time, which is what the authors recommend. The paper calls for coordinated selling. But they offer a fall-back position: leasing. I will return to this theme later in this report.

In the paper, there is a chart of the distribution of gold, government vs. private. The chart counts the estimated gold in mines, which seems strange. Gold in the ground affects today's price only indirectly, insofar as it suggests possible increases in supply over the years. If you wanted delivery of gold today, gold in the ground would do you no good.

A lot of gold is flowing into Asia. India's fathers endow their daughters with gold jewelry before a marriage. This is the property that they bring into the marriage. This is an old tradition. It will not change soon. Meanwhile, Indians are getting steadily richer. They can buy more gold. Dowry gold rarely comes back onto the market except during economic crises, such as famines. India is steadily becoming a free market society, and famines are rare in free market societies. Japanese investors have begun to buy. There are indications that the central bank of China is buying more gold than previously estimated.

This means that if there were a rising price of gold because of fears about inflation or, far more interesting, realization that the central banks have quietly leased out most of their gold and cannot sell any more to keep down its price, then Indian wives are unlikely

candidates to supply gold in a panic move upward. At some price, yes, but would be a very high price.

GOLD LEASING

There is a very interesting section on gold leasing. The authors regard leasing is a viable alternative to actual gold sales. I believe that their advice here has been taken. I think it began over a year before the essay was published. There has been no formal announcement of this change in policy. There are other indications that central bankers have used gold leasing as a way to keep the price of gold declining. The authors argue:

> Governments can achieve a welfare gain roughly equal to that from an immediate sale through alternative policies. One such policy is specified in the bottom panel of Chart 5. Under this alternative policy, governments loan out all their remaining gold in each period. In the future when all gold now owned by private agents, whether above or below ground, has been used up, governments sell in every period whatever gold is necessary to make the price be what it would have been if they had sold all their gold immediately. The quantities of gold available for private uses are the same under the alternative policy as with an immediate sale. However, there is an important difference: under the alternative policy, governments relinquish title to their gold in the future and then only gradually. Therefore, to the extent that government uses can be satisfied by owning gold but not physically possessing it, most if not all of the gains associated with maximizing welfare from private uses can be obtained with little or no reduction in welfare from government uses until sometime in the future (p. 5).

Here we have the key that may unlock the question, "Why did gold fall from $350 to $280 in 1997?" Analysts have looked for the answer in central bank sales. Only Great Britain and Switzerland have been selling much gold. Great Britain next month will conclude three years of auctions of 365 tonnes, half of its gold reserves. In September, 1999, there was a 5-year agreement by central banks that they will not sell more than 400 tonnes a year, combined. The IMF agreed to this. But this agreement did not include leasing.

In a follow-up paper, the authors explained their recommendation.

> Governments can make gold available for private uses through a class of policies involving equivalent combinations of gold sales and gold loans. A gold loan involves receiving gold today and returning the same amount of gold and a loan fee at some future date. For simplicity, we focus most of our attention on the case of a sale of all government gold. A policy that is equivalent to a sale of all government gold in a given period is a commitment in that period to lend out at the beginning of every future period all remaining government gold and to sell at the end of every period after some date in the future whatever amount is required to satisfy the demands of depletion users at the price that would have prevailed in that period if all government gold had been sold in the given period. If government uses of gold require ownership but not storage, any loss in welfare from government uses resulting from making government gold available for private uses would be much smaller under the policy involving lending and gradual sales in the future. ("Can Government Gold Be Put to Better Use?" p. 2. Board of Governors, Federal Reserve System, June, 1997. International Finance Discussion Papers #582. The italics are in the original document.)
>
> **http://www.federalreserve.gov/pubs/ifdp/1997/582/ifdp582.pdf**
>
> [This document has been removed from the FED's website.]

Why would a government want ownership, but not storage? They did not explain. They did not have to. By retaining legal ownership, governments and central banks are not required to report the physical depletion of their gold reserves. Elected politicians are unaware of the physical transfer of their nations' gold into the private sector -- such as India -- and would-be speculators who are ready to buy gold as an inflation hedge remain fearful that the central banks will sell all of that gold, forcing down gold's price.

TURK'S REPORTS

In a pair of newsletter reports last year [2001], James turk has followed certain shifts in definition by the U.S. Treasury and the Federal Reserve System regarding U.S. gold reserves. The old term used to be "gold stock." The portion of the gold stock at West Point was re-named "custodial gold" in September, 2000. In June, 2001, this gold was re-named again: "deep storage gold." Turk presents a detailed report on the decline of SDR [Special Drawing Rights] Certificates in the Exchange Stabilization Fund, a fund

used by the United States to stabilize the exchange value of the dollar. The decline was from 9.2 billion (Dec. 1998) to 2.2 billion (Dec. 2000). (Freemarket Gold & Money Report, July 23 and August 13 issues. www.fgmr.com.) The SDR is defined in terms of gold: 35 SDR's = one ounce of gold. So, 9.2 billion = 262.9 million ounces. There are now 2.2 billion SDR Certificates remaining in the ESF, or 62.9 million ounces. The difference is 200 million ounces.

A summary is available on-line, posted by the Gold Anti-Trust Action Committee. It shows the decline in the SDR Certificates. I offer extracts from the full report, which you should read in its entirely.

> "Everything is fitting into place," [GATA's Bill] Murphy says. "It appears that the SDR certificates are being used by the ESF to hide its gold transactions from the American public."
>
> GATA has long claimed that central bank gold loans are two to three times the commonly accepted 5,000 tonnes cited by the gold industry. "Eighty-seven percent of the U.S. gold reserves is very close to 7,000 tonnes, which would increase to 12,000 tonnes the official sector gold out on loan in some way," Murphy notes.
>
> "No wonder former Treasury Secretaries Robert Rubin and Lawrence Summers and current Secretary Paul O'Neill have refused to directly answer members of Congress regarding their gold market queries," Murphy goes on. "The ESF reports only to the president of the United States and the treasury secretary, which means that these men are very aware of the mechanics of manipulating the gold price." . . . .
>
> Then in an August 7, 2001, letter, John P Mitchell, deputy director of the U.S. Mint, offers no explanation why 1,700 tonnes of U.S. Gold Reserves stored at West Point, N.Y., were reclassified in September 2000 from "Gold Bullion Reserve" to "Custodial Gold." In May this year all 7,700 tonnes of the U.S. gold reserves in Treasury Department depositories were reclassified as "Deep Storage Gold."
>
> Mitchell says the U.S. Gold Reserve was "not reclassified -- it was renamed to better conform to our audited financial statements."
>
> "But Mitchell offers no explanation why that change is being made now.

Could it be that these changes to conform to accounting principles were necessary because of the dramatic reduction in SDR Certificates and encumbering of the U.S. Gold Reserve?" Murphy asked.

"This is most frightening," Murphy says. The U.S. Government defaulted on its gold obligations in 1933 and 1971. Could it be happening all over again?

http://www.gata.org/gold_reserves.html

I asked Turk a series of questions by e-mail. His replies are quite revealing. My questions related to the means by which the leasing operations have taken place.

North: That the U.S. may be making available gold to the Bundesbank is conceivable, but to what purpose?

Turk: The ESF needs gold in Europe for lending to bullion banks. There is no bullion lending in the States. So the ESF lends the Bundesbank gold which is stored in Frankfurt, Zurich, London etc. In return, the Bundesbank gets the US gold in West Point.

North: Is the bulk of gold leasing conducted through the Bundesbank?

Turk: The ESF lends the gold to JP Morgan Chase, Citibank and Deutschebank of course.

North: The price of gold can only be forced down by the sale or lease of gold, or the threat of a sale. There has to be an outlet into the private market. Is there any monitoring of such purchases?

Turk: Yes, Frank Veneroso is one of the leading gold analysts with great central bank connections. He believes that upwards toward 15,000 tonnes has been loaned by central banks, much more than the estimates by Gold Fields Mineral Services. The reason is that GFMS, as I understand it from Veneroso, largely ignores the borrowing by commercial banks to fund their own portfolios, i.e., the so-called carry-trade. GFMS only looks at hedging.

My guess is that it is being leased, so that there is no evidence of reduced central bank inventories. Still, someone has to be selling gold into the

market if downward price pressure is to be maintained. Why wouldn't this huge increase in purchases be visible to the public?

According to Veneroso's statistics, it is. Last year demand was 1500 tonnes greater than supply.

North: If the IMF is doing it, then what role does the Bundesbank play?

Turk: Pawn, for the US banking interests, which they manipulate through the IMF.

It gets even more interesting. In his July 23 report, he wrote: "The US Reserve Assets report now excludes all reference to the ESF, and previous reports already published have been changed. Not only were the figures adjusted, but all references to the ESF have been eliminated." This policy began in February, 2001. Turk had blown the whistle in his December, 2000 report. "I guess the January 2001 report was already being prepared when my December article appeared, so it was too late to change that report." Here is the famous bottom line: "The ESF has been erased out of the US Reserve Assets report as if it had never previously existed." The ESF was created in 1934, the year that Roosevelt raised by 75% the price of the gold that the government had confiscated from Americans in 1933.

THE IMF

GATA has now revealed evidence that the IMF is doing exactly what that 1997 Fed report recommended. The IMF has unofficially changed the rules. It now allows central banks to keep leased-out gold on their books as actual reserves.

In October 1999 the IMF held a meeting for its member countries in Santiago, Chile, only a couple of weeks after a lightening $84 run-up in the price of gold. GATA's Mike Bolser found the IMF manual distributed to the attendees, which explains how member central banks are to account for something called gold swaps -- gold that leaves the vaults of the central banks. In effect, Bolser came across the IMF's gold "play book."

As you will learn shortly, it appears the gold swap issue is at the heart of the manipulation of the gold price.

Bolser's discovery led GATA's Andrew Hepburn to query the IMF with the following:

Why does the IMF insist that members record swapped gold as an asset when a legal change in ownership has occurred?

The IMF answered:

> "This is not correct: the IMF in fact recommends that swapped gold be excluded from reserve assets. (see Data Template on International Reserves and Foreign Currency Liquidity, Operational Guidelines, para. 72,"

Over the years the GATA camp has received nothing but denials from the U.S. Treasury, Alan Greenspan, BIS, bullion banks and the IMF. In essence, their responses have been well-couched, disingenuous and difficult to disprove. THIS response was NOT because of the sleuthing of Canada's Hepburn. Their constant lying finally caught up with them. The central bank of the Philippines responded to Hepburn as follows:

> "Beginning January 2000, in compliance with the requirements of the IMF's reserves and foreign currency liquidity template under the Special Data Dissemination Standard (SDDS), gold swaps undertaken by the BSP with non-central banks shall be treated as collateralized loan. Thus, gold under the swap arrangement remains to be part of reserves and a liability is deemed incurred corresponding to the proceeds of the swap."

In other words, the IMF instructed the central banks that even though the gold was gone, it should still be counted as part of their reserves. The central banks of Portugal, Finland and the ECB itself all confirmed the Philippine's response to Hepburn.

The GATA camp caught the IMF flagrantly deceiving the public. Since then, the IMF has refused to answer all follow-up questions from GATA supporters.

http://www.gata.org/neworleans.html

Central banks seem to have been secretly dumping gold into the market in order to depress its price. All of this is guesswork based on obscure statistics and a change in the IMF's reporting rules. But it would explain the failure of gold to hold above $300. I think GATA's analysis makes sense.

If this analysis is true, then we are seeing the greatest irony in the history of fractional reserve banking. Always before, the banks had taken in gold from the public, issuing IOU's to gold in exchange. Then the banks have loaned out IOU's to gold that they did not have in reserve. They drew interest on the loaned IOU's to gold. Then the banks defaulted, keeping the public's gold, refusing to redeem gold on demand. The governments of the world accepted this lawless transfer of gold officially to them, the governments.

