Redstone Advisors

Economic and Market Review

Second Quarter 2012

"Is there a greater tragedy imaginable than that in our endeavour consciously to shape our future in accordance with high ideals we should in fact unwittingly produce the very opposite of what we have been striving for?"
Friedrich A. Hayek, 'The Road to Serfdom'

"Hayek's greatest contribution lay in the discovery of a simple yet profound truth: man does not and cannot know everything, and when he acts as if he does, disaster follows.
Edwin J. Feulner Jr. on Friedrich Hayek's book, 'The Road to Serfdom'.

"We're doomed!" Such was the spontaneous exclamation of an eighteen year old summer intern working in our offices upon hearing the announcement that the Supreme Court had inexplicably voted to uphold the constitutionality of the individual mandate, the centerpiece of the national health care legislation popularly known as ObamaCare. To be sure, our current health care system is fatally flawed and unaffordable to the average American and as such, it should be radically reformed. However to suggest, as does most contemporary reporting on the subject, that the current status quo of our health care system somehow represents an indictment of free market libertarian ideals is to completely misdiagnose the disease. On the contrary, our current system of **government-controlled** licensing and regulation of physicians, health care providers, and hospitals, **government-conferred** monopoly privileges for pharmaceutical companies through FDA-approved patent protection, and **government control** over the pricing of health care, primarily through Medicare reimbursement rates, have, in the opinion of Dr. Gilbert Berdine, created *"a complex leviathan of interdependent cartels rather than a free market, and that leviathan is responsible for the problems."* With the good doctor, we are in complete agreement. In fact such has been our long-standing contention regarding the underlying cause and effect of the current global economic and financial crisis. For far from its' popular characterization as a **"black swan event"**, the current crisis was not only eminently predictable, but is in fact the inevitable outcome of the intractable law of **"sowing and reaping."**

However it is insufficient to merely identify a causal relationship between the interventionism of the central planners and the maladjustments of the market and economy. To stop there is to find fault solely on utilitarian grounds, i.e., it is to reject the "means" simply because they do not work. Economics, as we have oft repeated, is the ***"science"* of human choice**. It is not, as it is so often portrayed today, a quantitative discipline governed by exacting and unrelenting laws of nature. As such, the act of choosing by self-interested human beings is not well explained by either probability distributions or mathematical algorithms, no matter how sophisticated. We live in a world of uncertainty, and what is uncertain is by definition, both unknowable and non-quantifiable. Lacking omniscience, acting man determines and chooses in an effort to attain a certain end, and because we are moral beings, it follows that all such choice has moral implications. Therefore one of the primary goals of the science of human choice is to evaluate not simply the utility, but also the **fitness** of the **means chosen** to achieve a particular end. We have been agitating against the injustice of the means chosen by our government and our monetary authorities for many years, specifically the perpetual production of money and credit and the intentional debasement of our currency via inflationism and its resulting insidious impact on society. This **policy of inflationism** in order to enlarge and empower the state is, to borrow a phrase coined by the imminent French economist Jacques Rueff, ***"the monetary sin of the west."*** And as the word *"sin"* suggests, a policy of inflationism and interventionism ***is wrong***, and by extension ***"we are doomed"***, not just because the policy doesn't work, but because it is **immoral**. Ultimately Margaret Thatcher's famous imprecation against socialism – *"The problem with socialism is that sooner or later you run out of other people's money"* – does not describe a problem of economics, but a problem of social injustice.

