THE GOLD BASIS IS DEAD — LONG LIVE THE GOLD BASIS!

Antal E. Fekete
Professor of Money and Banking
San Francisco School of Economics

Fool's gold basis

A year ago I conducted a Seminar on the gold basis and backwardation in Canberra, Australia. I suggested to my audience that the gold basis (premium in the nearby futures on spot gold, with negative basis meaning backwardation) as a "pristine indicator that, unlike the gold price, cannot be manipulated or falsified by the banks or by the government. Thus it is a true measure of the perennial vanishing of spot gold from the market, never to return, at least not as long as the present fiat money system endures."

That was then. Today we are one year older and that much more experienced. We now know that the banks and the government have in the meantime found a way or two to manipulate the gold basis as well. Next month I have another Seminar coming up in Canberra. I shall address the problem of gold basis, giving a full account of what we know about the efforts of the powers that be in trying to falsify this most important indicator, the guiding star of refugees who have entrusted their fate to a golden dinghy on a stormy sea. To the government, the gold basis is like the naughty child who blurts out unpleasant truths. He must be gagged and silenced at all hazards. Fool's gold basis is even more important than fool's gold in terms of the number of people victimized.

The "Let's get physical" movement could trigger a chain reaction

A prime suspect is the gold basis calculated using COMEX futures prices, or the forward gold price of the London Bullion Market Association (LBMA). Further suspects are: certain gold Exchange Traded Funds (ETF's) such as GLD and their weekly updated bar lists; certain central banks such as the Bag Lady of Threadneedle Street (nickname of the Bank of England) that has rushed to the rescue of her agents, the bullion banks, trying to bail them out by offering substandard (22 carat) gold in settlement of contracts at the verge of being defaulted. Substandard gold stinks, as I shall explain below.

There seems to be circumstantial evidence that this month the gold exchanges are unable to honor their expiring contracts for which delivery notices have been issued in September. It has occurred in spite of a robust, even increasing, contango. Furthermore, circumstantial evidence exists that counterparties to these expiring contracts for future delivery — bullion banks, to be precise, the name of J.P.Morgan and Deutsche Bank being prominently mentioned — have offered bribe money up to 125 percent of the quoted spot price to holders of long contracts if they would take settlement in paper, on condition that the embarrassing affair will be kept secret. If true, these maneuvers are motivated by the desire to conceal the real gold basis, and to deny that gold is in or approaching backwardation. If the truth were widely known, then there would be a run on the bullion banks. The "let's get physical" movement would trigger a chain-reaction culminating in all offers to sell physical gold being permanently withdrawn around the globe. "Gold would not be for sale at any price", whether quoted in US or in Zimbabwe dollars — or, for that matter, in any irredeemable currency — the only kind of money people are allowed to have nowadays. The curtain would fall on the "Last Contango in Washington". The day of permanent gold backwardation would dawn. The chapter on a reactionary episode of history, irredeemable currency, allowing the Treasury and its central bank to create unlimited liabilities out of nothing which they have neither the means nor the intention to honor, but could use them for check-kiting purposes to mesmerize gullible people around the world, would be closed and become but a bad memory.

"Honey, I've shrunk the bar-list!"

We must guard ourselves against falling victim to the rumor-mills, while keeping our eyes peeled for the very real possibility that the growing shortage of physical gold can no longer be papered over with paper gold (pun intended). Another story is about GLD, a leading gold ETF, which publishes its bar-list every Friday at the close of business, reporting the serial number of every bar in inventory. The list is customarily well over a thousand pages long. But, lo and behold, on Friday, October 2, and on Friday, October 9, the bar-list shrank to a mere couple hundred pages, with no explanation offered. Could it be that the management of GLD has taken a bribe, and replaced physical gold in inventory by paper gold, in order to save the face and skin of the bullion banks that have gone naked short and subsequently got cornered?

If so, it won't get very far. The leadership of the US House of Representatives may well be able to put in deep freeze the motion of Dr. Ron Paul, seconded by over 250 other congressmen on both sides of the aisle, to audit the Federal Reserve, but it has no power to stop the auditing of the ETF's or bullion banks as required by contract law. According to some reports independent auditors, at the insistence of parties holding expired forward purchase contracts to deliver gold, are descending on ETF's and check their vault's contents against their books. The noose is tightening around the neck of fraudulent banksters caught in the short squeeze.

Archimedian test

Reports are circulating that similar audits of certain Asian depositories have already produced "good" delivery bars (400 oz or 12.5 kg gold bricks) that have been gutted and stuffed with tungsten — a metal whose specific weight approximates that of gold, so that the famous test of Archimedes (fl. 287-212 B.C.) based on the Law of Buoyancy, designed to expose fraudulent goldsmiths, would be inapplicable. Isn't it strange that criminal law punishes the fraudulent stuffing of gold bars, but allows the stuffing of gold assets in the balance sheet with paper gold? After all, the specific value of tungsten is much higher than that of paper!

