The Gold Standard

The journal of The Gold Standard Institute

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

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Annual Member	US$100 per year
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Gold Member	US$15,000
Gold Knight	US$350,000
Annual Corporate Member	US$2,000

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While Gold is not something talked about in polite company, impolite company relishes hearing and talking about it, shouting about it; none more so than the members of the Gold Standard Institute.

These are the people who not only have the wit to understand the cause of the world's current predicament, but the level of responsibility to contribute to the solution.

For some it is just too hard: hard to understand, and even harder to imagine being able to change the status quo. Oddly enough changing the status quo is easy; it will happen even if no one does anything. Change is the only thing that is certain. The trick is putting a sensible direction to it.

There are many Gold quasi-experts banging on their drums. Their heart is in the right place, but their willingness and/or ability to apply themselves to the real problems at hand is lacking.

So much nonsense is talked about money; so many charlatans are given space that it is not surprising the general public is confused. Those who proposed that Bitcoins could rise to the heights of Gold, or exceed its applicability, are prime examples of this.

Those who cheerlead for a Gold standard controlled by governments should also hang their heads in shame. There is a saying about doing the same thing over and over while expecting a different result.

Support for government control of money is usually done from the point of view that it has been that way for so long that no other way can be imagined. If governments had always had a monopoly on wheel making it would be defended with the same intellectual rigour and by the same people, and we would still be driving around on wooden wheels.

Philip Barton
President, Gold Standard Institute
Dawn of Gold

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The Coming Liquidation

Total world debt has been calculated recently at $223 Trillion dollars. World debt has increased some 40% since the crisis of 2008-2009; as I recall, it was about $157 Trillion at that time. The $223 Trillion is actual debt, and does not include the potential debt lying in derivates of this debt, which is another humongous amount and would become debt should there be any default on the $223 Trillion world debt.

The $223 Trillion world debt is like a huge cloud up in the sky.

It is of vital importance for the world of finance, as it presently exists, that the $223 Trillion world debt continue up in the sky, and that it not be subject to liquidation.

Liquidation and payment are two different things.

Liquidation means that holders of debt seek to exchange the debt they hold, for cash.

The problem for the world´s central bankers is to keep the debt cloud up in the sky and avoid at all costs a deluge of liquidation. That is to say, there must be no movement to get rid of bonds in exchange for cash.

World debt will continue to be a massive cloud up in the sky, as long as investors wish to own bonds; since central banks drove down interest rates all over the world to absurdly low levels - even to negative interest rates - prices of previously issued bonds rose to equally absurd levels and thus created huge profits for those who owned those bonds.

World debt is not being paid down and has to grow, because the debt is being rolled-over, and rollovers include interest due. So the debt cloud has to get bigger.

When interest rates tick up, as they did just recently, this is an indication that the market is showing a nascent preference for cash, rather than bonds.

This incipient increase in interest rates is warning that we may see, at some point, a widespread desire to dump bonds for cash; that would mean a jump in interest rates which would lower the prices of bonds, and the fall would cause losses to holders of bonds and other credit instruments which form the debt cloud. Hasty sales of bonds would aggravate the fall in values and reinforce the rise in interest rates. As in all cases of panic, those who panic first have the greater chance of avoiding losses.

There is a further problem: the great majority of investors and the giant investment funds are, all of them, invested in bonds, on which they realized great profits when interest rates began to fall. But if all the big investors are owners of bonds, who are they going to sell their bonds to when they wish to liquidate them and get into cash? These investors are going to suffer big losses, because the prices of bonds will have to collapse. This is going to take place the moment that the investors think that the trend in interest rates is no longer down, but up.

Banking systems are investors in bonds, and bonds make up an important part of their assets. In Europe, if the assets of the banking system fall by only 4%, then the whole European banking system is bankrupt. A collapse in bond prices caused by rises in interest rates would be deadly for the whole European banking system, and if Europe collapses, the rest of the world would have to follow suit.

Interest rates will have to rise, sooner or later; central bankers tremble when they see the slightest sign that interest rates are ticking up. Obviously, the FED and ECB cannot even think of raising interest rates; they are trapped and wait in dread for the deluge of bond liquidation when the $223 Trillion debt cloud hanging over the world turns into a cloudburst.

Hugo Salinas Price

Hugo Salinas Price is a retired entrepreneur and President of the Mexican Civic Association Pro Silver, which he founded.

How Could the Fed Protect Us from Economic Waves?

Mainstream economists tell us that the Federal Reserve protects us from economic waves, indeed from the business cycle itself. In their view, people naturally tend to go overboard and cause wild swings in both directions. Thus, we need an economic central planner to alternatively stimulate us and then take away the punch bowl.

Prior to the global financial crisis of 2008, a popular term described the supposed benefits created by the Fed. The Great Moderation referred to the reduced volatility of the business cycle. For example, I have written before about economist Marvin Goodfriend, who asserted that the Fed does better than the gold standard.