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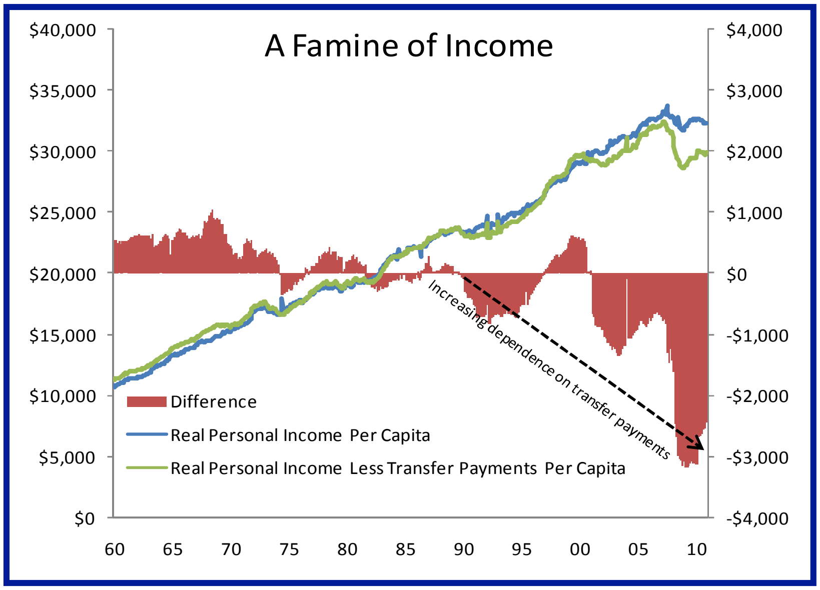
The production of money has an enormous impact on the relationships between people and societal groups. The implementation of legal monopolies, legal-tender laws and the legalized suspension of payments have become instruments of social injustice. They breed inflation, irresponsibility, and an arbitrary and inequitable distribution of wealth and income. Yet these ideals are not new. Aside from their grounding in Scripture, they are clearly articulated in the writings of economic philosophy, most prominently amongst the Scholastic tradition of the fourteenth and fifteenth centuries. In particular, the French Bishop Nicholas Oresme whose book 'The De Moneta' which was written sometime between 1348 and 1355, was the first formal treatise on inflationism. In his treatise, Orseme argues persuasively and conclusively that monetary inflation by way of a monarch's debasement of the currency is not only harmful, it is a moral evil. And while this particular method of monetary debasement is no longer practiced, the principals Orseme brought to bear on this topic are as relevant and important for our consideration today as they were then. Unfortunately the present day separation of monetary theory and theology has reduced the national discussion of monetary policy to the narrow confines of a central bank policy concerned solely with the chimera of "stability." As a result, the question of crucial import has gone largely unconsidered: Are there any just and equitable social benefits to be derived from the manipulation of the natural production of money?

How does the money arise naturally? It arises *from* production, not *by* it. All wealth is created through and backed by the production of goods and services through the application of labor. The writer of the book of Ecclesiastes affirms this in his description of a man's bequest of his wealth to his posterity: *"He will rule over all my labor in which I toiled."* As such, the nature of money is that of a claim against labor, a claim against wealth since all wealth is born of labor applied. The function of money is that of a means to exchange this production of labor within society. Money, then, was originally developed *by society* as an indirect medium of exchange in order to overcome the limitations of direct exchange or barter. In particular the fundamental problem of a "double coincidence of wants" – barter exchange only takes place if each trading partner has a direct personal need for the good he receives in exchange. In time, societies discovered that they would be better off exchanging their labor "indirectly" for a highly marketable commodity rather than waiting for the opportunity to make a "direct" exchange. Therefore in its most basic form, money is a claim against labor and production, which has historically taken the form of the most marketable commodity agreed upon by a free society to exchange this production. It is in this way that money may be said to *arise naturally* from production *and* the voluntary exchange of cooperation individuals. It also follows that as money is a claim against labor, money is rightfully the property of the society whose labor gave rise to it, not of governments. Therefore only natural money defined as commodity money of a specified and unchanging weight and fineness such as that authorized under our Constitution, can stand as the guardian of private property rights and individual liberty. The ideal of self ownership renders certain behaviors unambiguously immoral. Murder, rape and theft are immoral because they violate a person's property rights to himself. The intentional production and attendant devaluation of money by governments is immoral for the same reason. Ironically it was the modern day father of inflationism, Lord Keynes himself, who, writing in his book 'The Economic Consequences of Peace' in 1919, offers us perhaps the most striking commentary on the immorality of inflationism. While criticizing the belligerent governments of WWI for *"practicing from necessity, or incompetence, what a Bolshevist might have done from design"*, he vividly describes the reprehensible nature of this crime by government: *"By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency."* Such an abomination of justice is clearly forbidden in the Third Book of the Law; *"You shall do no injustice in judgment, in measurement of length, weight, or volume. You shall have just balances, just weights."* Nevertheless, the track record of ancient civilizations with regard to the practice of social injustice through monetary manipulation was no better than that of existent civilizations. Writing around the mid-eight century B.C., the prophet Amos warned his countrymen regarding their disobedience; *"Hear this, you who trample on the needy, and make the poor of the land fail. . . . Falsifying the scales by deceit, that you may buy the poor for silver. . . . . Behold the days are coming, says the Lord God, that I will send a famine on the land."*

We have written previously about the possibility of a **"coming famine of income",** the cause of which will be the continuing production and devaluation of fiat money to maintain and expand the encroachment of the state upon individual liberty (**Figure 1**), all done under the guise of *extremis malis, extrema remedia*, i.e., desperate times require extreme measures. [Recall it was Rohm Emanuel who at the start of the crisis famously said; *"Never let a serious crisis go to waste . . . it's an opportunity to do things you couldn't do before."*] In our opinion, this coming famine of income will be the result, not of an act of God, but of the deliberate choice of acting man. The production of money without a commensurate amount and disposition of work and production is both fraudulent and ultimately *doomed* to failure. When one counterfeits money, he takes useful things out of the market without producing other useful things to go into the market. If everyone tried to live off counterfeit money, one would at once discover its effect in the extreme. There would be nothing to buy with the money and in time, the money would become completely worthless. Such money, as we have suggested on previous occasions, would ultimately fail.