According to a well-known anecdote, King Hiero II of Syracuse ordered his goldsmith to make him a new crown in the shape of a laurel wreath out of solid gold. When the finished crown was delivered to him, the king had reasons to suspect that he had been short-changed by the goldsmith who presumably diluted the gold with base metals. He called upon Archimedes to make the determination but without damaging the crown. After some hard thinking Archimedes solved the problem. He could determine the volume of the crown by submerging it in water, and from the volume and weight he could calculate the crown's density. Comparing it to that of gold, the fraud would be exposed if the density of the crown were lower. It is evident that, if the goldsmith had had a metal at his disposal of the same density, but cheaper than gold, then Archimedes' test would have been inconclusive. It is this property of gold that makes it second to none among the metals, along with other similar fine properties, explaining why it is a most desirable form of wealth.

The revenge of the looted coins

In 1933 F.D. Roosevelt did not stop at the mere confiscation of the constitutionally mandated gold coins of the realm. He sent them to the refinery in order to melt them down. He wanted to expunge the evidence from history that this great republic once had the largest pool of circulating gold coins anywhere, ever. Roosevelt betrayed his oath that he would uphold the U.S. Constitution and went ahead to rob the citizenry by calling in the gold replacing it with Federal Reserve notes, the value of which he promptly cried down by 56 percent, under the disguise of monetary reform. The melted gold was given the shape of gold bars and was stored in Fort Knox, West Point, and other depositories.

Careful as though Roosevelt was to cover his trail in getting away with the loot, he has made one major blunder. He failed to make the looted gold fungible. The coins were not made of pure gold: they were an alloy 22 carat in fineness. The reason was to make them stand up to wear and tear better in circulation. All countries striking coins for general circulation employed an alloy. Roosevelt thought that he could save the cost of refining the melted gold to the international standard of 995 fine (24 carat) so the gold bars in Fort Knox are only 22 carat fine. In consequence these gold bars are not fungible. They are easily identifiable as contraband, the proceeds of the Great Gold Heist of 1933. The shear quantity of this looted gold makes it impossible to refine it at this late hour. The U.S. gold stinks, and will keep on stinking.

The memory of the Crime of 1933 comes back to haunt the government that committed it. For 75 years nobody suspected that one day these gold bars may be needed to pacify the market. Everybody thought that they could rest in peace in the depositories till doomsday. But then, as the proverb says, ill-gotten goods seldom prosper. The Great Financial Crisis of 2007 struck and the dollar got into hot water. The U.S. Treasury ran out of fungible gold and had to dip into its hoard of looted gold. It is too late now; the bad odor cannot be expurgated from the U.S. gold hoard. Should this gold ever show up at an audit, or as bribe money, it will immediately be recognized. Everybody will see that it originated from the Great Gold Heist of Roosevelt and that the shame of the U.S. government is attached to it. Worst of all, it will also reveal that the U.S. has fallen upon hard times. The looted gold was released in desperation, in trying to stem the tide of burgeoning gold backwardation.

The result is that every time 22 carat gold pops up anywhere in the world, for example, as an offer to pacify angry possessors of expired gold futures contracts, it will be new evidence of the fact that Uncle Sam is cornered and tries to bribe his way out of the corner with looted gold. If Uncle Sam is trying to pay the blackmail on behalf of his cohorts the bullion banks, in offering 22 carat gold in settlement of contracts calling for 24 carat fineness, then the world will immediately know what's up, even if the substandard gold is offered through intermediaries. Everybody will know that Uncle Sam is trying to cover up, or fend off, backwardation to prevent the gold basis from going permanently negative. The telltale sign will haunt him and make the gold crisis worse, not better. Most of the possessors of expired gold futures contracts will refuse to take substandard gold for settlement, but neither will they keep Uncle Sam's secret. Apparently there are already two known instances where the looted gold turned up. Central banks, in coming to the rescue of their agent bullion banks that were caught red-handed in being naked short in gold, offered 22-carat gold to bail out their agents. This fact in itself makes the quantity of gold available for resolving the gold crisis smaller. Permanent backwardation in gold, the Nemesis of irredeemable currency, cannot be postponed much longer.

Blight on Humanity

Rob Kirby, the best sleuth we have to uncover government hanky-panky in the gold market, has castigated the cover-up of what he considers a severe backwardation in no uncertain terms. He calls central banks for their complicity in the cover-up a blight on humanity. In his opinion, the central banks are aiding and abetting the plunder of the sovereign assets of their countries to bail out their agents or friends in an attempt to "sweep the whole bloody mess under the carpet". This assessment is apt. It is no exaggeration to say that the regime of irredeemable currency is a blight on humanity. The Uncle Sam will never be able to live down his shameful role in plunging the whole world into the monetary abyss.