OUT THE BACK DOOR

Today, we know that central banks have lent some of their nations' gold bullion to bullion banks for an interest payment of 1.3% per annum: the gold-lease rate. That was in 2002. These days, the rate is about 0.16% per year. This is posted on

http://www.thebulliondesk.com

Look to the right of "Top Reports." You will see buttons: "PGMs," "Charts (near)," etc. The eighth button is "Leases." Click it.

The bullion banks sell the borrowed gold into the private markets, receive money for it, and invest the money at the market rate of interest, which is above .37%. The bullion banks have told the central banks, "we'll repay, someday." The question of questions now is this: Can they ever repay? The gold is long gone. It's in some Indian bride's dowry.

The European central banks stole gold from the public in 1914 by revoking gold redeemability when World War I broke out. Now these banks have lent this gold to bullion banks for 1% per annum. Bullion banks have transferred ownership of this gold back to the public, paying 1% to the central banks for the privilege, plus a promise of repayment Real Soon Now. So, the masters of fractional reserves, central bankers, have been conned by the public's economic agents: the bullion bankers, who got the central banks to turn over the gold. The bullion banks have now issued IOU's to the central banks. They are "borrowed short": and "lent long." In short, the bullion banks have done

to the central banks what the commercial banks and central banks did to the public in 1914.

We the people have now got most of our gold back, and we don't even know it yet.

The exception seems to by the Federal reserve. It looks as though the FED has not leased its gold. But Turk's figures indicate that the FED may have swapped its gold for the Bundesbank's gold, and then the Bundesbank sold off 86% of the FED's gold. This means that the gold in storage at West Point -- "custodial gold" -- is exactly what the phrase indicates: we are keeping this gold for the Bundesbank.

The privately owned bullion banks are short: they have promised to return the central banks' gold at some future date. The major gold mines are also short: they have promised to repay gold out of production at some future date. In a January 23, 2002, report by John Hathaway, "The Investment Case for Gold," the author observes:

> Forward selling or hedging by gold companies to "lock in" margins is the antecedent of business practices adopted by Enron and other entities that prefer counter party to market risk. The architects of the gold industry's lamentable dalliance with derivatives will engineer grief well beyond the gold sector. Financial market exposure to interest rate and foreign exchange derivatives dwarfs the notional value of gold and commodity contracts. Gold derivative traders have laden the books of their host institutions with the financial equivalent of toxic waste dumps. The intellectual basis for the existing gold derivative books, representing at least 5000 tonnes, or two year's mine production, was a bearish view of gold and a uniformly bullish view of the dollar.

What happens to the price of gold when gold investors finally realize that the overhang of central bank gold is not there?

They may not recognize this for several years. But, at some point -- I believe within the next three years -- the central banks will cease selling gold every time its price rises above $300. [This turned out to be true -- so far (Canada excepted, which is almost out of gold) -- last year, when I was writing this report.] Their actual physical reserves are too depleted. If investors perceive that this is the central banks' new policy, gold will jump way above $300. At that point, the bullion banks, which are short, will be caught in a monumental squeeze. They will not be able to cover by buying gold futures, because

the physical gold is not available for delivery. This will leave them exposed to bankruptcy, and it will leave shorts on the futures market trapped.

What would happen on the gold futures market when everyone knows that there is not enough gold for delivery? Lock limit up. Lock limit up. Lock limit up. The gold futures market will not be where the gold shorts will want to be. Or anywhere else, for that matter.

If China starts selling dollars and taking delivery of gold, then there will be a crisis in the gold futures markets on the scale of January, 1980. This policy would be consistent with China's goal to become the dominant economic nation in Asia, replacing Japan.

CONCLUSION

If price deflation really is coming, despite monetary inflation, gold could fall. But I think today's monetary inflation will secure the U.S. economy against a price-deflationary scenario.

The other major negative factor, another series of unexpected gold sales by central banks, is increasingly unlikely. They are running out of gold, despite the official statistics on their unchanging official reserves. They can sell gold reserves again, but at some point, the game must end. We are closer to the end than five years ago, when the gold-leasing strategy was adopted. (***Remnant Review***: $129/12 issues: **800-528-0559**)

Chapter 11

CLICHES AGAINST GOLD

"Gold Is Just Another Commodity"

It's one thing to invest in gold. It's another to understand the logic of gold in a free economy. You should do both. But understanding the economic logic of is more important than investing in gold.

One of my goals in publishing this newsletter is to make the economics of gold clearer to people. If you don't understand why I recommend gold as an investment, you may decide to buy gold just because you take my word for it. Don't do this. Buy gold or gold-related investments such as North American gold shares only when you understand the economics behind gold.

If you finish reading this manual, you will become an expert on gold. Compared to everyone you know, you will be the expert.

Four decades ago, the Foundation for Economic Education (FEE), published a series of essays that were later assembled into a book, *Cliches of Socialism*. (It was later updated as "ClichΘs of Politics.") They were standard accusations against the free market. They were wrong-headed, but initially they sounded plausible. One by one, these essays refuted them.

I think it's worthwhile to assemble a few of the standard clichΘs against gold, and then offer answers.

Cliche #1: "Gold Is Just Another Commodity"

This is the equivalent of saying "Warren Buffett is just another stock market investor." In my day (and, I would argue, still), it would have been like saying, "Sophia Loren is just another woman." Or, in 1990, "Michael Jordan is just another basketball player."

Gold is a commodity. That's why it has functioned as money for thousands of years. Ludwig von Mises argued in his book, "The Theory of Money and Credit" (1912) that

money is the most marketable commodity. This is another way of saying that money is the most liquid asset. Liquidity consists of the following:

1. Instant sale without offering a discount
2. Instant sale without advertising costs
3. Instant sale without paying a commission

Historically, gold functioned as money. It no longer does. Gold is not liquid any longer. The general public has gotten used to credit money issued by banks. It is used to pieces of paper with dead politicians' pictures on them (United States) or live politicians's pictures (Third World countries), or a missing politician's picture (Iraq).

But until World War I led to the universal confiscation of depositors' gold by commercial banks, followed by the gold's confiscation from the commercial banks by the central banks, gold was money.

Why? Because gold had four crucial characteristics:

1. Divisibility
2. Transportability
3. Recognizability
4. High value in relation to volume and weight

Silver also possesses these features, but it has lower value in relation to volume and weight. It was used for smaller transactions.

Here is the ultimate fact of gold as money: it is cheaper to print pieces of paper than it is to mine gold. It is easier still to create digits in a computer.

OTHER COMMODITIES

Most other commodities are consumed in use. Gold, in its monetary function, is not consumed. Most of the world's above-ground gold is in vaults. It is used in exchange, but it is not used up.

Most other commodities wear out. Gold doesn't. It doesn't tarnish. An acid, aqua regia, destroys it, but nothing else does. Gold coins and bars at the bottom of the ocean can be salvaged and instantly put back into the economy. There is a ready

market for these coins.

Most other commodities are not the objects of nearly universal demand. The Spanish conquistadores found that gold was highly prized by the monarchs of the Indian empires in Mexico and South America.

Most other commodities do not have a "track record" of thousands of years. Gold does. It has been in high demand for as long as societies based on extensive trade have left records.

Most other commodities have not been political metals. Gold has. This is why the Roman emperors put their images and slogans on the empire's coins.

Nobody says, "it's as good as copper," let alone "it's as good as pork bellies."

The Bible says, "And Abram was very rich in cattle, in silver, and in gold" (Genesis 13:2). It did not mention platinum. As for the Bible's assessment of the value of wisdom,

> But where shall wisdom be found? and where is the place of understanding? Man knoweth not the price thereof; neither is it found in the land of the living. The depth saith, It is not in me: and the sea saith, It is not with me. It cannot be gotten for gold, neither shall silver be weighed for the price thereof. It cannot be valued with the gold of Ophir, with the precious onyx, or the sapphire. The gold and the crystal cannot equal it: and the exchange of it shall not be for jewels of fine gold (Job 28:12-17).

Not one reference to soybean oil!

A SPECIAL COMMODITY

Gold is used as jewelry. It is used for ornaments of great value. It is used in art, especially religious art. It is associated with God in many religions, probably because of the characteristics already mentioned, plus this one: it's brightness and color. It is associated with the sun, just as silver is associated with the moon.

This explains why gold and silver became money. Both metals were highly valued for reasons other than their use in exchange. They became valuable in exchange because they possessed value prior to their circulation as money. This was the insight of Professor

Mises, his “regression theorem” of money. This is why money was created by the market itself, not by kings.

When used as money, gold extended the market across borders. People on both sides of a border desired gold, irrespective of the image on the bar or coin (after 700 B.C.). It could be melted down and re-cast. Someone else’s image could be stamped on it.

Additional voluntary exchanges became possible because there was a ready market for gold. Thus, because gold was not just another commodity, it facilitated the extension of the division of labor. Men’s productivity rose because they could specialize in their work. They got better at whatever it was that they did for a living.

CENTRAL BANKERS’ MONEY

If gold is just another commodity, why do the world’s central bankers use it to settle final accounts? Why aren’t bars of some other commodity stored in the vault of the Federal Reserve Bank of New York. Why didn’t they make *Diehard III* about a heist of, say, hard red winter wheat?

Central bankers don’t trust each other. They know how easy it is to create money out of nothing. They hold dollar-denominated assets, such as U.S. Treasury-bills, because they can earn interest -- not much these days – but they settle their final accounts with each other in gold.

If gold were just another commodity, there would be greater flexibility in settling accounts. They could choose a different commodity. But they choose gold. They did throughout the 20th century, even during World War II. That’s why they created the Bank for International Settlements in Basle, Switzerland. Western and Nazi bankers met with each other because each side knew that without a money economy, it could not win the war. Gold is the base of the money economy in international trade.

There is talk about replacing the dollar with some other currency as the unit of account, i.e., the world’s reserve currency. But in the final settlements, gold is the world’s reserve currency. For central bankers gold is money. It has liquidity.

A RETURN TO GOLD

Gold bugs believe that there will be a voluntary return to the use of gold by the general public. The computerized technology now exists to create private money

systems based on gold -- digital gold. There can be 100% reserve banking. The digits allow us to make exchanges in the range of one dollar's purchasing power.

This doesn't mean that the public will necessarily adopt "gold cards," i.e., debit cards in gold -- to conduct their common economic affairs. It will probably take a breakdown of the present debt-based system monetary system to persuade the average Joe or Mitsuo to make the switch. The problem is, such a breakdown could involve the destruction of the entire credit system and therefore the exchange system, i.e., a vast contraction of the economy, which would drastically shrink the division of labor and with it, specialization of production. This would involve gridlock: Bank A could not settle accounts with Bank B until Banks C and D settled with Bank A. Greenspan called this disaster "cascading cross defaults."

http://snipurl.com/awo4

Perhaps a major country, such a China, will restore currency convertability into gold. This would surely make China's currency the world's new reserve currency. But it would place people at risk, since the government could suspend convertibility at any time. This is what governments invariably do when gold runs begin. I do not expect a return to a gold coin standard in my lifetime, but I do expect it eventually. The free market can offer a better product than any government can. This is as true of money as it is of any other mass-produced product. The money of preference historically has been a commodity, and gold has been the favored commodity for large transactions. Silver and copper are in second and third place, respectively.

CONCLUSION

Anyone who says that gold is just another commodity is ignorant of the history of money. He is spouting a cliche, not making an argument.

Chapter 12

CLICHES AGAINST GOLD

"There Isn't Enough Gold"

One of the standard arguments against a gold standard is this: "There's not enough gold to facilitate all of the transactions in a free market economy." This is an old criticism. It was a lot more popular before the desktop computer industry started cutting prices every year, while increasing product quality. These days, people expect falling prices in desktop computers.

What if they expected price cuts in all other industries?