(Credit for The Fed Protect Us from Economic Waves visual: Greg Ziegerson and Keith Weiner, click here for larger image)

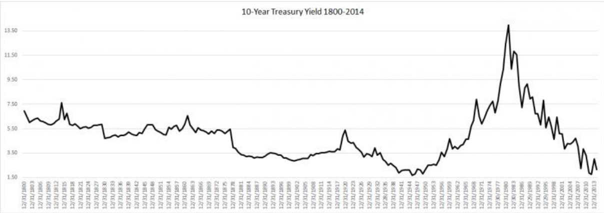
This belief is inherent in the Fed's very mandate from Congress. The Fed states its three statutory objectives as, "maximum employment, stable prices, and moderate long-term interest rates." These terms are Orwellian. Maximum employment means five percent of able-bodied adults can't find work. Stable prices are actually rising relentlessly, at two percent per year. The meaning of moderate long-term interest rates must be changing, because rates have been falling for a third of a century.

That aside, the basic idea is that the Fed has both the power and the knowledge to somehow deliver an economic miracle. However, we know that central planning never works, even for simple things such as wheat production. Communist states have invariably failed to produce the food to keep their people alive. Stalin, Mao, and other communist dictators have deliberately starved off segments of their populations that they couldn't feed.

The business cycle is vastly more complicated than the crop cycle. It plays out over decades. It involves every participant in the economy. It affects every price, including, especially, the price of money. It causes changes in how people coordinate in the present and how they plan for the future. And, there are feedback loops. Changes in one variable cause changes in others, which come back to affect the first variable. The very idea of centrally planning money and credit boggles the mind.

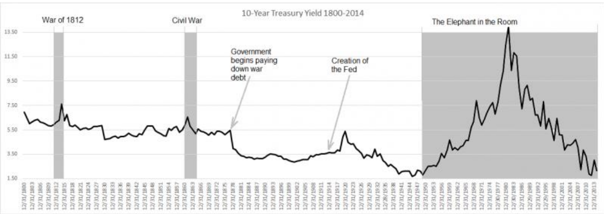
This should not be controversial. Yet, even those who know why government food planners fail, somehow retain their faith in central planning of the economy as a whole. Marvin Goodfriend—who spoke in favor of free markets, by the way—called his faith in central banking, "optimism."

Is it true that the Fed is actually somehow providing stability, or even improving on a free market? Let's look to the interest rate on the 10-year Treasury bond. The rate of interest is a key economic indicator.



(source: National Bureau of Economic Research 1800-2001, US Treasury 2002-2014, click here for larger image)

With that giant peak on the right side of the graph, we can immediately reject all claims to Fed-imposed stability. Now let's label a few key dates.



(click here for larger image)

The pre-Fed period is pretty stable. Two spikes occur due to wars that we know disrupted the economy—and they're pretty small, considering. Interest declines to a lower level when the government was paying down its war debt. Things remain stable until the creation of the Fed.

After that, we get a rise, a protracted fall, an incredible and truly massive rise, and an endless freefall. Both rising and falling interest make it more difficult to run a business that depends on credit, such as manufacturing, banking, or insurance. The post-Fed period is a lot less stable than the pre-Fed.

A feature of the free market and its gold standard is interest rate stability. The rate can vary between the marginal time preference and marginal productivity. This tends to be a stable and narrow range.

Fed apologists argue that the economy would be even more unstable, if we had no monetary central planner. However, the fact is that it became a lot less stable after the Fed was created.

Keith Weiner
President, Gold Standard Institute USA

Discounting Accommodation Bills

Some proponents of the real bills doctrine and many opponents of the real bills doctrine present accommodation bills as legitimate bills for discounting. Some do so out of ignorance. Others do so to disparage the real bills doctrine.

An accommodation bill is essentially a promissory note where the borrower secures accommodation from a bank on his own note (single name paper) or on an endorsed note of his customer (double name paper). Whereas real bills of exchange represent past transactions, accommodation bills represent future transactions. With a real bill of exchange, goods are in the process of being purchased or have been purchased. With an accommodation bill, the goods are not in the process of being purchased; they are to be purchased in the future.

A real bill of exchange provides for its own payment; it is self-liquidating. When the retailer sells the merchandise represented by the bill of exchange, the retailer receives the gold necessary to pay the bill. Thus, a real bill of exchange is self-liquidating.

An accommodation bill is not self-liquidating. As it represents goods not yet produced, whatever the accommodation bill represents does not provide the gold necessary to pay it.

Discounting accommodation bills leads to inflation, i.e., more bank credit money (bank notes and checkbook money) enters the community than new goods. This inflation is eventually followed by an economic contraction.

Discounting a real bill of exchange leads to a smooth operating economy. Credit money represents goods in the process of being sold, i.e., the goods represented by the bill of exchange, and provides the money to purchase the new merchandise. It also provides the funds to pay workers before the goods are sold without resorting to borrowing. As this credit money is removed when the merchandise is sold, it does not lead to inflation or economic contraction.

The following example illustrates the difference between discounting a bill of exchange and an accommodation bill. New products of a community are being produced and consumed at the rate of £100,000,000. The value of these products is represented by bank notes and checkbook money via the discounting of bills of exchange. As far as currency is concerned, business would remain in a normal healthy condition.