Figure 1



Upon what grounds may we make such an assertion? One has only to review the historical record for confirmation. And while there have been numerous instances in history depicting the role played by the intentional inflation of paper money and the resulting financial and economic crisis which ultimately lead to the destruction of societies and the overthrow of elected governments, we would commend two specific instances to your attention, the hyperinflationary episode of the French Revolution of the late eighteenth century and that of Weimar Germany in the early twentieth century. Both episodes involved sovereign governments who choose to abandon the restraint of commodity money in favor of the unlimited production of paper fiat money in the midst of severe fiscal and economic crises. Likewise both episodes resulted in the wholesale destruction of society whereupon thrift, integrity, humanity, and every principle of morality were thrown into a cauldron of chaos. And ultimately both episodes, through the evisceration of the political process, paved the way for the establishment of totalitarian regimes. For France it was Napoleon and for Germany it was Hitler.

The following is an excerpt from the Introduction of Andrew Dickson White's unsurpassed essay on the hyperinflation in France, written initially in the late-1870s and entitled **'Fiat Money Inflation in France'**. Ironically, Mr. White, co-founder of Cornell University, a professor of history, and a US diplomat, originally wrote this essay as a speech he gave in 1876 to the Senate of the State of New York as a warning to the country against the nascent stirrings of demand for large issues of paper money and an elastic currency in the United States at a time when the ground was being prepared for the eventual establishment of the Federal Reserve.

> *"The story of "Fiat Money Inflation in France" records the most gigantic attempt ever made in the history of the world by a government to create an inconvertible paper currency, and to maintain its circulation at various levels of value. Every fetter that could hinder the will or thwart the wisdom of democracy had been shattered, and in consequence every device and expedient that untrammeled power and unrepressed optimism could conceive were brought to bear. But the attempts failed. They left behind them a legacy of moral and material destruction and woe, from which one of the most intellectual and spirited races of Europe has suffered for a century and a quarter, and will*

continue to suffer until the end of time. There are limitations to the powers of governments and of peoples that inhere in the constitution of things, and that neither despotisms nor democracies can overcome. Legislatures are as powerless to abrogate moral and economic laws as they are to abrogate physical laws. They cannot convert wrong into right nor divorce effect from cause, either by parliamentary majorities, or by unity of supporting public opinion. The penalties of such legislative folly will always be exacted by inexorable time. The story, therefore, of the colossal folly of France in the closing part of the eighteenth century and its terrible fruits, is full of instruction for all men who think upon the problems of our own time."

Additionally, we offer the following excerpt from the book **'When Money Dies: The Nightmare of the Weimar Collapse'** by Adam Fergusson. Though written in 1975 and detailing events which occurred nearly 100 years ago, we believe that Mr. Fergusson's description of the crisis in 1920s Germany is eerily reminiscent of the crisis occurring today.

"The take-off point in the inflationary progress, after which the advent of hyperinflation was but a matter of time, the point indeed when it became self-generating and politically irreducible except for short periods, was not indeed to be found on the graph of the currency depreciation, or of the velocity of its circulation, or of the balance of payments deficit. What really broke Germany was the constant taking of the soft political option in respect of money. Day by day through 1920, 1921 and 1922, the reckoning was postponed, the more readily as the prospective consequences of inflation became more frightening. The take-off point therefore was not a financial but a moral one; Stability came only when the abyss had been plumbed, when the credible mark could fall no more, when everything that four years of financial cowardice, wrong-headedness and mismanagement had been fashioned to avoid had in fact taken place, when the inconceivable had ineluctably arrived. Money is no more than a medium of exchange. Only when it has a value acknowledged by more than one person can it be so used. The more general the acknowledgement, the more useful it is. Once no one acknowledged it, the Germans learnt, their paper money had no value or use — save for papering walls or making darts. . . . . This is, I believe, a moral tale. It goes far to prove the revolutionary axiom that if you wish to destroy a nation you must corrupt its currency. Thus must sound money [always] *be the first bastion of a society's defense."*

While the political institutions and monetary systems present during the hyperinflationary episodes in France and Germany were certainly different than those in existence today, the violation of the underlying moral principles remain the same. By pursuing a **policy of postponement** through the continuing production of money, we not only prevent the return of confidence and the resumption of business through the liquidation of malinvestments and the readjustment of the prices of the factors of production, but we **institutionalize injustice** by enabling the theft and transfer of wealth from, in the words of Vilfredo Paretto, the ***"trivial many"*** to the ***"vital few"*** [Vilfredo Paretto was the nineteenth century Italian economist who suggested the distribution of wealth and income in a nation followed a "power law", the famous 80/20 Rule] Writing in the third quarter of 2010, we said;

