



The Gold Standard

The journal of The Gold Standard Institute

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The Gold Standard Institute

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

<http://goldstandardinstitute.org>

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Editorial

The news dam, so securely constructed by the mainstream media, is starting to crack. Articles ranging from criticisms of the Federal Reserve Bank to questions about the legitimacy of paper money itself are beginning to seep through. It will eventually become a torrent as the media seek to regain some semblance of credibility.

There are two scenarios in front of us. The first, and it has to be thought more likely, is a sudden crisis. At a time when our media is full of revolution in the streets and a surge in oil prices, that sudden crisis would have to be major just to be noticed, let alone justify the resultant 'emergency actions'. The second is a move to the gold standard.

Unfortunately it is too early to be very optimistic for the latter. Too many of our entrenched officials will continue to react dogmatically in the manner of Gaddafi. Full of the righteousness of their cause, indifferent to the evidence of failure and suffering that stares them in the face, they will continue striving to prove just how right they have always been.

One suspects it has to become worse before it can become better. The positive side is that these same 'leaders' are going to find it much harder to defend their performance with the media finally beginning to ask some pertinent questions.

News

Almost the whole Malaysian gold bullion industry attended the launch of the Perak State dinar on the 28th of February. The first batch (minted in Perak) have sold out. Approximately 90% were bought by Malaysians. Many of the local Chinese have managed to successfully hedge against the erosion of fiat with real estate which hasn't popped... yet.

Professor Ahamed Kameel Mydin Meera also launched his new book "Real Money - Money and Payment Systems from an Islamic Perspective".

The state of Johore has also announced plans to launch a Gold Dinar.

Bloomberg [announced](#) that Chinese central bank adviser, Xia Bin, has recommended that silver be included in China's official reserves. To my knowledge this is a first since I don't know when. I wonder if they will inform us how much silver they already hold.

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The link to this story has died unfortunately:

A South Carolina state politician wants the state to develop its own gold and silver-based currency in case the Federal Reserve collapses and hyperinflation ensues.

"If folks lose faith in the dollar, we need to have some kind of backup," State Sen. Lee Bright told the Spartanburg Herald Journal. His bill asks a committee to look into the development of a state currency, citing the Constitution and Supreme Court precedents to prove the bill's legality.

There are similar bills in Georgia and Virginia

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Western government and central bank officials discussed coordinating their gold market policies at a private meeting of the G-10 Gold and Foreign Exchange Committee in April 1997, according to [minutes of the meeting](#) released to GATA today by the Federal Reserve Board upon the order of a federal court.

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Editorial of The New York Sun | February 11, 2011

The editorial was entitled "[The Fiat Kilogram](#)". The thrust was that if a dollar, which is supposed to be a measure and can float, then why not a kilogram. Why not indeed?

The real story here is that we have finally reached the predicted point where the system of paper money itself is being called into question by the mainstream media... a significant moment.

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Ron Paul To Ben Bernanke "[I Want A Definition Of Money!](#)"

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[Saudi king back home, orders \\$37 billion in handouts](#)

Saudi King Abdullah returned home on Wednesday after a three-month medical absence and unveiled benefits for Saudis worth some \$37 billion (23 billion pounds) in an apparent bid to insulate the world's top oil exporter from an Arab protest wave.

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Odd Spot

The Bank of Chicago 1853

"A run on the bank occurred. During this run, Mrs. Herrick, a medium, sat behind the counter and indicated which depositors should be allowed to redeem notes. When the bank officers were brought to trial, the mediums relied on their spiritual counselors to defend their case. There was a hectic court scene, Eddy (the bank's president) was found insane, and Paine was jailed for assault and battery. The doors of the bank were closed by court order in February."

From: 'Fiat Paper Money-The History and Evolution of our Currency' by Ralph T. Foster

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[Fox News](#) March 4, 2011: Utah took its first step Friday toward bringing back the gold standard when the state House passed a bill that would recognize gold and silver coins issued by the federal government as legal currency.