To this example, let's add the assumption that banks want to maintain a 20 percent reserve in gold coins. That is, bank reserves equal £20,000,000. Furthermore, let's assume that some smooth-talking pettifoggers convince bankers to discount their accommodation bills equal to £10,000,000. Now the community has £110,000,000 of credit money with which to buy £100,000,000 of goods. We also assume no loss in confidence.

The result is inflation and a rise in prices. As the community was producing only £100,000,000 in products, much of the new demand will be met by increasing imports to absorb the additional £10,000,000. Gold would be used to pay for the imports as the foreign sellers have no need of the community's credit money. The remainder of new demand would cause additional unsustainable domestic production.

Having consumed the money for the accommodation bills, the drafters, the pettifoggers, would have nothing with which to pay the bills when they mature. Thus, the holders of the bank credit money created by the accommodation bills become creditors of the banks of the amount of £10,000,000 when the bills mature. Thus, the outstanding credit money would be presented to the banks for gold.

If the banks had maintained their 20 percent reserve ratio, they would have £22,000,000 in gold backing their outstanding credit money issued to buy bills of exchanges and accommodation bills. If the excess credit money created by discounting the accommodation bills were redeemed, bank reserves would fall to £12,000,000. Thus, banks have to reduce new discounting to £60,000,000 to maintain a 20-percent ratio. Instead of being able to discount £100,000,000 in bills of exchange as the community requires, they could only discount £60,000,000.

As a result of discounting accommodation bills, the quantity of credit money drops from £110,000,000 to £60,000,000. Economic stagnation quickly follows and bank runs become highly likely. As the banks lack the means, gold, to pay all their outstanding notes and checking account moneys, bankruptcy and suspension of payment results — all from discounting non-self-liquidating bills.

As the above overly simplified example shows, banks should only discount self-liquidating bills, real bills of exchange, with bank credit money. Otherwise, economic disaster can, and often does, occur.

Thomas Allen
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Today: War on Cash. Tomorrow: War on Gold?

The "war on cash" story is getting a good run on the usual websites (try here, here and here for a sample) and no surprise to see some hype involved like this from Martin Armstrong (debunked by Bullion Baron here). Generally commentators are seeing this as positive for gold, but I'm not so sure it is good for gold in the long run.

The idea is that to get around the "zero bound problem" – where central banks cannot reduce interests rates too far below zero because people will withdraw cash to avoid negative interest rates (see JP Koning for more on this issue) – central banks will ban or punitively tax cash. To avoid this, people will buy gold instead of holding bank deposits, and/or use gold transactionally, which will increase demand for gold and its price.

I think that is a viable scenario with potential to go mass market depending on how aggressive the government gets. However, consider this selection of quotes on the "cash problem", which are fairly representative of mainstream economic thinking:

- Frances Coppola: *"it is only those who seek to evade monetary policy who find convertibility suspended"*

- Jim Leaviss: *"the authorities will be able to encourage us to spend more when the economy slows or spend less when it is overheating"*
- Peter Bofinger: *"it would make it easier for the central bank to enforce its monetary policy"*
- Kenneth Rogoff: *"given the persistent and perhaps recurring problem of the zero bound"*

Note the use of "evade" and "enforce" (lets ignore for the moment that they are talking about policy, not law) – the attitude is that a central bank cannot be restricted in its need to *"fight a large deflationary shock"*, it must be able to reduce interest rates as far as possible until people do what it wants. There is no consideration of whether the existing policy is working or is counterproductive, more of the same medicine must be allowed to be administered.

This attitude means that if people find another way of evading the "policy" to force spending over savings, we can be sure that the thinkers will call for that method to be banned as well. They are already there, as Rogoff notes in his paper:

"It is unclear how easily these activities [use of anonymous cash] *could substitute into other transactions media, but presumably this could be made difficult by restricting other potential anonymous transactions vehicles."*

It doesn't get any clearer than that. I like the euphemistic "anonymous transaction vehicles" – gold and silver surely are the only globally recognised and easily used substitutes for physical cash (sorry, bitcoin is not easily used or understood by the mass market).

In the past I haven't see gold confiscation as a likely scenario, but that was pre negative interest rates. If central banks continue down this path and can get governments to agree that they must be allowed to force people to spend, then it does change the risk assessment of confiscation.

However, I do not want to get all hype-ish myself. Policy and politics wise it is not a universally held view that cash should be banned, and we are speculating that people will just take a cash ban without any resistance. To be fair, Kenneth Rogoff did raise a number of costs to banning cash, which would cause policy makers to move cautiously. Also consider these thoughts from Carl-Ludwig Thiele from the German Bundesbank:

"we believe that there should be a mix of different payment instruments and government agencies do not have the right to tell the citizens how they should pay"

Then again, Germany is repatriating a fair bit of gold from the US, even if slowly.

Bron Suchecki

Bron Suchecki writes in a personal capacity and the views expressed do not represent those of the Perth Mint.