*"The stabilizer-induced boom-bust-boom cycle, both **redistributes** and **destroys** wealth through the debauchment of the currency, but it does not do so evenly. The favored few who receive the new emission of credit first [the banking oligarchy] obtain a **"claim"** against existing wealth that did not arise from productive activity. As such they stand in a position to exercise their claim and so command or **"draw off"** existing wealth before any adjustment to the relative price structure can take place. . . . . . However, those unfortunate enough to possess the new money at the moment of its depreciation will obtain a **smaller gratification** for the same amount and it is in this way that they are **impoverished**, almost imperceptibly, day by day. It is that **"loss"** that small, undetectable act of legalized theft which, **after forty years**, has swollen into a massive deprivation which today threatens many in the US and indeed throughout much of the socialized West, with a **famine of epic proportions**. Not a famine of grain, but a **famine of income** as reflected by the **stagnation of real incomes** and the ongoing **polarization of income** between the wealthy and the poor."*

The repudiation of the Bretton Woods gold-based standard in favor of the **"something for nothing"** promise of paper money, has led directly to an increased concentration of wealth and the demise of real income growth in the US. According to Edward Wolff, as of 2007, the wealthiest 1 per cent of households in the US owned 35 percent of all net household wealth and 56 percent of all stocks, while the **top 5 percent owned 72 percent of all net household wealth** and 80 percent of all stocks. (**Figure 2**) In addition, there has been a noticeable rise in the number of Americans beneath the official poverty level as well as a marked increase in the polarization of income. (**Figure 3**) As the lessons of France and Germany remind us, it is not the total wealth of a nation, but its distribution that is of paramount importance. The greater the imbalance in a nation's distribution of wealth and income, the greater the instability of its' society. For if the distribution is grossly imbalanced, a significant proportion of the population will be unable to ride out the storm, delaying the onset of the famine only by the encroachment of their personal liberty. Quoting yet another historian with a front row seat to a debauched currency and a declining empire, the Roman historian Plutarch observed; *"An imbalance between rich and poor is the oldest and most fatal element of all republics."*

Figure 2

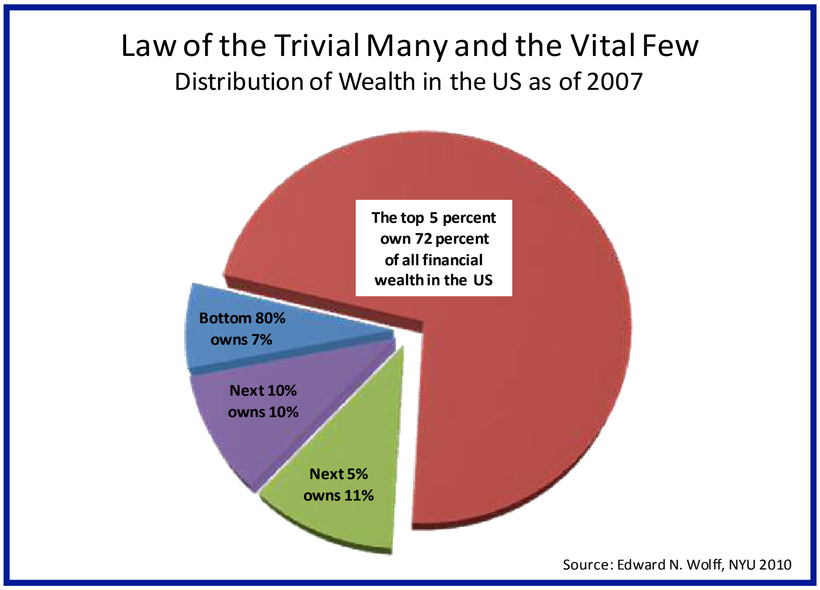
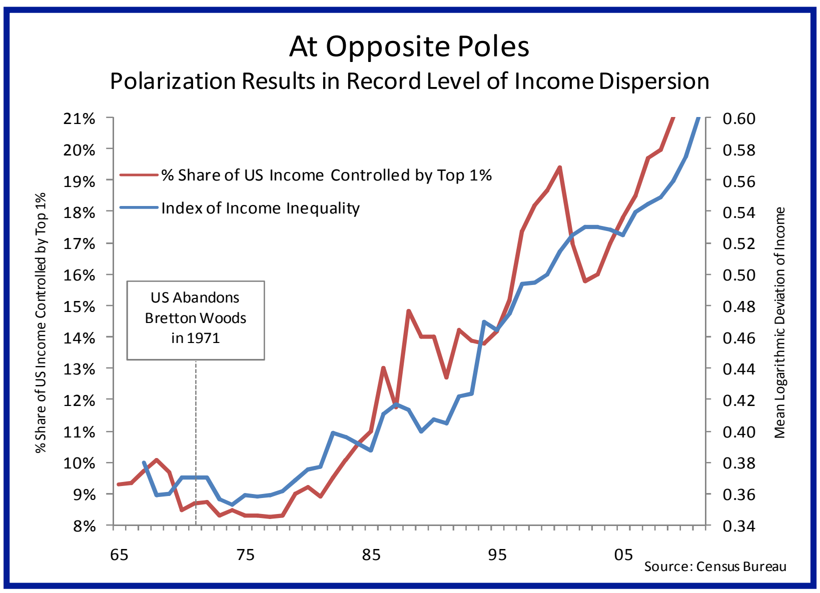