The House voted 47-26 in favor of the legislation that would also exempt the sale of gold from the state capital gains tax and calls for a committee to study alternative currencies for the state.

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False Belief #2: Risk-Free Investments

By Louis Boulanger

*“The Fed’s increased presence in the market for long-term Treasury securities also poses nontrivial risks. **The Treasury market is special. It plays a unique role in the global financial system. It is a corollary to the dollar’s role as the world’s reserve currency. The prices assigned to Treasury securities--the risk-free rate--are the foundation from which the price of virtually every asset in the world is calculated.** As the Fed’s balance sheet expands, it becomes more of a price maker than a price taker in the Treasury market. And if market participants come to doubt these prices--or their reliance on these prices proves fleeting--risk premiums across asset classes and geographies could move unexpectedly. The shock that hit the financial markets in 2008 upon the imminent failures of Fannie Mae and Freddie Mac gives some indication of the harm that can be done when assets perceived to be relatively riskless turn out not to be.”* (I added the emphasis)

- Kevin Warsh (a member of the US Federal Reserve System’s Board of Governors)

The above was taken from his article entitled [‘The New Malaise and How to End It’](#).

For those of us who have come out of the normalcy bias, we recognise that things are no longer what they seem to be. There is an overwhelming breakdown of trust in the system. This, I think, is principally due to the abject failure to prosecute fraud on Wall Street. Matt Taibbi’s recent article (*“Why Isn’t Wall Street in Jail?”*) in *Rolling Stone* magazine says it all!

There seems to be little attention paid to the long term consequences of extraordinary monetary policy decisions made over the last three years or so. All that seems to matter is the immediate effect, the short term market reaction. But, recently, there has been an astonishing admission, coming as it did from no less than a Governor of the Fed. Kevin Warsh conceded that the Fed is effectively price-fixing on a global scale.

As correctly pointed out by the youngest ever Fed Governor, the market for US Treasuries is special. It **is** special because their pricing determines what is widely regarded and still used by the investment industry as THE RISK-FREE RATE. This ‘risk-free rate’ is then used by the industry as the foundation from which all other (and presumably riskier) financial assets are priced or from which future expected returns are derived for all financial asset classes.

So, if there is price-fixing in the very foundation from which all financial assets are priced, what does that say about the pricing of all financial assets? Well, it means that the level of risk which is inherent in investments of all sorts is being underestimated by most investors. As a result, higher prices are being paid for investments than would otherwise be the case should the (false) belief that US Treasuries are ‘risk-free’ cease to prevail.

In other words, the bulk of the risk premiums (rewards for risk) that are assumed to exist in the riskier asset classes than, say US Treasuries, are simply not there for investors to enjoy. The risk-free rate is ‘rigged’; it’s not a sound footing to build investment portfolios on. Why is this important? Because of the way the industry works. You see, investment portfolios are constructed by allocating assets between different asset classes based on their expected future risk premiums over and above the illusory risk-free rate.

How will the industry break its addiction to the convenient assumption that there is a risk-free rate? I don’t know. But I do know that there is no such thing as a risk-free investment. The origin of the now popular delusion that there is such a thing can be traced back to the industry’s desire for a simplified asset pricing model some fifty years ago. That seemingly benign desire turned into quite a malignant one, now that we are almost forty years into a global fiat only money experiment.

The only ‘risk-free’ aspect of US Treasuries, during this ongoing period of monetary madness or quantitative easing, is that they do offer risk-free profits to those willing to front-run the Fed (as described brilliantly by Professor Fekete in his writings, in particular in ‘There is No Business Like

Bond Business' of January 2010). But such profits are not for everyone and they will come to pass eventually.

The 'new malaise' Kevin Warsh alludes to in his article is not new at all. The history of ideas about money shows, on the contrary, that we are dealing with a very old conflict that comes up periodically. The difference is that, this time, the malaise is global: the US dollar is losing its global reserve currency status. As a result, I do not share Mr Walsh's confidence that the Fed's Open Market Committee will have the tools required to end the so-called 'malaise'.

