

Today's Notes:

1. Silver Fever
2. Silver in Antiquity

1. SILVER FEVER

The silver purchase program, initiated by President Franklin Roosevelt in late 1933 in response to the economically small but politically potent silver block, gave a large short run subsidy to the silver producers at the cost of destroying any long run monetary role for silver.

More important, it imposed severe deflation on China, the only major country still on a silver standard, which brought forward in time and in increased severity subsequent war time inflation and postwar hyperinflation. The silver purchase program thereby contributed, though perhaps only modestly, to the ultimate triumph of the Communists.

Milton Freidman, *Franklin D. Roosevelt, Silver and China*, Journal of Political Economy 1992 Vol. 200

Silver Fever! Many people today are talking about silver's undervaluation relative to gold. Numerous analysts see gold prices moving higher and with them silver prices. Several large organizations have forecast \$20 to \$25 per ounce silver by year end 2010. This is silver fever! A look back in history tells us that silver has been around much longer than any fiat currency and had a much larger geopolitical impact. As I was researching the other day, I came across an article from Time Magazine from May 1933. The title of the article ... "Silver Fever!"

It seems President Roosevelt decided to increase the price of silver by allowing the Treasury to purchase 400,000,000 ounces of the white metal in 1933, above the market price. The idea here, in part was to raise silver's price through a sequence of open market purchases and hence help drive the U.S. economy out of its deflationary funk by remonetizing silver. The Roosevelt Administration was interested in creating a silver monetary economy given the depth of the Depression. In April 1933 the President authorized the Treasury to pay \$.71 per ounce when silver was selling for \$.64. The world took note. Speculators bid the price of silver higher.

The U. S. had purchased about 400,000,000 oz. or about 1 ounce in every 30 thought to exist. This was however twice the world's annual output. So the US government had effectively cornered the global silver market. Time's editorial writes,

"Eager to profit from the corner, speculators helped the U. S. boost the world price to the U. S. price, 71¢. Last week when it reached that level, Franklin Roosevelt raised the ante for a second time, put the U. S. price at 77¢."

Speculators then took the metal to \$.81 per ounce very quickly. There were no sellers. Silver went bid globally. As Milton Freidman pointed out in his 1992 article (above) silver's prospective monetary role in the US was destroyed. Perhaps the saying "Be careful what you wish for ..." has much verity here. It is interesting to note however that the Roosevelt Administration saw the silver re-pegging of the US monetary system as a way out of the Depression.

Since the printing press has seemed ineffective in our present situation, we wonder how Dr. Bernanke might feel about remonetizing today?

But every action has an equal and opposite reaction. China had been the one country that had remained on a silver monetary standard. With Washington's silver purchase program their currency values (Yuan) soared. Physical silver left China en masse. China actually put export controls on silver and appealed to "all patriotic

countrymen” to keep their silver at home. It was of no use. Silver was smuggled out of the country. On May 6, 1933 Time wrote,

“Last week silver standard China had a taste of the same (editor: the US had experienced a similar demand for gold before it was confiscated), though silver instead of gold was the metal wanted. Ever since the U. S. began to boost the price of silver, China has had deflation.”

Mexico did not experience deflation to the extent China did but very quickly her coinage was worth more than its face value. This affected demand and reduced the money supply. Mexico begged the US, to no avail, for more time to create paper money in smaller denominations. As the Roosevelt Administration began to see the error of its ways and the impact on currency stability and economic growth they relented and did not raise the price of silver for the third time even though silver was trading well below the legal value in the U.S. of \$1.29 per ounce. Time notes,

“Secretary Morgenthau had to reconsider his immediate plans for reintroducing silver to the world.”

By November 1935 China adopted a fiat paper currency as the rest of the world had depreciated their currencies. And so it went. Damage? Milton Friedman suggests that Roosevelt’s actions forced removal of China from its much beloved and effective silver monetary standard. Silver had been effective monetary solution for China during the global Depression in 1929 and 1930. This, in turn, meant the Chiang Kai-shek had to print fiat money to fight the Communists after the WWII. Inflation and poverty ensued which must have had a great deal to do with the victory of the Communists in the final analysis. Here is how China’s fiat money supply ballooned.

When war with Japan (versus China) broke out in 1937, the total quantity of money in circulation (currency and demand deposits) was 3.6 billion Yuan. By December 1941, when the United States entered the war, the Chinese money supply had increased to 22.8 billion Yuan. For the remainder of the war years the figures were: 1942, 50.8 billion; 1943, 100.2 billion; 1944, 275 billion; and 1945, 1,506.6 billion.

In June 1937, 3.41 Yuan traded for one U.S. dollar. By December 1941, on the black market 18.93 Yuan exchanged for a dollar. At the end of 1945, the Yuan had fallen to 1,222 to the dollar. And by May 1949, one dollar traded for 23,280,000 Yuan.

Ultimately China was forced to introduce a new Yuan at 3,000,000 old to 1 new Yuan.

Germans love gold and Chinese love silver for these reasons. Chinese citizens are now buying gold and silver. As are Germans buying gold. Are we now in the U.S. about to experience a deflationary then inflationary scenario? No one knows for sure. But there is clearly instability in the world’s forex system. Gold and silver are soaring and have escaped the clutches of the Central bankers. Today China has pegged her Yuan to the U.S. dollar. She is now allowing an agonizingly slow appreciation. Perhaps she remembers the Roosevelt silver purchase program of 1933 and the failure of the re-monetization of the U.S. currency along with a torturous deflation and fiat currency hyperinflation that destroyed China’s silver wealth so carefully accumulated in China from 1650 through the 1920s.

2. SILVER IN ROME

Another silver case in point – this one from antiquity. Yes, currency debasement through inflation is so much more common that you might think. In the US today Washington would love to escape deflationary clutches through debasement. We all know that in antiquity silver was the currency of choice. The ancient Greeks defeated the Persians through the discovery of a very rich silver vein at the Laurion mine complex in Attica in about 5th century BC. This was accomplished through the creation of a navy with the silver and it also allowed for the establishment of a democracy in the city state of Athens.

More on that later. Later in Rome the situation was similar to elsewhere particularly as the population of Rome grew to be about 1 million at its height. Tainter, in his book on social collapse, argues very persuasively that complex systems ***“succumb to diminishing returns.”*** Wright (***A Short History of Progress***) notes the

“costs of defending an empire eventually grow so burdensome that it becomes more efficient to throw off the entire superstructure. By the time of Constantine the Imperial Army was more than half a million men an enormous drain on ... treasury.” (Sound Familiar?)

In Rome the government's solution was to debase the currency used for payrolls. (Sound familiar?) Inflation of Weimar and Chinese proportions ensued in Rome. A measure of Egyptian wheat that had sold for half a Denarius cost 100,000 Denarii by AD 338. Wright notes,

“By the beginning of the fourth century it took 4,000 silver coins to buy one gold solidus; by the end of the century it took 180 million ... citizens worn down by inflation began to defect.”

Can it happen here? Of course it can. Please take note, you can do something about it.

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