Figure 3



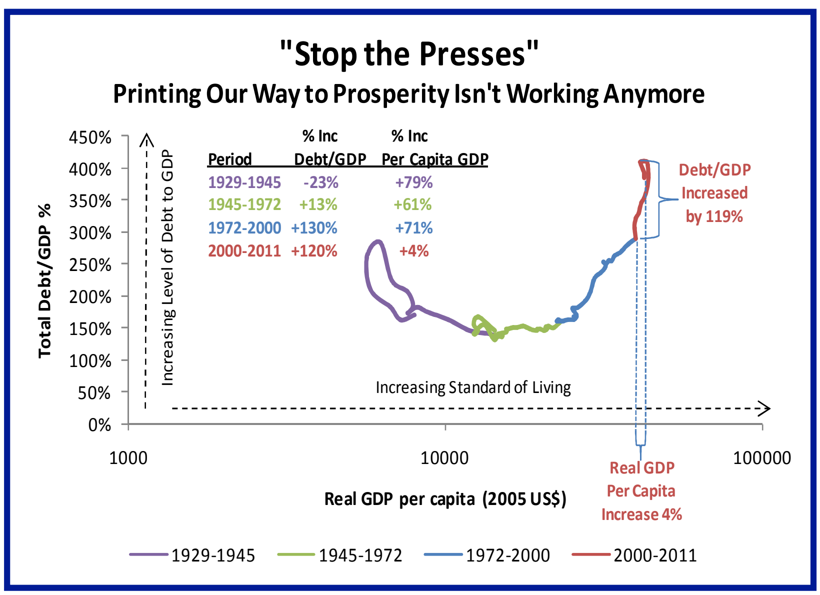
As we have maintained for years, faced with the prospect of an inevitable debilitating debt deflation [a famine of income] as a consequence of a perpetual policy of inflationism, the postponement of the day of reckoning has become the default political option of choice. This policy of postponement long pursued by the stabilizers in a vain effort to overcome scarcity and so annul uncertainty is reflective of a choice to take the road most traveled and pursue what Ferguson referred to as the *"soft political option."* For a nation seduced by the siren song of the Keynesian money miracle of turning stones into bread, the ultimate point of no return is not financial or economic in nature, it is moral. As such, the identification of a specific **"tipping point"** into hyperinflation for a nation committed to a policy of perpetual inflation through the production of money, lies, as Ferguson suggested, on the *"falling curve of political possibility",* the ever diminishing degree of political courage that a nation or its government is able to muster as the severity of the inevitable outcome of its own unsound action increases. This, in our opinion, is the real **"Tragedy of the Commons"**, when a nation finds it politically untenable to take action that, though morally right and in the best interest of the country in the long-run, would exacerbate unemployment and increase dislocation in the short-term, the ultimate consequences of which would be the disempowerment of the very government with the responsibility to take action.

However as we pointed out last quarter, the near universal agreement by professional economists and prognosticators of all stripes that the unprecedented level of intervention and money production has most certainly averted a repeat of the Great Depression, effectively reduces the national conversation to a sterile debate regarding which lever the man behind the curtain should pull. That he should in fact, pull no lever whatsoever, has not even entered into the discussion. In fact the suggestions being offered by those in positions of authority are illustrative of a man carrying an unlit torch into a dark room. By way of example, on June 3rd, former US Treasury Secretary and current Harvard professor Lawrence Summers penned an editorial for the Financial Times entitled ‘Look beyond interest rates to get out of the gloom’. In his editorial, which we commend to your careful attention, Mr. Summers spins a tapestry of sophism worthy of Lewis Carroll. Noting the *“signs of increasing financial strain”* in the US, Europe and Asia, Mr. Summers, in posing the question *“what is to be done?”*, concludes that *“rather than focusing on lowering already epically low rates* [QE3]*, governments that enjoy such low borrowing costs* ***can improve their creditworthiness by borrowing more not less****.”* [Clearly Standard & Poor’s did not get the fax prior to their downgrade of US credit] He grounds his conclusion firmly in the *“logic”* that *“at a time of negative real rates, accelerating any necessary maintenance project and issuing debt leave the state* ***richer not poorer****.”* Finally he augments his conclusion with a moral imperative; *“The greater your concern about the ability to borrow in the future, the stronger the case for borrowing for the long term today.”* We can only ruminate along with Will Rogers; *“If stupidity got us into this mess, then why can’t it get us out?”*