Central banks are also guilty of corrupting the young — a crime that was punishable by death in Athens at the time of Socrates. They have hijacked monetary economics lock, stock, and barrel. They have commissioned scribes for hire to rewrite it as a eulogy of their sordid trade, the creation of fiat money. Graduates of our universities are no longer taught that this regime has a 100 percent mortality rate through the sudden death syndrome, pauperizing the population in the process. The role of gold in history is falsified and distorted. People are told that harking back to gold money is a sign of backwardness and reactionary thinking. Modern money is managed money — as long as they themselves are entrusted with its management. In this view the U.S. Constitution is a backward document not worth bothering with, so they don't bother with proposing a constitutional amendment changing its monetary clauses to conform it to present practice.

Aristotle on alibi

An axiom of Aristotle states that no substance can be present at two different places at the same time. The reason for gold's monetary role is rooted in this very axiom. The same paper promise can be present in the asset column of the balance sheets of any number of individuals. The same gold coin cannot. This eliminates the possibility of a miraculous proliferation of money — putting latter-day money changers out of business. But once gold is removed from the monetary system, the miraculous proliferation of money starts in earnest. Central bankers will distribute it, if need be, from helicopters hovering overhead. The proof that this is beneficial to society is *ad hominem*. In this way, so the argument goes, the niggardliness of nature to release only so much gold per annum from the gold mines can be overcome. Money will get into the hands of those who need it most. They will certainly spend it. Never again will the economy seize up because of shortage of money.

The Quantity Theory of Money is a false doctrine because it describes the economy in terms of a linear model, when in reality the world runs on a highly non-linear pattern. Therefore we need a better theory to show that the miraculous proliferation of money is bound to come to a sorry end. It has been my ambition to construct a better theory. I am pleased that my theory of the vanishing of gold basis, and the ultimate permanent backwardation of gold under the regime of irredeemable currency has found resonance in some blogs and discussion groups, even if it is still *taboo* in the media and academia.

We have made great progress since last year's Seminar in Canberra. This year's Seminar will discuss the gold basis in the light of the very latest developments. The gold basis is not dead, it just needs to be correctly interpreteded. I shall show it to my audience how to do that through uncovering the hidden premium in the price of 24 carat gold available for immediate delivery; through the spread between the share price and the NAV of the gold ETF's; through the popping up of 22 carat gold bars offered as bribe money, and other miscellaneous signs of a very real physical short squeeze in the market for monetary gold.

See you in Canberra in November!

October 17, 2009

References

A.E. Fekete, *Red Alert: Gold Backwardation!!!* www.professorfekete.com, December 5, 2008

Rob Kirby, *Backwardation: Facts from Fiction,* www.financialsense.com, December 8, 2008

Rob Kirby, *Central Banking: A Blight on Humanity*, www.financialsense.com, October 9, 2009

Rob Kirby, *Blight on Humanity*, *Addendum*, www.financialsense.com, October 15, 2009

Calendar of Events

Auckland Club, 34 Shortland Street, Auckland City, New Zealand, 7 p.m., 28th of October, 2009.
Fund-raising dinner for the benefit of Ficino School. Invited guest speaker: Professor Fekete, *The Forgotten Centenary of the Introduction of Legal Tender Currency in 1909*.
Further information: www.goldstandard.co.nz

University House, Australian National University, Canberra: November 1, 2009.
Gold Investment Day, Common Room, from 9 a.m. to 5 p.m . Admission is free.

University House, Australian National University, Canberra: November 2 – 5, 2009.
The Vanishing of the Gold Basis and the World Financial Crisis, a Seminar of Professor Fekete with other invited speakers, sponsored by the Gold Standard Institute,
Further information: www.feketeaustralia@gmail.com

Cara Bahamas 2010 Conference, Lucaya Resort, Freeport, Grand Bahamas: January 15-20, 2010.
Professor Fekete, Sunday, January 17, **Hedging non-gold investments with gold.**
Further information from Cara Trading Advisors (Bahamas) Ltd., billcara@caratrading.com, www.caratrading.com

Martineum Academy, Szombathely, Hungary, in March 2010.
Stay tuned for further announcement.

Professor Fekete on DVD: Professionally produced DVD recording of the address before the Economic Club of San Francisco on November 4, 2008, entitled The Revisionist History of the Great Depression: Can It Happen Again? plus an interview with Professor Fekete. It is available from www.amazon.com and from the Club www.economicclubsf.com at $14.95 each.

DVD's of the Gold Standard University Sessions
Session 3 (Adam Smith's Real Bills Doctrine and Its Relevance Today)
Session 4 (The Bond Market and the Market Process Determining the Rate of Interest)
Session 5 (A Primer on the Gold and Silver Basis)
Session 6 (Encore Session: The Great Depression)
are now available. For details how to order, see the announcement on the upper left corner of the website www.professorfekete.com.