How it all ends is not for the Fed to say or decide. History shows that what matters now is how many ounces of gold you and I own. This is because the global financial system where all investments are made is based on the quiet assumption that financing the US national debt (or buying US Treasuries) is risk-free. In other words, the foundation from which the price of virtually every asset in the world is calculated is based on... a false belief!



Louis Boulanger

Louis holds a B.Sc. from Laval University in Canada; is a Fellow of the Canadian Institute of Actuaries and the New Zealand Society of Actuaries; and is a Chartered Financial Analyst.

Prior to coming to New Zealand in 1986, Louis worked for nine years with a global consulting firm based in Montreal, Canada. In New Zealand, Louis worked for another global consulting firm for 18 years, including as Chief Executive of New Zealand operations for five years. In 2006, he launched his private practice.

Louis is also Founder & Director of LB Now Ltd, which provides independent investment advice to private and institutional clients, facilitates the purchase of bullion for private and institutional clients as an authorized dealer for BMG BullionBars and also helps firms comply with GIPS.

For more information of LB Now's services or to subscribed to Louis' e-letter 'Prosper!' see the contact details below.

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From London

Against the United States Dollar, gold reached an all time high of 1434.9 on 1st March before pulling back. Silver has had a sharp ride higher as well reaching 31 year highs against the same currency.

Ignoring the influence of fiat currency, which is the way par excellence of observing the gold and silver markets, one sees that the gold/silver ratio is approaching new depths. 46 at the last journal's release, the current value is a shade over 41: a 12% move in silver's favour against gold as both were advancing against the United States Dollar. The way to trade the ratio is via observing the ratios of the gold and silver bases - pioneered by Prof. Fekete.

The Gold Basis Service is the only letter to comment, with a rigorous background, on movements in the gold/silver ratio. The state of the silver COMEX market for all terms out to December 2012 has degraded much further with actionable backwardation evident. Will this persist? If the silver market changes to positive carry from this state, what will be the implications?



Sandeep Jaitly

The 'Gold Basis Service' is a monthly subscription newsletter that describes movements in the gold and silver bases. The service offers forewarning of potential exchange default - as well as of significant changes likely in the gold price and gold-silver ratio from movements in the bases. Along with the monthly gold basis service is the quarterly 'Course of the Exchange' economic commentary. This commentary relates to general observations from a Mengerian perspective on the current market place for global equities; government paper and other goods.

The cost of the subscription is US\$490 per annum. Full details can be found at Bullionbasis.com.

Gold Myth: Many people don't own any gold and would be disadvantaged.

This myth is really more socialist whining than anything else. After all, many people in the world don't own paper 'money' either... and are thus equally 'disadvantaged'. The real motive behind this statement is the socialists' delusional and destructive effort to make the world 'egalitarian'... not in the morally and functionally correct sense that all human beings should have equality before the law, or that all human beings should have equal opportunity... but in the totally immoral and destructive sense that if Peter has more than Paul, then society is 'entitled' - or even required - to rob Peter to pay Paul... thus achieving 'equality'.

The very same myth is applied in another sense, that under a Gold standard, countries with a lot of Gold would have an 'unfair advantage' over countries with less. This sense is just as incorrect. The very motive for international trade, no less for inter personal trade, is that one party has something that the opposite party wants to acquire; and so offers to trade. If the item offered in trade is desired by the first party, the deal is consummated, and BOTH parties end up better off than before they made the trade... else the trade would not happen. Of course, this is the very basis of the free - voluntary - market; offer some of what you have in order to acquire what you want.

India has the most Gold of any country (not per capita, but in total) yet India mines NO significant amounts of Gold. So, how does India become the greatest owner of Gold in the world? They trade for Gold. By the way, Switzerland is the country with the largest per capita holding of Gold.

Reality is that trade and the division of labor is the root of prosperity and progress. This is expressed by the economic law of comparative advantage. This law states that it is more beneficial for countries and individuals to do more of what they do best, and trade for what some other country or person does best, than to try to 'do it all'. In other words, autarky

- self sufficiency in everything - is (much) less efficient than the division of labor... and free trade.