As Henry Hazlitt said in his book ‘Economics in One Lesson’, *“economics is haunted by more fallacies than any other study known to man.”* We believe that it is equally true that **every fallacy floats on a plausibility**, a plausibility usually made possible by the persistent tendency to consider only the immediate effects of a given policy, relegating the long-run effects of that policy to benign neglect. In fact we may even say that in this one fact lies almost the entire difference between good and bad economics. One need only consider how deftly Lord Keynes disparaged all consideration of the long-run in the sphere of economic calculation with his infamous statement that *“in the long run we are all dead.”* Keynes held that the long-run is a misleading guide to current affairs. Yet what is the long-run if it is not a compilation of the short-run. May not the short-run ever become the long-run? We have long criticized the exclusive focus on a short-run evaluation of the stabilizers long-running Sisyphean-like policy of money production as being worse than futile, it is ultimately destructive. As predicted by the science of human choice and borne out by the lessons of history, the continuing emission of paper money has acted to increase the volume of money and credit claims outstanding without a commensurate increase in the overall standard of living.

The fallacy of focusing on the perceived short-run benefits (increased economic activity) of a long-running policy of inflationism is clearly illustrated in **Figure 4** which is a reproduction of a chart originally found in Dr. Peter Warburton’s book, ‘Debt and Delusion’. This chart is somewhat complicated and requires careful interpretation. The vertical axis measures the ratio of the total

Figure 4



stock of debt in the US economy as a percentage of GDP. A rising line indicates an increase in the debt to GDP ratio. The horizontal axis is a logarithmic scale of real US GDP per capita and is a proxy for the standard of living in the US. A line which moves left to right indicates a rising standard of living while a line that moves right to left indicates a declining standard of living. The evolution of these two variables is reflected in the resulting wiggly line. The annual data covers the period from 1929 through 2011, with the data broken down into four time intervals, each represented by a different color line segment. And while the data points are presented in chronological order, there is nothing to prevent a line segment from folding back on itself or looping the loop.

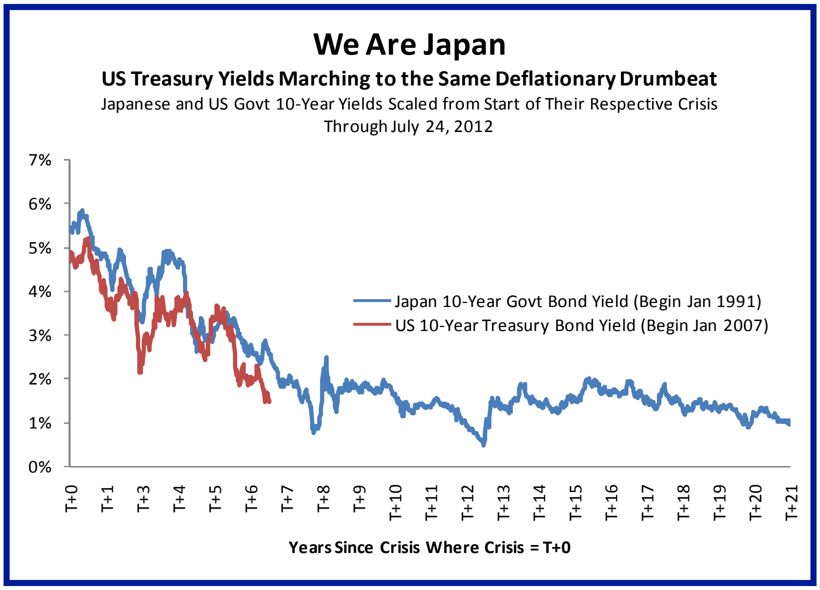
The interpretation of the chart is as follows. When the line moves horizontally from left to right as it did during the Bretton Woods era of 1945 to 1972, the standard of living was rising in the context of a stable debt multiplier. When the line moves from bottom-left to top-right as it did between 1972 and 2000 in the aftermath of the repudiation of Bretton Woods and the inauguration of the paper money era, a rise in the standard of living was accompanied by an expanding debt to GDP ratio. The steeper the line, the smaller the benefit to living standards for a given increase in debt. And while both scenarios saw a rise in the standard of living, clearly the Bretton Woods era of stable debt represents the most ideal arrangement. In the extreme situation of a sharply **rising vertical line** such as has been occurring since 2000, **credit is expanding exponentially without delivering any discernable short run benefit to real per capita income**. In fact, since 2009, the line has looped over on itself, indicative of the start of a debt deflation not unlike the period from 1929 to 1945 when the credit system broke down and living standards were failing [A famine of income]. As such, **Figure 1** strongly suggests we are now in a period of diminishing marginal returns for money production whereby each additional dollar of fiat credit put in place results in an ever diminishing return in the form of economic activity. This, in our opinion, offers corroborating macro-economic evidence of an impending famine of income resulting from the continuous application of a short-run stimulus over a long-running period of time. And while we would certainly agree with Mr. Keynes that in the long run we are all dead, it is nevertheless equally true that we can be just as sincerely dead in the short-run when in time, the short-run becomes the long-run. After all, it was Einstein who observed; *"The only reason for time is so that everything doesn't happen at once."*