If you have ever wondered what would happen if a relatively fixed supply of above-ground gold were the primary medium of exchange, this essay may help clarify things.

This essay is long. It may seem boring. My view is this: when your economic future is at stake, it's never boring.

Most people have no conception of what you are about to read. They are not interested. They don't know that their futures will depend heavily on the answers to these questions that will be adopted by the Federal Reserve System's policy-makers. They think, "I can't be bothered with monetary theory." Therein lies your investment opportunity.

You may want to print out this issue and read it later, with a yellow marker in hand.

Cliche #2: "There Isn't Enough Gold"

> It would appear that the reasons commonly advanced as a proof that the quantity of the circulating medium should vary as production increases or decreases are entirely unfounded. It would appear also that the fall of prices proportionate to the increase in productivity, which necessarily follows when, the amount of money remaining the same, production increases, is not only entirely harmless, but in fact the only means of avoiding misdirections of production. (F. A. Hayek, *Prices and Production*" (1931),

p. 105)

What Professor Hayek wrote in 1931 was not accepted then, and it is not accepted today. Note: it would take over $1,200 to match the purchasing power of $100 in 1931, according to the **inflation calculator** of the U.S. government's Bureau of Labor Statistics.

http://www.bls.gov

If policy-makers had listened to him, we might be able to buy for $25 what it took $100 to buy in 1931. That is because economic growth has continued steadily since 1931.

THE GOAL OF ECONOMIC GROWTH

Economic growth is one of the chief fetishes of modern life. Hardly anyone would challenge the contemporary commitment to the aggregate expansion of goods and services. This is true of socialists, interventionists, and free enterprise advocates; if it is a question of "more" as opposed to "less," the demonstrated preference of the vast bulk of humanity is in favor of the former.

To keep the idea of growth from becoming the modern equivalent of the holy grail, the supporter of the free market is forced to add certain key qualifications to the general demand for expansion.

> First, that all costs of the growth process be paid for by those who by virtue of their ownership of the means of production gain access to the fruits of production. This implies that society has the right to protect itself from unwanted "spill over" effects like pollution, i.e., that the so-called social costs be converted into private costs whenever possible.
> Second, that economic growth be induced by the voluntary activities of men cooperating on a private market. The state-sponsored projects of "growthmanship," especially growth induced through inflationary deficit budgets, are to be avoided.
>
> Third, that growth not be viewed as a potentially unlimited process over time, as if resources were in unlimited supply.

In short, aggregate economic growth should be theproduct of the activities of individual men and firmsacting in concert according to the impersonal dictates of

acompetitive market economy. It should be the goal of national governments only in the limited sense of policiesthat favor individual initiative and the smooth operationof the market, such as legal guarantees supportingvoluntary contracts, the prohibition of violence, and so forth.

MONETARY POLICY

The “and so forth” is a constant source of intellectual as well as political conflict.

One of the more heated areas of contention among free market economists is the issue of monetary policy. The majority of those calling themselves free market economists believe that monetary policy should not be the autonomous creation of voluntary market agreements. Instead, they favor various governmental or quasi-governmental policies that would oversee the creation of money and credit on a national, centralized scale.

Monetary policy in this perspective is an “exogenous factor” in the marketplace -- something that the market must respond to rather than an internally produced, “endogenous factor” that stems from the market itself. The money supply is therefore supposedly indirectly related to market processes; it is controlled by the central governments acting through the central bank, or else it is the automatic creation of a central bank on a fixed percentage increase per day and therefore not subject to “fine-tuning” operations of the political authorities.

A smaller number of free market advocates (myself among them) are convinced that such monopoly powers of money creation are going to be used. Power is never neutral; it is exercised according to the value standards of those who possess it. Money is power, for it enables the bearer to purchase the tools of power, whether guns or votes.

Governments have an almost insatiable lust for power, or at least for the right to exercise power. If they are granted the right to finance political expenditures through deficits in the visible tax schedules, they are empowered to redistribute wealth in the direction of the state through the invisible tax of inflation.

Money, given this fear of the political monopoly of the state, should ideally be the creation of market forces. Whatever scarce economic goods that men voluntarily use as a means of facilitating market exchanges-goods that are
durable, divisible, transportable, and above all scarce -- are sufficient to allow men to

cooperate in economic production. Money came into existence this way; the state only sanctioned an already prevalent practice. Generally, the two goods that have functioned best as money have been gold and silver: they both possess great historic value, though not intrinsic value (since no commodity possesses intrinsic value).

Banking, of course, also provides for the creation of new money. But as Ludwig von Mises argued, truly competitive banking -- free banking -- keeps the creation of new credit at a minimum, since bankers do not really trust each other, and they will demand payment in gold or silver from banks that are suspected of insolvency.

Thus, the creation of new money on a free market would stem primarily from the discoveries of new ore deposits or new metallurgical techniques that would make available greater supplies of scarce money metals than would have been economically feasible before. It is quite possible to imagine a free market system operating in terms of nonpolitical money. The principle of voluntarism should not be excluded, a priori, from the realm of monetary policy.

SOVEREIGNTY, EFFICIENCY, CATASTROPHE

There are several crucial issues involved in the theoretical dispute between those favoring centralized monetary control and free market voluntarists.

> First, the question of constitutional sovereignty: Which sphere, civil government or the market, is responsible for the administration of money?
>
> Second, the question of economic efficiency: Would the plurality of market institutions interfere with the creation of a rational monetary framework?
>
> Third, and most important for this chapter: Is not a fundamental requirement for the growth of economic production the creation of a money supply sufficient to keep pace, proportionately, with aggregate productivity?

The constitutional question, historically, is easier to answer than the other two. The Constitution says very little about the governing of monetary affairs. The Congress is granted the authority to borrow money on the credit of the United States, a factor which has subsequently become an engine of inflation, given the legalized position

of the central bank in its activity of money creation. The Congress also has the power "To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures" (Article 11, Section 8). Furthermore, the states are prohibited to coin money, emit bills of credit, or "make any Thing but gold and silver Coin a Tender in Payment of Debts" (Article II, Section 9).

THE CONSTITUTIONAL QUESTION

The interpretation of these passages has become increasingly statist since the 1860's. Gerald T. Dunne describes his book, *Monetary Decisions of the Supreme Court*, in these terms: "This work traces a series of decisions of the Supreme Court which have raised the monetary power of the United States government from relative insignificance to almost unlimited authority." He goes on to write: ". . . the Founding Fathers regarded political control of monetary institutions with an abhorrence born of bitter experience, and they seriously considered writing a sharp limitation on such governmental activity into the Constitution itself. Yet they did not, and by "speaking in silences" gave the government they founded the near absolute authority over currency and coinage that has always been considered the necessary consequence of national sovereignty."

The most detailed study of the changing views of the Supreme Court is the 1,600-page book by Edwin Viera, *Pieces of Eight*. He is a Harvard-trained lawyer and a first-rate monetary theorist. He shows how the original dollar was based on a free market currency, the Spanish "piece of eight," which was silver.

The great push toward centralization came, understandably, with the Civil War, the first truly modern total war, with its need of new taxes and new power. From that point on, there has been a continual war of the Federal government against the limitations imposed by a full gold coin standard of money. It is all too clearly an issue of sovereignty: the sovereignty of the political sphere against that of individuals operating in terms of voluntary economic transactions.

THE MATTER OF EFFICIENCY

The second question is more difficult to answer. Would the plurality of monetary sovereignties within the over-all sovereignty of a competitive market necessarily be less efficient than a money system created by central political sovereignty? As a corollary, are

the time, capital, and energy expended in gold and silver mining worse spent than if they had gone into the production of consumer goods?

In the short run and in certain localized areas, plural monetary sovereignties might not be competitive. A local bank could conceivably flood a local region with unbacked fiat currency. But these so-called wildcat banking operations, unless legally sanctioned by state fractional reserve licenses (deceptively called limitations), do not last very long. People discount the value of these flat bills, or else make a run on the bank's vaults. The bank is not shielded by political sovereignty against the demands of its creditors. In the long run it must stay competitive, earning its income from services rather than the creation of fiat money. With the development of modern communications that are almost instantaneous in nature, frauds of this kind become more difficult.

The free market is astoundingly efficient in communicating knowledge, The activity of the stock market, for example, in response to new information about a government policy or a new discovery, indicates the speed of the transfer of knowledge, as prices are rapidly raised or lowered in terms of the discounted value that is expected to accrue because of the new conditions. The very flexibility of prices allows new information to be assimilated in an economically efficient manner. Why, then, are changes affecting the value of the various monetary units assumed to be less efficiently transmitted by the free market's mechanism than by the political sovereign? Why is the enforced stability of fixed monetary ratios so very efficient and the enforced stability of fixed prices on any other market so embarrassingly inefficient? Why is the market incapable of arbitrating the value of gold and silver coins (domestic vs. domestic, domestic vs. foreign), when it is thought to be so efficient at arbitrating the value of gold and silver jewelry? Why is the market incapable of registering efficiently the value of gold in comparison to a currency supposedly fixed in relation to gold?

THE FREE MARKET'S WAY

The answer should be obvious: it is because the market is so efficient at registering subtle shifts in values between scarce economic goods that the political sovereigns ban the establishment of plural monetary sovereignties. It is because any disparity economically between the value of fiat currency supposedly linked to gold and the market value of gold exposes the ludicrous nature of the hypothetical legal connection, which in fact is a legal fiction, that the political sovereignty assumes for itself a monopoly of money creation.

It is not the inefficiency of the market in registering the value of money but rather its incomparable efficiency that has led to its position of imposed isolation in monetary affairs. Legal fictions are far more difficult to impose on men if the absurdity of that fiction is exposed, hour by hour, by an autonomous free market mechanism.

Would there not be a chaos of competing coins, weights, and fineness of monies? Perhaps, for brief periods of time and in local, semi-isolated regions. But the market has been able to produce light bulbs that fit into sockets throughout America, and plugs that fit into wall sockets, and railroad tracks that match many companies' engines and cars. To state, a priori, that the market is incapable of regulating coins equally well is, at best, a dangerous statement that is protected from critical examination only by the empirical fact of our contemporary political affairs.

Changes in the stock of gold and silver are generally slow. Changes in the "velocity of money" -- the number of exchanges within a given time period-are also slow, unless the public expects some drastic change, like a devaluation of the monetary unit by the political authority. These changes can be predicted within calculable limits; in short, the economic impact of such changes can be discounted. They are relatively fixed in magnitude in comparison to the flexibility provided by a government printing press or a central bank's brand new IBM computer. The limits imposed by the costs of mining provide a continuity to economic affairs compared to which the "rational planning" of central political authorities is laughable.

What the costs of mining produce for society is a restrained state. We expend time and capital and energy in order to dig metals out of the ground. Some of these metals can be used for ornament, or electronic circuits, or for exchange purposes; the market tells men what each use is worth to his fellows, and the seller can respond accordingly. The existence of a free coinage restrains the capabilities of political authorities to redistribute wealth, through fiat money creation, in the direction of the state. That such a restraint might be available for the few millions spent in mining gold and silver out of the ground represents the greatest potential economic and political bargain in the history of man. To paraphrase another patriot: "Millions for mining, but not one cent in tribute."

POSSIBILITIES OF PREDICTION

By reducing the parameters of the money supply by limiting money to those scarce economic goods accepted voluntarily in exchange, prediction becomes a real possibility.

Prices are the fr ee market's greatest achievement in reducing the irrationality of human affairs. They enable us to predict the future.

Profits reward the successful predictors, while losses greet the inefficient forecasters, thus reducing the extent of their influence. The subtle day-to-day shifts in the value of the various monies would, like the equally subtle day-to-day shifts in value of all other goods and services, be reflected in the various prices of monies, vis-a-vis each other.