Both trading parties benefit, as long as the transaction cost is less than the gain made by trading. For example, suppose country A can profitably mine Gold, for a total cost of 100 man hours per oz. In country B, acquiring the very same oz of Gold costs 150 man hours. Then, it makes sense for country B to trade something and purchase the Gold it needs from country A... assuming similar wage scales.

If the wage scales are different, then this needs to be included in the calculation... of course, the market price of goods does just that; naturally incorporates all pertinent factors in the price of all products and services.

If country B has the capacity to grow wheat at a lesser cost than country A, and country A wants wheat, then the deal is done; trade wheat for Gold. A no brainer! Of course, trade can be and in fact mostly is multilateral, and goods are traded internationally. As long as the gain in any trade exceeds the transaction costs, all parties benefit.

This is the kicker: transaction costs limit trade; if the trade benefit is less than the transaction cost, the deal makes no sense... hence no trade will take place.

Notice that tariffs, customs duties, and 'regulations' all add to transaction costs. This means that government interference in international trade adds to the costs of BOTH parties. This is not generally understood; the misstatement is always made that tariffs are there to 'protect our industries/farmers/miners/whoever'. The reality is that an increase in transaction costs hurts both sides.

The law of comparative advantage plays out in interpersonal trade as well; for example, suppose we look at the choices Mr. S has in how to spend his working time most productively. Mr. S is a brain surgeon, who with his incredible, hard earned skills and great manual dexterity can 'sugerise' diseased brains... and earn 1/2 oz Gold per hour for doing so.

On the other hand, his skills are also apparent in washing dishes; he can wash his daily dirty dishes in

a superb 10 minutes flat. If he hires someone to wash dishes for him, the average dish washer will take 30 minutes to do the same work... so what should he do, brain surgery or dish washing? After all, he can do the dishes in 1/3 the time of a hired hand.

The answer is simple; if he hires a dish washer for 1/8 oz per hour, then he would pay 7 (days) x 1/8 oz (per hour) x 1/2 hour (time the dish washer works daily) = 0.43 oz per week to have his dishes washed every day.

If he invests the time he saves by NOT doing dishes in doing brain surgery instead, that is 7 x 10 Min, or about 1.15 hours per week, this would allow him to earn 1.15 x 1/2 oz = .58 Oz. Clearly he is well ahead (.58 - .43 = .14 oz)! Not only that, but he is supporting another worker... the dish washer. Therefore, not only he but the dish washer - and society - are better off.

Of course, there is a limit to how much he can afford to pay, before he takes a loss...

The most he can pay is .58 oz per week; this is what he makes by doing brain surgery for 1.15 hours. If the hired dish washer takes 30 minutes, then the 'break even' pay is about 1/6 oz per hour.

If there is a minimum wage imposed by government that is higher than the value he can afford to pay to have his dishes washed (1/6 oz per hour) he will be obliged to wash dishes himself or lose money. We now have more unemployment (the dishwasher) as well as more diseased brains going without treatment!

If any artificial transaction costs like sales tax or VAT are introduced, all parties suffer... both the seller and the buyer. And don't think that all Mr. S has to do in the modern world is buy a dish washing machine, and the whole problem goes away.

In fact, similar value calculation can be made; the capital cost of the dish washing machine, operating expenses including electricity and soap, maintenance, depreciation, and labor costs; loading/unloading time.

Exposing the truth behind this Gold myth exposes the truth behind socialist lies... the world will not make any real progress until these and other lies are recognized, and the sometimes well hidden truth is seen, and acted upon, by the 'silent majority'.