We have long chronicled the macro-economic impact of the ever-increasing dependence of the US economy on the perpetual production of money, a phenomenon we have dubbed the **"financialization of the economy."** We have insisted that the long-run macro-economic outcome of the stabilizers preferred policy of postponement through the continual production of money would be economic stagnation manifesting itself in historically high and intractable unemployment, stagnant to declining real incomes, and a **"rolling recession."** Last quarter we highlighted the recent experience of Japan as illustrative of this form of **economic sclerosis** by pointing out the unprecedented downshift in Japan's GDP **trend growth** since the collapse of their housing bubble in 1990 and the start of their unprecedented experiment with money printing. In particular we noted that since 1990, economic growth in Japan as measured by nominal GDP growth, has all but stagnated, providing us with a real-time illustration of a **20-plus year rolling recession**. Across that time, the difference between Japan's actual GDP and their estimated potential GDP 20-years after the initiation of their program of money printing currently stands at a gaping **50 percent**. In other words, we said that Japan's GDP 20-years after the inauguration of a *"forceful policy response"* is today, fully one-half the size it would have been had economic growth remained on its pre-crash trend. This, we concluded, ***"is the real price of the central planner's successful failure."*** Interestingly, just one week after we printed that report, an important academic study was published by economists Carmen Reinhart, Vincent Reinhart and Kenneth Rogoff entitled 'Debt Overhangs: Past and Present', in which the authors concluded that ***"extremely high levels of indebtedness lead directly to diminished economic growth."*** After reviewing 26 episodes of debt overhang since 1800, the authors found that **economic growth was reduced by an average of 1.2 percent per year, for an average duration of 23 years!** That represents an average loss of 32 percent in GDP growth from the pre-crisis trend. According to Churchill, this kind of success is best described as *"going from failure to failure without loss of enthusiasm."*

We also stated that another area in which our experience has been remarkably similar to that of Japan has been the trend in long-term interest rates. **Figure 5** is an **update** of the chart we used last quarter to illustrate our contention. Recall that the chart compares the trend in 10-year government bond yields since the onset of the respective financial crisis in both

Japan and the US. For Japan the start date is January of 1991 and for the US the start date is January 2007. The bottom axis of the chart denotes the time periods in years since the beginning of each respective crisis with t=0 being the start date. As such **Figure 5** depicts nearly 21 years of yield history for Japan and nearly 7 years for the US. And when laid on top of each other, they show a remarkable correlation. However, you may recall that we rejected an argument of *correlation as causation,* instead claiming ***correlation from a common cause*** – unprecedented money production. Referring again to the academic study **'Debt Overhangs: Past and Present'**, the same authors also found that contrary to the predictions of conventional *"textbook"* dogma on **risk premia**, a *"non-trivial share of the episodes* (11 of the 26) *were characterized by both lower growth and **lower or comparable real interest rates."*** And while neither we nor the authors of the study would insist that the long-term trend of US interest rates must unalterably follow Japan's, we may now offer **academic evidence** as well as **anecdotal evidence** in direct rebuttal to the "chicken-little" consensus opinion that US interest rates must of necessity, rise sharply. For as we detailed last quarter, ours, like Japan's, is not a bond market in which interest rates are freely determined by market forces. Instead the bond market is dominated by the self-interests of the stabilizers who are committed to keeping interest rates low and the yield curve steep for an extended period of time in order to avoid the abyss of a debt deflation. In such an environment, *"The state holds all the hammers and you know what happens to raised nails."*

Figure 5



And while we would all agree with Paul Simon that it is always preferable to *be a hammer rather than a nail*, agreement isn't always forthcoming on the nature of the relationship between the two. In economics, as in all things, there is always the question of the "ought." We have always been willing to concede that the stabilizers can produce without limit, legally or technically, any quantity of money they may chose, nevertheless we have always insisted that they should not. To create money *ex nihilo* (from nothing) is to favor some at the expense of others. This breeds contempt for morality and civic virtue. By promoting a *theory of abundance* through **inflationism**, the stabilizers' have encouraged the repudiation of the immutability of the relationship between work and income, in favor of the Keynesian heresy of ***'something for nothing.'*** Yet even Lord Keynes himself conceded that *"by a continuing process of inflation"*, governments **confiscate** the wealth of their citizens, ***"impoverishing many," and "enriching some."*** We have written extensively regarding the nature of the injustice due to the uneven redistribution of wealth and the polarization of incomes that results from the stabilizer-induced **boom-bust-boom cycles**. It is through these hidden, yet insidious processes that the ***"vital some"*** are enriched and the ***"trivial many"*** are impoverished almost imperceptibly, day by day. It is that loss, that small, undetectable act of **legalized theft called inflationism** which, after forty years, has swollen into a massive deprivation which today threatens many in the US and throughout the West with what we have described as a coming famine of epic proportions – **a famine of income** – which may ultimately place the US irrevocably on Hayek's ***'road to serfdom'***.