Professional speculators (predictors) could act as arbitrators between monies. The price of buying pounds sterling or silver dollars with my gold dollar would be available on request, probably published daily in the newspaper. Since any price today reflects the supply and demand of the two goods to be exchanged, and since this in turn reflects the expectations of all participants of the value of the items in the future, discounted to the present, free pricing brings thousands and even millions of forecasters into the market.

Every price reflects the composite of all predictors' expectations. What better means could men devise to unlock the secrets of the future? Yet monetary centralists would have us believe that in monetary affairs, the state's experts are the best source of economic continuity, and that they are more efficient in setting the value of currencies as they relate to each other than the market could be.

What we find in the price-fixing of currencies is exactly what we find in the price-fixing of all other commodities: Periods of inflexible, politically imposed "stability" interspersed with great economic discontinuities. The old price shifts to some wholly new, wholly unpredictable, politically imposed price, for which few men have been able to take precautions. It is a rigid stability broken by radical shifts to some new rigidity. It has nothing to do with the fluid continuity of flexible market pricing. Discontinuous "stability" is the plaque of politically imposed prices, as devaluations come in response to some disastrous political necessity, often internationally centered, involving the prestige of many national governments. It brings the rule of law into disrepute, both domestically and internationally. Sooner or later domestic inflation comes into conflict with the requirements of international solvency.

For those who prefer tidal waves to the splashing of the surf, for those who prefer earthquakes to slowly shifting earth movements, the rationale of the political monopoly of money may appear sane. It is strange that anyone else believes in it. Instead of the localized discontinuities associated with private counterfeiting, the

state's planners substitute complete, centralized discontinuities, the predictable market losses of fraud (which can be insured against for a fee) are regarded as intolerable, yet periodic national monetary catastrophes like inflation, depression, and devaluation are accepted as the "inevitable" costs of creative capitalism. it is a peculiar ideology.

FLEXIBLE VS. INFLEXIBLE PRICES

The third problem seems to baffle many well-meaning free market supporters. How can a privately established monetary system linked to gold and silver expand rapidly enough to facilitate business in a modern economy? How can new gold and silver enter the market rapidly enough to "keep pace," proportionately, with an expanding number of free market transactions?

The answer seems too obvious: the expansion of a specie-founded currency system cannot possibly grow as fast as business has grown in the last century. Since the answer is so obvious, something must be wrong with the question. There is something wrong; it has to do with the invariable underlying assumption of the question: today's prices are downwardly inflexible.

It is a fact that many prices are inflexible in a downward direction, or at least very, very "sticky." For example, wages in industries covered by minimum wage legislation are as downwardly inflexible as the legislatures that have set them. Furthermore, wages in industries covered by the labor union provisions of the Wagner Act of 1935 are downwardly inflexible, for such unions are legally permitted to exclude competing laborers who would work for lower wages. Products that come under laws establishing "fair trade" prices, or products undergirded by price floors established by law, are not responsive to economic conditions requiring a downward revision of prices. The common feature of the majority of downwardly inflexible prices is the intervention of the political sovereignty.

The logic of economic expansion should be clear enough: if it takes place within a relatively fixed monetary structure, either the velocity of money will increase (and there are limits here) or else prices in the aggregate will have to fall. If prices are not permitted to fall, then many factors of production will be found to be uneconomic and therefore unemployable. The evidence in favor of this law of economics is found every time a depression comes around (and they come around just as regularly as the gvernment-ponsored monetary expansions that invariably precede them). Few people interpret the evidence intelligently.

Labor union leaders do not like unemployed members. They do not care very much about unemployed nonmembers, since these men are unemployed in order to permit the higher wages of those within the union. Business owners and managers do not like to see unemployed capital, but they want high rates of return on their capital investments even if it should mean bankruptcy for competitors. So, when falling prices appear necessary for a marginal firm to stay competitive, but when it is not efficient enough to compete in terms of the new lower prices for its products, the appeal goes out to the state for "protection." Protection is needed from nasty customers who are going to spend their hard-earned cash or credit elsewhere.

Each group resists lower returns on its investment -- labor or financial -- even in the face of the biggest risk of all: total unemployment. And if the state intervenes to protect these vested interests, it is forced to take steps to insure the continued operation of the firms.

It does so through the means of an expansion of the money supply. It steps in to set up price and wage floors; for example, the work of the NRA (National Recovery Administration) in the early years of the Roosevelt administration. Then the inflation of the money supply raises aggregate prices (or at least keeps them from falling), lowers the real income from the fixed money returns, and therefore "saves" business and labor. This was the "genius" of the Keynesian recovery, only it took the psychological inducement of total war to allow the governments to inflate the currencies sufficiently to reduce real wages sufficiently to keep all employed, while simultaneously creating an atmosphere favoring the imposition of price and wage controls in order to "repress" the visible signs of the inflation, i.e., even higher money prices. So prices no longer allocated efficiently; ration stamps, priority slips ' and other "hunting licenses" took the place of an integrated market pricing system. So did the black market.

REPRESSED DEPRESSION

Postwar inflationary pressures have prevented us from falling into reality. Citizens will not face the possibility that the depression of the 1930's is being repressed through the expansion of the money supply, an expansion which is now threatening to become exponential. No, we seem to prefer the blight of inflation to the necessity of an orderly, generally predictable downward drift of aggregate prices. Most people resist change. That, in spite of the hopes and footnoted articles by liberal sociologists who enjoy the security of tenure.

Those people who do welcome change have in mind familiar change, potentially controllable change, change that does not rush in with destruction. Stability, law, order: these are the catchwords even in our own culture, a culture that has thrived on change so extensive that nothing in the history of man can compare with it. It should not be surprising that the siren's slogan of "a stable price level" should have lured so many into the rocks of economic inflexibility and monetary inflation.

Yet a stable price level requires, logically, stable conditions: static tastes, static technology, static resources, static population. In short, stable prices demand the end of history. The same people who demand stable prices, whether socialist, interventionist, or monetarist, simultaneously call for increased economic production. What they want is the fulfillment of that vision restricted to the drunken of the Old Testament: ". . . tomorrow shall be as this day, and much more abundant" (Isaiah 56:12). The fantasy is still fantasy; tomorrow will not be as today, and neither will tomorrow's price structure.

Fantasy in economic affairs can lead to present euphoria and ultimate miscalculation. Prices change. Tastes change. Productivity changes. To interfere with those changes is to reduce the efficiency of the market; only if your goal is to reduce market efficiency would the imposition of controls be rational. To argue that upward prices, downward prices, or stable prices should be the proper arrangement for any industry over time is to argue nonsense. An official price can be imposed for a time, of course, but the result is the misallocation of scarce resources, a misallocation that is mitigated only by the creation of a black market.

STABLE PRICES

There is one sense in which the concept of stable prices has validity. Prices on a free market ought to change in a stable, generally predictable, continuous manner. Price (or quality) changes should be continual (since economic conditions change) and hopefully continuous (as distinguished from discontinuous, radical) in nature. Only if some exogenous catastrophe strikes the society should the market display radical shifts in pricing, Monetary policy, ideally, should contribute no discontinuities of its own -- no disastrous, aggregate unpredictabilities. This is the only social stability worth preserving in life: the stability of reasonably predictable change.

The free market, by decentralizing the decision-making process, by rewarding the successful predictors and eliminating (or at least restricting the economic power of) the inefficient forecasters, and by providing a whole complex of markets, including specialized markets of valuable information of many kinds, is perhaps the greatest engine

of economic continuity ever developed by men. That continuity is its genius. It is a continuity based, ultimately, on its flexibility in pricing its scarce economic resources. To destroy that flexibility is to invite disaster.

The myth of the stable price level has captured the minds of the inflationists, who seek to impose price and wage controls in order to reduce the visibility of the effects of monetary expansion. On the other hand, stable prices have appeared as economic nirvana to conservatives who have thought it important to oppose price inflation. They have mistaken a tactical slogan-stable prices-for thestrategic goal. They have lost sight of the true requirement of a free market, namely, flexible prices. They have joined forces with Keynesians and neo-Keynesians; they all want to enforce stability on the "bad" increasing prices (labor costs if you're a conservative, consumer prices if you're a liberal), and they want few restraints on the "good" upward prices (welfare benefits if you're a liberal, the Dow Jones average if you're a conservative). Everyone is willing to call in the assistance of the state's authorities in order to guarantee these effects. The authorities respond.

What we see is the "ratchet effect." A wage or price once attained for any length of time sufficient to convince the beneficiaries that such a return is "normal" cannot, by agreed definition, be lowered again. The price cannot slip back. It must be defended. It must be supported. It becomes an ethical imperative. Then it becomes the object of a political campaign. At that point the market is threatened.

IN DEFENSE OF THE FREE MARKET

The defense of the free market must be in terms of its capacity to expand the range of choices open to freemen. It is an ethical defense. Economic growth that does not expand the range of men's choices is a false hope. The goal is not simply the expansion of the aggregate number of goods and services. It is no doubt true that the free market is the best means of expanding output and increasing efficiency, but it is change that is constant in human life, not expansion or linear development. There are limits on secular expansion.

Still, it is reasonable to expect that the growth in the number of goods and services in a free market will exceed the number of new gold and silver discoveries. If so, then it is equally reasonable to expect to see prices in the aggregate in a slow decline. In fact, by calling for increased production, we are calling for lower prices, if the market is to clear itself of all goods and services offered for sale. Falling prices are no less desirable in the

aggregate than increasing aggregate productivity. They are economic complements.

Businessmen are frequently heard to say that their employees are incapable of understanding that money wages are not the important thing, but real income is. Yet these same employers seem incapable of comprehending that profits are not dependent upon an increasing aggregate price level.

It does not matter for aggregate profits whether the price level is falling, rising, or stable. What does matter is the entrepreneur's ability to forecast future economic conditions, including the direction of prices relevant to his business.

Every price today includes a component based on the forecast of buyer and seller concerning the state of conditions in the future. If a man on a fixed income wants to buy a product, and he expects the price to rise tomorrow, he logically should buy today; if he expects the price to fall, he should wait. Thus, the key to economic success is the accuracy of one's discounting, for every price reflects in part the future price, discounted to the present. The aggregate level of prices is irrelevant; what is relevant is one's ability to forecast particular prices.

It is quite likely that a falling price level (due to increased production of non-monetary goods and services) would require more monetary units of a smaller denomination. But this is not the same as an increase of the aggregate money supply. It is not monetary inflation. Four quarters can be added to the money supply without inflation, just as long as paper one dollar bill is destroyed. The effects are not the same as a simple addition of the four quarters to the money supply.

The first example conveys no increase of purchasing power to anyone; the second does. In the first example, no one on a fixed income has to face an increased price level or an empty space on a store's shelf due to someone else's purchase. The second example forces a redistribution of wealth, from the man who did not have access to the four new quarters into the possession of the man who did, The first example does not set up a boom-bust cycle; the second does.

Prices in the aggregate can fall to zero only if scarcity is entirely eliminated from the world, i.e, if all demand can be met for all goods and services at zero price.
That is not our world. Thus, we can safely assume that prices will not fall to zero. We can also assume that there are limits on production. The same set of facts assures both results: scarcity guarantees a limit on falling prices and a limit on aggregate production. But there is nothing incompatible between economic growth and falling prices. Far from being

incompatible, they are complementary. There should be no need to call for an expansion of the money supply "at a rate proportional to increasing productivity."

It is a good thing that such an expansion is not necessary, since it would be impossible to measure such proportional rates. It would require whole armies of government-paid statisticians to construct an infinite number of price indexes. If this were possible, then socialism would be as efficient as the free market. Infinite knowledge is not given to men, not even to government statistical boards. Even Arthur Ross, the Department of Labor's commissioner of labor statistics, and a man who thinks the index number is a usable device, has to admit that it is an inexact science at best. Government statistical indexes are used, in the last analysis, to expand the government's control of economic affairs. That is why the government needs so many statistics.