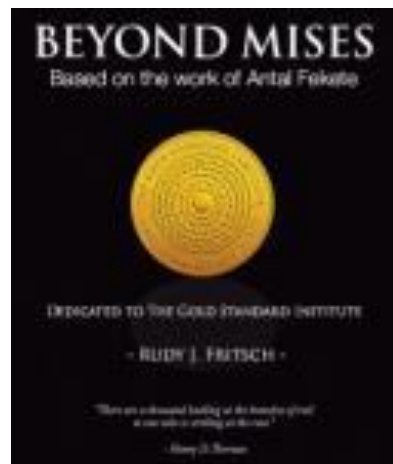
Instead of whining about how 'disadvantaged' some people may be under Gold, how about NOT robbing them through inflation, taxation, social engineering, and war... all made possible by fake paper 'money'?

If all these malevolent, non-productive costs are eliminated, there will be no poverty in this world. Thus the Gold Standard Institute motto; Liberty, Prosperity, Peace... all possible but ONLY under an honest, unadulterated Gold standard.



Rudy Fritsch

Order Rudy's [Beyond Mises](#) now.



Cash4Gold Means Gold for China?

Inflation is appearing in global food prices, arguably the main cause of recent Mid-East unrest. Economic shocks from the spreading revolution are further stressing the fiat currency system. Central banks may need to expand their interventionist activities yet again, or try an altogether different strategy.

Can we find clues to the *timing* of monetary authorities' next major change in tactics? In my last article, I discussed the possibility of a partial retreat by central banks to a semi-convertible gold standard, and the implications for the future of honest money. What might be a logical trigger for such an event?

Today, most physical bullion is already in the hands of long-term holders. Between central banks, the world's wealthiest families, and the upper-classes of nations such as India where multi-generational gold ownership/inheritance is common, very little metal remains available for large-scale accumulators.

China, Russia and other major nations seek to dramatically increase their official government holdings, yet the institutional market may not offer sufficient deliverable metal. Is there another potential source? Yes – the cash-for-gold industry.

Gold advocates might have mixed feelings about the new mail-in or store-front gold refinery services. While such companies highlight gold's rising dollar price, and also subtly remind people gold is synonymous with liquid cash, they may ultimately harm the cause of honest money.

First, the positive message to would-be gold owners implicit in these firms' very existence is distorted by astoundingly bad logic from financial commentators. Gold buyers are advertising regularly, including Cash4Gold's famous 2009 Super Bowl spot. But perversely this is held up as evidence that gold's gain in value (the US dollar's decline) is reaching an end - as though private corporations offering to buy gold from the public were the same thing as the public itself queuing to purchase metal.

To be fair, there are also numerous ads *selling* gold to the public, often at extremely unfavorable rates.

Whether the amounts being purchased by the public offset the actual weight collected by mail-in refineries is unclear, however.

Second, the wide dispersion of gold jewelry in western households can cushion the impact of an unplanned (panic) transition to gold and silver money. To the extent it has been extracted, leaving people with no immediate ability to feed themselves when fiat money fails, there will be additional barriers to a successful transition. A man with no food and no clear hope for improving circumstances has little to lose by rioting.

How much gold jewelry is available in North America for refiners? (I will ignore Europe and Asia, given the higher regard in which gold is held there.) An industry contact tells me the average household owns jewelry containing 0.75 ounces of gold. With 130 million households, that represents approximately 3,000 tons - a major source for potential accumulators. It would not surprise me if the Chinese government was the final buyer for all these mail-in services, or perhaps even the true behind-the-scenes operator of them.

How quickly is gold being extracted from the public? Cash4Gold's 2010 purchase rate was reported as in excess of 1,700 ounces per day – still less than 15 tons per year. Even assuming Cash4Gold represents only 25% of the market, 60 tons is only a 2% depletion rate. This suggests a long delay before available physical gold truly runs out.

But we know it is a dynamic process. There is a profit to be made... immediately on the operating margins and long-term through appreciation of gold's purchasing power. So, free market economics correctly dictates that cash-for-gold competitors will pile in until the market is totally saturated and the 3,000 ton resource is largely depleted. Or until the return of gold and silver as money. Where the tipping point might come depends on other circumstances in financial markets. But if, say, 1% of this reservoir had already been processed before 2010, and the current 2% annual rate of extraction doubles every year, fully one-third of this gold will be gone by the end of 2013.