To be clear, inflationism *per se*, does not destroy nations. Rather what it destroys is the **liberty** of the people of a nation. The systematic devaluation of the monetary standard of a nation committed to the principals of equal justice under law, involves, at the most fundamental level, a corruption of our most foundational and inalienable right – the right to the disposition of our possessions and persons as we think fit within the bounds of law. This principle was clearly enunciated by John Locke in his 'Two Treatises of Government' and was ably set down in the Declaration of Independence by Thomas Jefferson. If we remain committed to the philosophy of **inflationism**, the coming collapse that we will face will not be a **sovereign default**, but rather like Rome before us, we will face the long, slow decline into mediocrity and autocracy. Writing in the early 5th century, Christian priest Salvian of Marseille offered his explanation for why the Roman state was collapsing in the West. *"The Roman state was collapsing,"* Salvian said, "*because it had denied the first premise of good government, which is to secure justice to the people."*

Ultimately economic decisions will be evaluated, not on the "correctness" of the underlying theory, but on the degree to which justice was upheld. Economics and morals are both components of one inseparable body of truth. Therefore they must be in harmony with one another. What is right economically must also be right morally, and vice versa. As such, economic policies which violate moral truth will most certainly lead to degeneration and decline. This, we have contended, is the lesson of both economic philosophy and economic experience as chronicled in the pages of history. The all too prevalent viewpoint which holds that there is no inviolable relationship between morals and economics, provides the best explanation why immoral economic acts are tolerated, if not shamelessly promoted, by those in a position to wield public policy.

Back in 1935, in a ruling not unlike the recent Supreme Court ruling on ObamaCare, the Supreme Court was obliged to hear several **"Gold Clause Cases"** in response to the government's confiscation and criminalization of gold. As we detailed in our Third Quarter 2011 Market Review, within the first week of holding office, President Roosevelt closed the nation's banks, fearing gold hoarding and international speculation posed a danger to the national monetary system, basing his actions on the Trading with the Enemy Act. The President soon afterward issued Executive Order 6102, requiring the surrender of all gold coins, gold bullion, and gold certificates to the government by May 1, 1933 in exchange for their value in U.S. dollars. Congress also passed a joint resolution canceling all gold clauses in public and private contracts, stating such clauses interfered with the power of Congress to regulate U.S. currency. It was in fact the constitutionality of this action that the Supreme Court was charged with adjudicating. In a judgment that puts us in mind of the recent ruling regarding national health care, the court of 1935 said that what the government had done with regard to its unprecedented restrictions on the ownership of gold, was ***"immoral but not illegal."*** How could that be you ask? Because, in the words of author and journalist Garet Garrett; *"The American Government, like any other government, has the sovereign power to commit an immoral act."* Writing in 1781 in a book entitled 'Notes on the State of Virginia', Thomas Jefferson lamented; *"Indeed I tremble for my country when I reflect that God is just: that His justice cannot sleep forever."*

Faced with the growing realization that everyone cannot be enriched at the expense of everyone else, governments across the West are grappling with how best to renege on promises that in fact, were never possible to keep. This has always been the calumny of money production and socialism. For as you will recall, we began this Review by quoting Margaret Thatcher's famous dictum that there always comes a time when you run out of other people's money, i.e., when **"the money fails"**. And while we are a firm believer in the principle of reaping and sowing, and while ultimately the central planners, purveyors in social engineering, will indeed suffer from what Hayek called a **"fatal conceit"**, today is not that day. And so the cries of creeping collectivism will continue to go up for governments to do something about it. Regrettably, armed with a barren philosophy and faced with the prospects of a coming debilitating famine of income, the something that is always pursued is an increase in the supply and availability of debt-based money in support of the state. This, as we noted at the outset of this report, is the real monetary sin of the west. In closing, we return to Mrs. Thatcher, the Iron Lady who again offers a pithy warning to those who in Hayek's words, "*endeavour consciously to shape our future in accordance with high ideals"*: ***"No one would remember the Good Samaritan if he'd only had good intentions; he had money as well."*** And though we be charged with **"great impiety"** for saying so, if we would prevent our money from failing and so avoid the dustbin of history, we must reject the ***"something for nothing"*** exchange promised by the Keynesian theory of abundance. For only honest money commands all things. (Ecc 10:19)