CONCLUSION

The quest for the neutral monetary system, the commodity dollar, price index money, and all other variations on this theme has been as fruitless a quest as socialists, Keynesians, social credit advocates, and government statisticians have ever embarked on. It presupposes a sovereign political state with a monopoly of money creation. It presupposes an omniscience on the part of the state and its functionaries that is utopian. It has awarded to the state, by default, the right to control the central mechanism of all modern market transactions, the money supply. It has led to the nightmare of inflation that has plagued the modern world, just as this same sovereignty plagued Rome in its declining years.

In the case of ancient Rome, it was a reasonable claim, given the theological presupposition of the ancient world (excluding the Hebrews and the Christians) that the state is divine, either in and of itself or as a function of the divinity of the ruler. Rulers were theoretically omniscient in those days. Even with their supposed omniscience, their monetary systems were subject to ruinous collapse.

Odd that men today would expect a better showing from an officially secular state that recognizes no divinity over it or under it. Then again, perhaps a state like this assumes the function of the older, theocratic state. It recognizes no sovereignty apart from itself. And like the ancient kingdoms, the sign of sovereignty is exhibited in the monopoly over money.

Chapter 13

EXCHANGE RATES AND GOLD

Back in the 1960's, an academic debate began over currency exchange rates. Milton Friedman championed the idea of floating exchange rates, i.e., the abolition of government-imposed price controls on currencies.

This was an intellectual assault on the Bretton Woods (a New Hampshire hotel) agreement of 1944, which established the International Monetary Fund. Member nations of the IMF were supposed to maintain fixed exchange rates with other member nations. Nations would hold dollars as well as gold as their monetary reserves. Dollar-denominated U.S. Treasury securities paid interest. Gold didn't. The Americans who negotiated the IMF expected the agreement to increase demand for U.S. Treasury securities. It did.

The IMF also promised to lend dollars to any member nation that was experiencing a run on its dollar reserves, but only if that nation met certain IMF requirements. The IMF's loan was to give the besieged nation's central bankers some breathing room until they could reduce the rate of monetary expansion and thereby create a recession. This recession would ideally lead to lower domestic prices -- waves of bankruptcies produce that effect, after all -- which would make the nation's goods attractive to foreign buyers, who would cease bringing in the nation's currency and demanding dollars. Thus, the nation's central bank would not have to float its currency, i.e., cease providing dollars on demand at the older fixed rate.

No member nation was supposed to float its currency in the international currency markets. Fixed exchange rates were sacrosanct. This really meant that the various currencies' fixed exchange rates with the dollar were sacrosanct.

But why are fixed rates ever sacrosanct? The prices of most goods are left free to rise or fall in terms of supply and demand. Why should currencies be different? This was Friedman's rhetorical question. It was a reasonable question.

Defenders of fixed exchange rates had no intellectually viable answers. They sometimes tried, but they always wound up sounding like apologists for the wisdom of a government bureaucracy in fixing prices. Of course, this is exactly what they were, but to be exposed publicly for what they were was embarrassing for many of them.

Fixed exchange rates with the dollar meant that the Federal Reserve System could

crank up the printing press and force every other IMF member nation to crank up its printing presses. The dollar was the world's reserve currency. Thus, despite domestic monetary expansion, the dollar would maintain its value internationally, while the newly created money could keep the American economic boom
going strong.

When all the world wanted dollars after World War II, nobody complained. In the late 1950's, however, a few free market economists, most notably Jacques Rueff and Wilhelm Röpke, put a name on the process: exported inflation.

NIXON'S THE ONE!

On Sunday, August 15, 1971, President Nixon unilaterally announced the "closing of the gold window," i.e., the repudiation of America's promise in the Bretton Woods agreement to allow foreign governments and central banks to redeem dollars for gold at $35/oz. This promise was the heart of the original agreement. It made the dollar a substitute for gold. It made the dollar "as good as gold." It encouraged foreign central banks to buy dollar-denominated Treasury debt certificates instead of holding gold.

The IMF was an extension of the Genoa Conference of 1922, where European nations formally abandoned the pre-World War I gold standard, substituting British pounds or dollars for gold. This was a major step in freeing central banks from runs on their gold by other central banks. Each of the national central banks had stolen the gold from its nation's commercial banks after World War I broke out. The commercial banks had been granted the right to break contract and not redeem gold on demand by depositors. The central banks did to the commercial banks what the commercial banks had done to their depositors.

Nixon then did to the central banks what they had done to their commercial banks. The Federal Reserve System wound up with the largest hoard of gold on earth, which it holds on deposit for the U.S. government, or so the official explanation goes.

Nixon that same day also floated the dollar. Simultaneously, he froze most wages and prices. That is, he abandoned price controls over money and imposed them on everything else. This was economic schizophrenia. The National Association of Manufacturers and the U.S. Chamber of Commerce immediately applauded Nixon's decision. A Democrat-run Congress did not oppose him, either.

Nixon in 1971 was presiding over a recession. For each of the two years, fiscal 1970 and 1971 (which ended on September 30), his administration ran a deficit of $25 billion, which was considered huge in those quaint days. The Federal Reserve System was pumping in money to get the economy rolling, as usual. Prices were rising rapidly. A gold run had developed.

Nixon dealt with all of this by breaking America's contract with foreign central banks and by outlawing all new private contracts at prices higher than those that prevailed on August 15. In short, he put his World War II background as a bureaucrat with the Office of Price Administration to contract-undermining use.

According to the Inflation Calculator on the home page of the website of the U.S. government's Bureau of Labor Statistics (**www.bls.gov**), it takes over $4,700 today to purchase what $1,000 purchased in 1971.

THE OLD ASSUMPTIONS

The Genoa agreement was designed to square the circle. Its goal was to re-establish the pre-War stability of currency exchange rates, but without the use of gold. Currencies were to remain stable against each other, but without the public's legal right of convertibility of currency into gold at a fixed rate of exchange.

Governments wanted the fruits of the traditional gold standard, but without the roots. They wanted stable exchange rates based on fiat currencies. The gold coin standard had provided fixed exchange rates based on a legal contract: full redeemability on demand at a fixed rate.

The pre-War exchange rates among currencies were the result of fixed exchange rates between gold and each national currency. The fixed rate of exchange, gold vs. any national currency, was not officially a price control. It was a contractual agreement between the central bank and anyone holding the nation's currency.

If you hand over your dog for me to keep for you when you go on a trip, and I hand you an IOU for your dog, there is no price control. There is a legal relationship. My IOU isn't the same as your dog, but it establishes the fact that your dog is in my possession. Legally, you can get your dog back on demand when you present the IOU to me.

If the government then declares that collies are the same as bassets hounds, and you have given me your collie for safekeeping, I can now legally return a basset hound to you.

A price control is not the same as a warehouse receipt. A warehouse receipt for an ounce of 24-karat gold in exchange for ten shekels will circulate at a one-to-one fixed rate with a receipt for an ounce of 24-karat gold for ten denarii. There is no price control. The free market establishes a fixed rate of exchange between shekels and denarii. The fixed exchange rate is the product of fixed rates of exchange between denarii and gold and shekels and gold. As we learned in high school geometry, and occasionally actually remember, “things equal to the same thing are equal to each other.”

The Genoa agreement converted what had been a desirable outcome (stable prices among currencies) of a system of voluntary contracts (free convertibility of gold) into a system of price controls. It officially abolished internationally what had been abolished nationally in 1914 by every country involved in World War I: the redemption of currencies for gold. It substituted currencies for actual gold held in central bank vaults. Nations (central banks) henceforth would hold British pounds or the U.S. dollar instead of gold. This was agreed to even before Britain returned to gold, at the pre-War exchange rate, in 1925. Nations were expected to honor fixed exchange rates.

In fact, most nations continued to accumulate gold. The central bankers did not trust each other.

Fast forward. The Bretton Woods agreement worked from 1946, when the 1944 agreement was implemented, to 1971 because the United States had possession of most of the West’s gold. The United States had come out of World War II as the leading economy on earth. Its currency was trusted by central bankers because (1) the U.S. government promised full redeemability, and (2) the U.S. economy had so many goods for sale. Foreigners wanted dollars to buy things made in America. Only in the late 1950's did the sporadic run on U.S. gold reserves begin.

The old assumption -- the desirability of stable currency exchange rates -- still reigned, but the faith that sustained it had been abandoned: the right of anyone holding a nation’s currency to exchange it at a fixed rate for gold. Because the world’s currencies were not individually governed by fixed exchange rates with gold, the system of fixed exchange rates among currencies was not a free market phenomenon. It was a price control system. It was basset hounds = collies.

Stable exchange rates among currencies in a world without legally enforceable exchange rates between each currency and gold are like stable marriages without legally enforceable marriage covenants. Politicians want the benefits of stable currencies, while escaping runs on central bank gold reserves due to domestic monetary expansion, which they don't want to abandon. They also want their wives to show up at their campaign rallies, while they are having affairs with their 22-year-old aides, which they also don't want to abandon -- this week, anyway.

FRIEDMAN WAS RIGHT, SORT OF

Friedman was correct in identifying the inherent futility of fixed exchange rates in a world of fiat currencies. He saw that fixed exchange rates are merely a species of price control: price control on non-specie currencies.

Price controls always lead to a shortage of the good whose price is set by the government below the free market price. Friedman was hardly the first economist to observe this. Sir Thomas Gresham got there first in the late sixteenth century: "Bad money drives out good money," as his famous law has come down to us.

It is not that Friedman was a genius in spotting the obvious, namely, that fixed exchange rates are price controls. What is astounding in retrospect is that his academic opponents were utterly blind regarding price controls placed on currencies, despite their Ph.D.'s in economics. They had accepted the economic logic of free markets, but then they halted at the door of the International Monetary Fund. "All ye who enter here, abandon price theory."

What is not widely perceived is this: Friedman abandoned price theory at the door of the Federal Reserve System. He has always opposed the gold coin standard. He regards resources spent in digging gold out of the earth as wasted whenever this gold is put in central bank vaults, which are also usually below ground.

Friedman has understood the theory behind the ideal of a state-free gold coin standard. He has even admitted that it is a good system in theory. Unfortunately, he says, it is just not feasible. It has never existed. (See his 1961 book, *Capitalism and Freedom*, p. 41.)

The economic pragmatism of the Chicago School is too often like gold plating on lead slugs. Nowhere is this pragmatism clearer than in Friedman's theory of money. He

wrote the following in 1961, and has never retracted it.

> My conclusion is that an automatic commodity standard is neither a feasible nor a desirable solution to the problem of establishing monetary arrangements for a free society. It is not desirable because it would involve a large cost in the form of resources used to produce the monetary commodity. It is not feasible because of the mythology and beliefs required to make it effective do not exist. (*Ibid*., p. 42).

Yet this same two-fold argument can be brought against every other pricing system in a free market society, and has been. He rejects the gold standard because it cannot be achieved at zero price (free resources), which is the classic argument of the Marxists and utopians against free market capitalism in general. He also rejects the gold standard because people don't have faith in it, which is the classic argument of the anti-market socialists, i.e., the free market as the product of a corporate act of faith rather than the product of the right of individual ownership and contract.

The problem is not the public's lack of faith in the gold standard. The problem is the public's lack of faith in the binding nature of voluntary contracts. Voters repeatedly have allowed the state and its licensed agents to break their contracts and confiscate individuals' gold. The gold standard was the result of voluntary contracts: *warehouse receipts for gold*. Any gold standard that is not the product of voluntary contracts is just one more scheme by fractional reserve bankers or government officials to confiscate gold from naive depositors.