Some interesting recent commentary has highlighted another major pool of available metal. The largest gold exchange traded fund, the SPDR Gold Trust (GLD-NYSE), may also be serving as a final 1,200 ton reservoir for institutional investors, who can source physical gold through the delivery mechanism available to big purchasers. If true, this pool will be drained much faster than North America's aggregate household jewelry, because of the simplicity of the ETF's operation. At that point, whether gold mail-in operations can sustain the fiat system will depend on the extent (and rate) of jewelry extraction then prevailing.

Or, more accurately, it will depend on whether the average citizen has awoken to the monetary properties of what little gold he still possesses.

Publius

An Analysis of the Reserve Bank of Australia's 1997 gold sale

During 1997 the Australian government, through the central bank (RBA), 'sold' some two-thirds of Australia's gold reserves. The official version of events goes that since gold is no longer important to the international monetary system, the central bank no longer needs to hold it as an asset against its liabilities, there are much better assets to hold, ones that even pay interest!¹ And certainly, gold is not money now, even if it was in the olden days.

On the other hand there are many who believe that central bank gold sales - not just Australia's - were the deliberate policy of faceless bankers to suppress the price of gold. I think that the reality is more accurately described by applying the central tenet of the Gold Standard Institute, that *money is what extinguishes all debt*, which, owing to the fact that governments and their central bank obligations are irredeemable debt, they cannot possibly extinguish debt, which makes gold the only true money. Which means that central bank gold sales were nothing more than extinguishing debt. Who's debt? Ours.

As Graphs 1 & 2 on the following page show, RBA gold sales were about the time of the Asian Financial Crisis. Coincidence? I doubt it.

Graph 3 gives the percentage change 12 months ended of M3 and Broad Money, two measures of the growth of system credit, or, the money market. From Graph 4 it is clear that the increased issuance of government debt² is a response to rapidly declining credit growth, or, economic recession. Note the peak in total holdings of government debt we see in 1997, about the time of the Asian Financial Crisis.

During the crisis, governments of the nations affected were unable to issue more irredeemable obligations to assuage their creditors. At its low point the Indonesian rupiah had fallen by 86% against the US dollar³ and civil strife was prevalent throughout the archipelago. In desperation Thailand even encouraged people to hand over their gold jewellery to be melted down to boost the central banks' reserves³. In at least one case - The Solomon Islands - the credit of the government failed entirely. The Solomon Islands descended into a state of violent civil strife from - you guessed it - 1997 to 2003. The Solomon Islands dollar was devalued by 20% in December 1997 alone.

Considering the outstanding level of Australian government debt at the time, I think it likely that the Australian government was forced to extinguish a portion of its debt, rather than roll it over - issue new debt - or face a significant devaluation of the Australian dollar (AUD), with any attendant social consequences. It did this with the only commodity that can extinguish government debt, true money.... gold. Like many Asian currencies the AUD did depreciate against the USD from 1997. So the government did not 'sell' its gold at all, rather it redeemed part of its financial obligations.

The USD gold price did not rise in 1997 but rather fell, albeit slowly, until 2001. There was no financial crisis in the US in 1997 thus no need to extinguish US government debt. Instead the US financial crisis began a few years later in 2001 and continues to this day, along with every other nation. In fact only the other day I read of civil strife in Indonesia, similar to 1997 onwards.

Looking at the current level of outstanding government debt, it seems the Treasury has forgotten any lessons given by the Asian Financial Crisis and looking at the current gold reserves of the

RBA, I have to ask, where's the gold going to come from next time?

Justin Downie

Notes:

1. This explanation conveniently ignores the fact that the RBA had been loaning its gold reserves, according to the Australian Bureau of Statistics, since 1986. These gold loans of course accrue interest.
2. Data for Treasury note issuance is not available pre 2001 but I think it safe to assume that they were being issued pre 2001.