If gold were stored in private vaults as legal reserves to back up warehouse receipts for gold, the system would place great restraints on the civil government. The state would not have a monopoly over the currency. The best situation would be where no state had any currency of its own, and could therefore not seek to manipulate its supply or its value. Under such conditions, the money spent on mining gold would be cheap insurance against expanding government control over the lives of its citizens.

A gold coin standard, coupled with 100% reserve banking and the abolition of government currencies, would place golden chains on the state. This is the reason why the state has always demanded sovereignty over money. The war against economic freedom always begins with the state's assertion of sovereignty over money. That Friedman and all of the other academic guild-certified free market economists cannot see this is testimony to the effects of government propaganda. Repeat the mantra long enough -- "state sovereignty over money" -- and even intelligent people will not be able to accept

the truth. What is the truth? That the state can no more be trusted in monetary affairs than it can be trusted in educational affairs.

When it comes to faith in the academic guild vs. faith in gold, place me in the latter camp.

CONCLUSION

The case for fixed exchange rates is the case for voluntary pricing. Ideally, it is the case for fixed exchange rates between coins with the same weight and fineness of metal.

The case for floating exchange rates is the case for voluntary pricing. Ideally, it is the case for floating exchange rates between silver coins and gold coins.

The case against fixed exchange rates is the case against state-imposed price controls. Ideally, it is the case against government interference in the economy except in the prosecution of violence or fraud (fractional reserve banking).

Simple, isn't it? Yet economists just can't get these matters straight in their thinking.

Why should we expect politicians to understand anything this simple?

Chapter 14

THE RE-MONETIZATION OF GOLD

If gold is to be re-monetized, then this must mean that it has been de-monetized. But isn't gold money?

No, gold is not money. It has not been money for Europeans since 1914, when the commercial banks stole it from depositors at the outbreak of World War I, and central banks then stole it from commercial banks before the war was over. Gold has not been money for Americans since 1933, when Roosevelt unilaterally by executive order stole it from the public.

Gold is high-powered money for central bankers, who settle their banks' accounts in gold. But this is so far removed from the decisions of consumers that I can safely say that gold is not money.

The question is: Will it ever again become money? This is the most important of all monetary questions.

THE MARKETABILITY OF GOLD

Money is the most marketable economy. Gold is therefore not money. You have to buy gold from a specialized broker. There are so few gold brokers any more that they are all known to each other. Local coin stores don't do much business in bullion gold coins such as the American eagle or Canadian maple leaf. The large wholesale firms like Mocatta don't deal with the public. There are so few full-time bullion coin dealers that you could have a convention of them in a Motel 6 conference room. (When was the last time you were in a Motel 6 conference room?)

But . . . it costs $39 to rent a Motel 6 room. That tells us something. It's not $6 a room any longer. Inflation has done its work.

Money is liquid. Liquidity means that you can exchange money for goods and services directly without the following costs:

1. Advertising
2. Discounting
3. Waiting

There is a price spread between what you can sell a gold coin for (in money) and what you buy a gold coin for (in money). Gold coins therefore are not money.

I realize that old-time gold bugs go around saying "gold is the only true money" and similar slogans. These slogans reflect a lack of understanding of either gold or money. They are comforting slogans, no doubt, for someone who bought gold coins at twice the price that they command today, and held them for a quarter of a century at no interest while all other prices doubled or tripled. If he had instead made down payments on rental houses, he would be a whole lot richer. But the fact is, gold is not only not the only true money, it is not money at all. When you can walk into Wal-Mart and buy whatever you want with a gold coin or gold-denominated debit card, then gold will be money. Not until then.

To tell a gold bug this is to strike at his core beliefs. But his core beliefs are based on a lack of understanding of economics.

Money is the most marketable commodity. Gold is not the most marketable commodity. Given the lack of retail outlets where you can buy and sell gold, it is not even remotely money. Unless you are a central banker, gold is not money for you.

THE DE-MONETIZATION OF GOLD

Gold is a valuable commodity. It was originally valuable for its physical properties: its glorious shine, its imperviousness to decay, its limited supply (high cost of mining), its malleability, its divisibility. In most religions, gold is used to represent deity or permanent truth. When something is "as good as gold," it's valuable.

Because of these properties, gold long ago became widely used in economic exchange. When the city-state of Lydia started issuing gold coins over five centuries before the birth of Jesus, gold became the most recognizable form of money in the classical world. Gold had been monetized long before this, as all historical records indicate, but the convenience of the coins amplified what had already been the case. This increased the demand for gold.

Gold was no longer money in Western Europe after the fall of Rome in the fifth century. In March of 2003, I visited the British museum. The museum has an exhibit of an early medieval grave-ship, where a Saxon seafaring king had been buried. The wood is

gone, but metal implements remain. There was a small stash of gold coins. This is the Sutton Hoo exhibit. The burial's date is estimated at 625. By that time, gold coins were rare in the West. In another museum exhibit of gold coins, you can see that from about 625 until the introduction of gold coins in Florence in 1252, there is only one gold coin.

Gold coins did circulate for the entire period in the Eastern Roman Empire (Byzantium), from 325 (Constantinople) to the fall of Byzantium to the Turks (1453). But there was little trade between the two halves of the old Roman Empire until late in the Middle Ages. The low division of labor in the West made barter far more common, and silver and bronze coins were the media of exchange.

It was the rise of the modern world, which was marked by an increasing division of labor, that brought gold coins back into circulation. Fractional reserve banking and gold coins developed side by side. Fractional reserve banking is why the boom-bust cycle has been with us, with credit money stimulating economic growth (an increase in the division of labor), and bank runs shrinking the money supply and contracting the economy (a decrease in the division of labor).

There has been a 500-year war in the West between gold coins and bank-issued credit money.

THE WAR

Bankers want to make money on money that their institutions create. They use the promise of redemption-on-demand in gold or silver as the lure by which they trick depositors into believing in something for nothing, i.e., the possibility of redemption on demand of money that has been loaned out at interest. The public believes this numerical impossibility, but then, one fine day, too many depositors present their IOU's for gold or silver to the bank. A bank run begins, the lie is exposed, and the bank goes bankrupt (bank + rupture). The depositors lose their money. They get nothing for something, which is always the small-print inscription on the other side of something for nothing.

The bankers hate gold as money. Gold as money acts as a restraint on their profits, which are derived from creating money "out of thin air" and lending it at interest. Gold as money acts as a barrier to the expansion of credit money. The public initially does not trust the bankers or their money apart from the right of redemption on demand. Depositors initially insist on IOU's for gold coins. So, the bankers partially submit to gold, but only grudgingly.

To keep from facing their day of judgment -- redemption day, when the public presents its IOU's and demands payment -- fractional reserve bankers call on the government. They persuade the government to create a bankers' monopoly, called a central bank, which stands ready to intervene and lend newly created fiat money to any commercial bank inside the favored cartel that gets into trouble with its depositors. By reducing the risk of local bank failures, the central bank extends the public's acceptance of a system of unbacked IOU's, called "an elastic currency" when members of the banking cartel create it, and called "counterfeiting" when non-members of the cartel create it.

Then why do central bankers use gold to settle their own interbank accounts? Because central bankers don't trust each other -- the same reason why the public prior to 1914 used gold coins and IOU's to gold coins. The central bankers don't want to get paid off in depreciating money. At the same time, they do want to retain the option of paying off the public in depreciating money.

It's not that they want depreciating money. They want economic growth, lots of borrowers, and lots of opportunities to lend newly created money at interest. The problem is, they are never able to maintain the economic boom, which was fostered by credit money, without more injections of credit money. The same holds true for additional profits from lending. If a bank has additional money to lend and a booming economy filled with would-be borrowers, that's great for the bankers. But the result has always been either a deflationary depression when the credit system collapses or else price inflation, which overcomes the collapse at the expense of reliable money. The result in both cases is lost profits.

Bankers want the fruits of a gold coin standard: predictably stable or slowly falling prices, a growing economy, international trade, and a currency worth something when they retire. But they don't want the roots of a gold coin standard: lending limited by deposits, a legal link between the time period of the loan and the time period when the depositor cannot redeem his deposit, and profits arising solely from matching lenders (depositors) with borrowers. Bankers sacrifice the roots for the profitable pursuit of the fruits. The results: boom-bust business cycles, bankruptcies, depreciating currencies, shattered dreams of retirement, and political revolutions.

In the twentieth century, fractional reserve bankers won the war of economic ideas: Keynesianism, monetarism, and supply-side economics. They also won the political wars. They succeeded in getting all governments to de-monetize gold, thereby creating unbreakable banking cartels (but not unbreakable currencies). The result was the

decline in purchasing power of the dollar by 94%, 1913-2000. Verify this here:

http://www.bls.gov

Inflation Calculator: $1,000 in 1913 = $17,300 in 2000. So, 1 divided by 17 = .06, or 6%. 100% minus 6% = 94%.

In other nations, the depreciation was even worse: World War I and its post-war inflations, plus World War II and its post-war inflations, when added to the Communist revolutions, destroyed entire currency systems, sometimes more than once.

WHERE IS THE GOLD?

Official statistics indicate that most of the world's gold is stored in the vaults of central banks. The bulk of the rest of it is in women's dowries in India, or on ring fingers of Westerners, or in jewelry of affluent women. But, as I have argued previously (Chapter 10, "Is America's Gold Gone?"), central banks have in fact been transferring their gold to private owners by way of the "bullion banks," which have borrowed gold at 1% per annum, sold it to the public, and invested the money at high interest rates.

If my thesis is correct, then gold has been de-monetized almost completely. It is no longer serving as an ultimate restriction on central bank policies. The central bankers are now trading paper gold -- promises to pay gold -- that have been issued by private bullion banks, which cannot afford to buy the gold back to re-pay the central banks. The bullion bankers have done to the central bankers what the fractional reserve bankers did to their depositors and the central bankers did to the commercial banks. They have gotten their hands on gold in exchange for written promises to repay this gold -- promises that cannot possibly be fulfilled -- and have made oodles of money by lending the money derived from the sale of the gold.

This means two things: this gold has been repatriated to the private markets (yea!), and gold in general is now almost fully de-monetized (boo!). Men have put bracelets and necklaces on their daughters (India) and wives (the West), but consumers do not have gold coins in their individual repositories, especially their pockets.

This means that what had been the highest-value use for gold for 2,600 years -- gold as money -- has disappeared except among central bankers, and even then increasingly merely IOU's to gold issued by bullion banks. There has been a huge,

historically unprecedented reduction in demand for gold since 1914. This should be obvious to anyone. Demand for gold today is for industrial and ornamental uses, not monetary uses. Yet I am just about the only person within the camp of the gold bugs who is willing to admit this in print.

IS THIS SITUATION PERMANENT?

Nothing is permanent except death, taxes, and the lies of politicians, but in the West, the de-monetization of gold appears to be as permanent as the West. The West has bet its future on fractional reserve banking. This is additional evidence that the West is doomed. It has placed the extension of the division of labor into the hands of the bankers' cartel.

Faculty members in Western universities are agreed on few things, but one universally shared assumption is that gold should not be money. In business schools and economics departments, in political science department and history departments, the professors are agreed: gold is a relic, and probably a barbarous relic.

But then there is Asia.

In Asia, the people are still barbarians. This means that they don't trust their governments because they know the truth: governments cheat, lie, and steal. Government corruption is a way of life in heartland Asia. This is a tremendous advantage that Asians enjoy. The less educated the Asian, the more likely he is to distrust the government. He is partially immunized against trusting promises to pay that are issued by governments. This is why Chinese peasants still want silver coins and Indian peasant wives still have gold jewelry. All over the Asian mainland, paper money has universally depreciated. The division of labor has been thwarted.

In the Asian tiger nations, whose economies have been closely tied to the capitalist West, fractional reserve banking is accepted, and fiat currencies are trusted. These nations have experienced a loss of trust in gold, which the other side of the debased coin of fractional reserve banking. The war is on in Asia.

China's currency is government-controlled and highly inflationary. What is saving China from mass price inflation is the rapid spread of the division of labor through freeing the economy. Capitalism's extension of the division of labor is parallelling the Bank of China's extension of credit money. So far, capitalism has won the race. But the

race is not a sprint; it's a marathon. At some point, there will be a massive recession in China as a result of the monetary inflation that has been going on for two decades. The boom will turn into a bust. Then the Chinese may remember the truth that their great-grandparents knew: you cannot safely trust government money. Those Chinese who did trust government's money in 1948 were destroyed economically by Chiang's mass inflation and then wiped out politically and economically by Mao's tyranny.

CONCLUSION

Gold is an inflation hedge. But there has been inflation since 1980. But gold has not risen in price since 1980 for many reasons: the gold bubble of 1979, the continuing de-monetization of gold by central banks, the steady sell-off of gold by central banks, the central banks' gold leasing programs (disguised sales), and dollar supremacy internationally. The third factor, dollar supremacy, is looking shaky.

Gold is not a deflation hedge whenever it is not monetized, and it has not been monetized for generations. But, in the midst of deflation, there is a possibility of the re-monetization of gold. I regard this as a distant possibility. During a breakdown in the payments system -- cascading cross defaults, as Greenspan calls it -- there is an outside possibility that gold will become used again in the monetary system. But for this change to take place, a massive breakdown is necessary, in order to overcome a century of anti-gold economic theories. There is no case for gold being made by Ph.D-holding economists, politicians, pastors, and TV commentators. A return to gold as money in the West will take a cataclysm, which will impose enormously high costs on the public for not using gold as money, thereby pressuring consumers to adopt gold as money. In a cataclysm, the cost of moving from fiat money to gold would be accompanied by a horrendous reduction in the social division of labor -- life-threatening, in my view. A collapse of the derivatives market could produce such a cataclysm. To say that it cannot happen is foolish, but very few people can afford to do much to prepare for such an event. I have. Maybe you have. But we are a minority. We are all dependent on the division of labor to sustain our lives, let alone our lifestyles.

In Asia, the costs of returning to gold as money are much lower. The division of labor is lower. There is less trust in government. Old ideas die hard. There is also increasing wealth, which will further the purchase of gold. But I think this will be gold as ornament and investment, not gold as money.

That's why I do not expect to see gold as money in my lifetime. But I still

recommend gold as an investment. This is because, when it comes to monetary inflation, the mamby-pamby policies of the post-war West are only a cautious prelude to the future. To overcome any deflation of the money supply in today's debt-induced, credit-induced world economy, central bankers will stop acting like wussies. They will start inflating in earnest, for only through inflation can the fractional reserve process continue. It is inflate or die. They will inflate. Then the West's currencies will die. But bankers will inflate now in order to postpone the death of money. They believe that "something will turn up" other than prices.

For gold to become money in the West will take an economic cataclysm. I am too old to be enthusiastic about going through such a cataclysm. So, I remain content with the de-monetization of gold. The consumer is economically sovereign, and he has not shown any interest in gold as money. Long live the consumer, especially in his capacity as a producer!

But as for gold as an inflation hedge . . . that's a horse of a different color. Gold as a commodity will outperform digits as money.

In this sense, I remain a pessimist. The world needs gold as money, but the transition costs are astronomical. "Everybody wants to go to heaven, but nobody wants to die."

Nevertheless, I would rather be a rich pessimist with gold than a poor optimist with digits.

How about you?

Chapter 15

GOLD'S DUST AND DUSTY GOLD

> The best way for a nation to build confidence in its currency is not to bury lots of gold in the ground; it is, instead, to pursue responsible financial policies. If a country does so consistently enough, it's likely to find its gold growing dusty from disuse.

Editorial, *Wall Street Journal* (July 8, 1969)

This statement is true, but it is unlikely that the editorial writer all those years ago understood why it is true.

When it comes to wise economic policy-making, let us get one thing straight: it doesn't come like manna from heaven. It isn't a free lunch. It comes only because there are political sanctions that reward government officials who devise and enforce policies that make consumers better off, and punish government officials who devise and enforce policies that make consumers worse off. These institutional sanctions must be consistent with the laws of economics -- and there really are laws of economics. If the policies violate economic law, then the nation will get irresponsible financial policies, and lots of other kinds of irresponsible government policies.

The editorial writer implied that dusty gold is a silly thing to pursue. He also implied that a nation doesn't need a supply of gold if it pursues wise financial policies. What he was really saying is that gold has nothing to do with wise financial policies. A gold standard is therefore irrelevant. It is an anachronism. It gathers dust, like gold itself.

I think otherwise. I think dusty gold is a great thing. I believe that gold bullion is good. I even believe that gold dust is good. But dust on a government's supply of gold is even better, assuming that the public can legally obtain this gold on demand, as is the case with a gold coin standard. Permit me to explain why I believe this.

But first, let me mention a fact of political life: the Establishment hates gold.

THE ESTABLISHMENT VS. GOLD

Hostility to the traditional gold coin standard has been the mark of Establishment economists and editorialists ever since the U.S. government confiscated Americans' gold

in 1933. The Establishment hates gold. Its spokesmen ridicule gold. They want responsible fiscal and monetary policies, of course -- all of them publicly assure of this fact, decade after decade o but the national debt just keeps getting bigger, and price inflation never ceases, also decade after decade. Somehow, fiscal and monetary responsibility just never seem to arrive.

Why do they hate gold? Because gold represents the public. More than this: gold is a powerful tool of control by the public. A gold coin standard places in the hands of consumers a means of controlling the national money supply. A gold coin standard transfers monetary policy-making from central bankers and government officials to the common man, who can walk into a bank and demand payment for paper or digital currency in gold coins. This is the ultimate form of democracy, and the Establishment hates it. The Establishment can and does control political affairs. They make democracy work for them. They are masters of political manipulation. But they cannot control long-run monetary policy in a society that has a gold coin standard. They hate gold because they hate the sovereignty of consumers.

We are also officially assured by Establishment-paid experts that fiscal and monetary responsibility has nothing to do with a gold coin standard, in the same way that international price stability, 1815-1914, had nothing to do with the presence of a gold coin standard. A gold coin standard would not provide fiscal responsibility, we are told. This is a universal affirmation, the shared confession of faith that unites all branches of the Church of Perpetual Re-election.

On this one thing, the economists are agreed, whether Keynesians, Friedmanites, or supply siders: gold should have no role to play in today's monetary system. (A few supply siders do allow a role for bullion gold in central bank vaults o without full redeemability by the public o as a psychological confidence-builder in a pseudo-gold standard economy. They do not call for full gold coin redeemability by the public, or 100% reserve banking.)

The *Wall Street Journal* is no exception to this rule. It thinks that we can somehow get fiscal responsibility without a gold standard. Nevertheless, the editorial writer stumbled upon a very important point. The gathering of dust on a government's stock of monetary gold is as good an indicator of fiscal responsibility as would be the addition of gold dust to the stock of monetary gold.

ENOUGH IS ENOUGH

New money, including newly mined gold, confers no net benefit to society. New money does confer benefits on those people who get access to it early, but it does this at the expense of late-comers who get access to the new money late in the process. Those people who have early access to the new money gain a benefit: they can spend the newly mined (or newly printed) money at yesterday's prices. Competing consumers who do not have immediate access to the new money are forced to restrict their purchases as supplies of available goods go down and/or prices of the goods increase. Thus, those people on fixed incomes cannot buy as much as they would have been able to buy had the new money not come into existence.

Some people benefit in the short run; others lose. There is no way that an economist can say scientifically that society has benefited from an increase in the money supply. He cannot add up losses and gains inside people's minds. There is no such standard of measurement. Murray Rothbard made this point a generation ago.

> Thus, we see that while an increase in the money supply, like an increase in the supply of any good, lowers its price, the change does not o unlike other goods o confer a social benefit. The public at large is not made richer. Whereas new consumer or capital goods add to standards of living, new money only raises prices o i.e., dilutes its own purchasing power. The reason for this puzzle is that money is only useful for its exchange-value. Other goods have "real" utilities, so that an increase in their supply satisfies more consumer wants. Money has only utility for prospective exchange; its utility lies in its exchange-value, or "purchasing power." Our law ii that an increase in money does not confer a social benefit -- stems from its unique use as a medium of exchange. [Murray N. Rothbard, *What Has Government Done to Our Money?* (1964), p. 13.

Rothbard's point is vital: an increase of the total stock of money cannot be said, a priori, to have increased a nation's aggregate social wealth. This implication has a crucial policy implication: the existing supply of money is sufficient to maximize the wealth of nations. Enough is enough. "Stop the presses!"

An economist who says that society has benefited from an increase in the money supply has an unstated presupposition: it is socially beneficial to aid one group in the community (the miners, or those printing the money) at the expense of another group (those on fixed incomes). This is hardly neutral economic analysis.

Let us assume a wild, unlikely hypothesis: the supply of dollars will someday be

tied, both legally and in fact, to the stock of gold in the Federal Reserve System vault. Let us also assume that banks can issue dollars only for gold deposited. For each ounce of gold deposited in a bank, a paper receipt called a "dollar" is issued by the bank to the person bringing in the gold for deposit. At any time, the bearer of this IOU can redeem a paper "dollar" for an ounce of gold. By definition, one dollar is now worth an ounce of gold, and vice versa.

What would take place if an additional supply of new gold is made by some producer, or if the government (illegally) should spend an unbacked paper dollar? Rothbard describes the results.

An increase in the money supply, then, only dilutes the effectiveness of each gold ounce; on the other hand, a fall in the supply of money raises the poser of each gold ounce to do its work. [Rothbard is speaking of the long-run effects in the aggregate.] We come to the startling truth that it doesn't matter what the supply of money is. Any supply will do as well as any other supply. The free market will simply adjust by changing the purchasing power, or effectiveness of its gold unit. There is no need whatever for any planned increase in the money supply, for the supply to rise to offset any condition, or to follow any artificial criteria. More money does not supply more capital, is not more productive, does not permit "economic growth."

Once a society has a given supply of money in its national economy, people no longer need to worry about the efficiency of the monetary unit. People will use money as an economic accounting device in the most efficient manner possible, given the prevailing legal, institutional, and religious structure. In fact, by adding to the existing money supply in any appreciable fashion, banks bring into existence the "boom-bust" phenomenon of inflation and depression. The old cliche, "let well enough alone," is quite accurate in the area of monetary policy.

This leads to a startling conclusion: the existing money supply is sufficient for all economic transactions. We don't need any more money. (Well, actually, I do. But you don't.) We also don't need a Federal Reserve System to manage the money supply. We don't need a government rule that compels the Federal Reserve or the Treasury to increase the money supply by 3% per annum or maybe 5% (Friedman's suggested rule). Besides, who would enforce such a rule? It's a rule for rulers enforced by rulers.

Then what do we need? Freedom of contract and the enforcement of contracts. Nothing else? Only laws that prohibit fraud. To issue a receipt for which there is nothing in reserve to back up the receipt is fraudulent.

WHY GOLD?

A productive gold miner, by slightly diluting the purchasing power of the gold-based monetary unit, achieves short-run benefits for himself. He gets a little richer. Those people on fixed incomes now face a slightly restricted supply of goods available for purchase at the older, less inflated, price levels. Miners and mine owners bought these goods with their newly mined gold. This is a fact of life. But this is a minor redistribution o miner redistribution o of wealth compared to the effects of a government monopoly over money. The compulsion of government vastly magnifies the redistribution effects of monetary inflation. It is cheaper to print money than to mine gold.

We live in an imperfect universe. We are not perfect creatures, possessing omniscience, omnipotence, and perfect moral natures. We therefore find ourselves in a world in which some people will choose actions which will benefit them in the short run, but which may harm others in the long run. Our judicial task is to minimize these effects. We should pursue a world of minor imperfections rather than accept a world with major imperfections. But we would be wise not to demand political perfection. Messianic societies never attain perfection. They attain only tyranny.

To compare a gold standard with perfection o zero monetary expansion o misses the point. Perfection is not an available option. Instead, we should compare the effects of a gold coin standard, where no one can issue receipts for gold unless he owns gold, with the effects of a monetary system in which the government forces people to accept its money in payment for all debts, goods, and services. Compared to the cost of creating a blip on a computer, the costs of mining are huge. The rate of monetary inflation will be vastly lower under a pure gold coin standard with 100% reserve banking than under a credit money standard run by central bankers through the fractionally reserved commercial banks.

Professor Mises defended the gold standard as a great foundation of our liberties precisely because gold is so expensive to mine. Mining expenses reduce the rate of monetary inflation. The gold standard is not a perfect arrangement, he said, but its effects are far less deleterious than the power of a monopolistic State or a State-licensed banking system to create credit money. The economic effects of gold are far more predictable, because they are more regular. Geology acts as a greater barrier to monetary inflation than can any man-made institutional arrangement. [Ludwig von Mises, The Theory of Money and Credit (New Haven, Connecticut: Yale University Press, [1912] 1951), pp. 209-11, 238-40.] The booms will be smaller, the busts will be less devastating, and the

redistribution involved in all inflation (or deflation, for that matter) can be more easily planned for.

On all this, see my on-line book, *Mises On Money*.

http://www.lewrockwell.com/north/mom2.html

Nature is niggardly. This is a blessing for us in the area of monetary policy, assuming that we limit ourselves to a monetary system legally tied to specie metals. We would not need gold if, and only if, we could be guaranteed that the government or banks would not tamper with the supply of money in order to gain their own short-run benefits. For as long as that temptation exists, gold (or silver, or platinum) will alone serve as a protection against policies of mass inflation.

HOW WOULD THE SYSTEM WORK?

The collective entity known as the nation, as well as another collective, the State, will always have a desire to increase its percentage of the world's economic goods. In international terms, this means that there will always be an incentive for a nation to mine all the gold that it can. While it is true that economics cannot tell us that an increase in the world's gold supply will result in an increase in aggregate social utility, economic reasoning does inform us that the nation which gains access to newly mined gold at the beginning will able to buy at yesterday's prices. World prices will rise in the future as a direct result, but he who gets there "fustest with the mostest" does gain an advantage. What applies to an individual citizen miner applies equally to national entities.

So much for technicalities. What about the so-called "gold stock"? In a free market society that permits all of its residents to own gold and gold coins, there will be a whole host of gold coins, there will be a whole host of gold stocks. (By "stock," I mean gold hoard, not a share in some company.) Men will own stocks of gold, institutions like banks will have stocks of gold, and all levels of civil government -- city, county, national -- will possess gold stocks. All of these institutions, including the family, could issue paper IOU slips for gold, although the slips put out by known institutions would no doubt circulate with greater ease (if what is known about them is favorable). The "national stock of gold" in such a situation would refer to the combined individual stocks.

Within this hypothetical world, let us assume that the United States Government wishes to purchase a fleet of German automobiles for its embassy in Germany. The

American people are therefore taxed to make the funds available. Our government now pays the German central bank (or similar middleman) paper dollars in order to purchase German marks. Because, in our hypothetical world, all national currencies are 100 percent gold-backed, this would be an easy arrangement. Gold would be equally valuable everywhere (excluding shipping costs and, of course, the newly mined gold which keeps upsetting our analysis), so the particular paper denominations are not too important. Result: the German firm gets its marks, the American embassy gets its cars, and the middleman has a stock of paper American dollars.

These bills are available for the purchase of American goods or American gold directly by the middleman, but he, being a specialist working the area of currency exchange, is more likely to make those dollars available (at a fee) for others who want them. They, in turn, can buy American goods, services, or gold. This should be clear enough.

PAPER PROMISES ARE EASILY BROKEN

Money is useful only for exchange, and this is especially true of paper money (gold, at least, can be made into wedding rings, earrings, nose rings, and so forth). If there is no good reason to mistrust the American government -- we are speaking hypothetically here -- the paper bills will probably be used by professional importers and exporters to facilitate the exchange of goods. The paper will circulate, and no one bothers with the gold. Gold just sits there in the vaults, gathering dust. As long as the governments of the world refuse to print more paper bills than they have gold to redeem them, their gold stays put.

It would be wrong to say that gold has no economic function, however. It does, and the fact that we must forfeit storage space and payment for security systems testifies to that valuable function. It keeps governments from tampering with their domestic monetary systems.

Obviously, we do not live in the hypothetical world which I have sketched. What we see today is a short-circuited international gold standard. National governments have monopolized the control of gold for exchange purposes; they can now print more IOU slips than they have gold. Domestic populations cannot redeem their slips. The governments create more and more slips, the banks create more and more credit, and we are deluged in money of decreasing purchasing power. The rules of the game have been shifted to favor the expansion of centralized power. The laws of economics, however, are

still in effect.

TRADING WITHOUT GOLD

One can easily imagine a situation in which a nation has a tiny gold reserve in its national treasury. If its people produce, say, bananas, and they limit their purchases of foreign goods by what they receive in foreign exchange for exported bananas, the national treasury needs to transfer no gold. The nation’s currency unit has purchasing power (exported bananas) apart from any gold reserves.

If, for some reason, it wants to increase its national stock of gold (perhaps the government plans to fight a war, and it wants a reserve of gold to buy goods in the future, since gold stores more conveniently than bananas), the government can get the gold. All it needs to do is take the foreign money gained through the sale of bananas and use it to buy gold instead of other economic goods. This will involve taxation, of course, but that is what all wars involve. If you spend less than you receive, you are saving the residual. A government can save gold. That’s really what a gold reserve is: a savings account.

This is a highly simplified example. I use it to convey a basic economic fact: if you produce a good (other than gold), and you use it to export in order to gain foreign currency, than you do not need a gold reserve. You have chosen to hoard foreign currency instead of gold. That applies to citizens and governments equally well.

What, then, is the role of gold in international trade? Free market economist Patrick Boarman (the translator of Wilhelm RÖpke’s *Economics of the Free Society*) explained the mechanism of international exchange in *The Wall Street Journal* (May 10, 1965).

> The function of international reserves is *not* to consummate international transactions. These are, on the contrary, financed by ordinary commercial credit supplied either by exporters, or in some cases by international institutions. Of such commercial credit there is in individual countries normally no shortage, or internal credit policy can be adjusted to make up for any un-toward tightness of funds. In contrast, international reserves are required to finance only the inevitable net differences between the value of a country’s total imports and its total exports; their purpose is not to finance trade itself, but net trade imbalances.

The international gold standard, like the free market's rate of interest, served as an equilibrating device. I think it will be again someday. What it is supposed to equilibrate is not gross world trade but net trade imbalances. Boarman's words throw considerable light on the perpetual discussion concerning the increase of "world monetary liquidity."

> A country will experience a net movement of its reserves, in or out, only where its exports of goods and services and imports of capital are insufficient to offset its imports of goods and services and exports of capital. Equilibrium in the balance of payments is attained not by increasing the quantity of a mythical "world money" but by establishing conditions in which autonomous movements of capital will offset the net results, positive and negative, of the balance of trade.

Some trade imbalances are temporarily inevitable. Natural or social disasters take place, and these may reduce a nation's productivity for a period of time. The nation's "savings" -- its gold stock -- can then be used to purchase goods and services from abroad. Specifically, it will purchase with gold all those goods and services needed above those available in trade for current exports. If a nation plans to fight a long war, or if it expects domestic rioting, then, of course, it should have a larger gold stock than a nation which expects peaceful conditions. If a nation plans to print up millions and even billions of IOU slips in order to purchase foreign goods, it had better have a large gold stock to redeem the slips. But that is merely another kind of trade imbalance, and is covered by Boarman's exposition.

THE GUARDS

A nation that relies on the free market to balance supply and demand, imports and exports, production and consumption, will not need a large gold stock to encourage trade. Gold's function is to act as a restraint on government's spending more than the government takes in. If a government takes in revenues from its citizenry, and then exports the paper bills or fully backed credit to pay for some foreign good, then there is no necessity for the government to deplete its semi-permanent gold reserves. The gold will sit idle -- idle in the sense of physical movement, but not idle in the sense of being economically irrelevant.

The fact that a nation's gold does not move is no more (and no less) significant than the fact that the guards who are protecting this gold can sit quietly on the job if the storage system is really efficient. Gold in a nation's treasury guards its citizens from that

old messianic dream of getting something for nothing. This is also the function of the guards who protect the gold. The guard who is not very important in a "thief-proof" building is also a kind of "equilibrating device." He is there just in case the overall system should experience a temporary failure.

A nation that permits the free market to function is, by analogy, also "thief-proof." Everyone who consumes is required by the system to offer something in exchange. During economic emergencies, the gold is used, like the guard is used during vault emergencies. Theoretically, the free market economy could do without a large national gold reserve, in the same sense that a perfectly designed vault could do without guards. The nation that requires huge gold reserves is like a vault that needs extra guards: something is probably breaking down somewhere -- or breaking in.

CONCLUSION

What I have been trying to explain is that a full gold coin standard, within the framework of a free market economy, would permit the large mass of citizens to possess gold. This means that the "national reserves of gold," that is, the State's gold hoard, would not have to be very large.

If we were to re-establish full domestic convertibility of paper money for gold coins (as it was before 1933), while removing the "legal tender" provision of the Federal Reserve Notes, the American economy would still function. It would function far better in the long run. Consumers would be able to reassert their sovereignty over politicians and government-licensed bankers.

This, of course, is not the world we live in. Because America is not a free society in the sense that I have pictured here, we must make certain compromises with our theoretical model. The statement in *The Wall Street Journal*'s editorial would be completely true only in an economy using a full gold coin standard: "The best way for a nation to build confidence in its currency is not to bury lots of gold in the ground." Quite true; gold would be used for purposes of exchange, although one might save for a "rainy day" by burying gold. But if governments refused to inflate their currencies, few people would need to bury their gold, and neither would the government.

If a government wants to build confidence, it should "pursue responsible financial policies," that is, it should not spend more than it takes in. The editorial's conclusion is accurate: "If a country does so consistently enough, it's likely to find its gold growing

dusty from disuse."

In order to remove the necessity of a large gold hoard, all we need to do is follow policies that will "establish Justice, insure domestic Tranquility, provide for the common defense [with few, if any, entangling alliances], promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity."

To the extent that a nation departs from those goals, it will need a large gold hoard, for it costs a great deal to finance injustice, domestic violence, and general illfare. With the latter policies in effect, we find that the gold simply pours out of the Treasury, as "net trade imbalances" between the State and everyone else begin to mount. A moving ingot gathers no dust.

This leads us to "North's Corollary to the Gold Standard" (tentative):

> "The fiscal responsibility of a nation's economic policies can be measured directly in terms of the thickness of the layer of dust on its gold reserves: the thicker the layer, the more responsible the policies."

* * * * * * * * *

This article is a revision of an article that I published in *The Freeman* in 1969. My analysis has not changed since 1969, but the price level in the United States is 4.9 times higher. See the inflation calculator of the Bureau of Labor Statistics.

The government's gross national debt (on-budget debt, not accrual debt, which is vastly larger) at the end of 1969 was $366 billion. At the end of this fiscal year, it will be approximately $9.3 trillion. To monitor the debt clock of U.S. on-budget debt, click here:

http://snipurl.com/debtclock

The Establishment still ridicules gold. The public still doesn't understand gold. And academic economists tell us that central banking is the wave of the future: the best conceivable world.

The more things change (debt, prices), the more they stay the same (economic opinions).