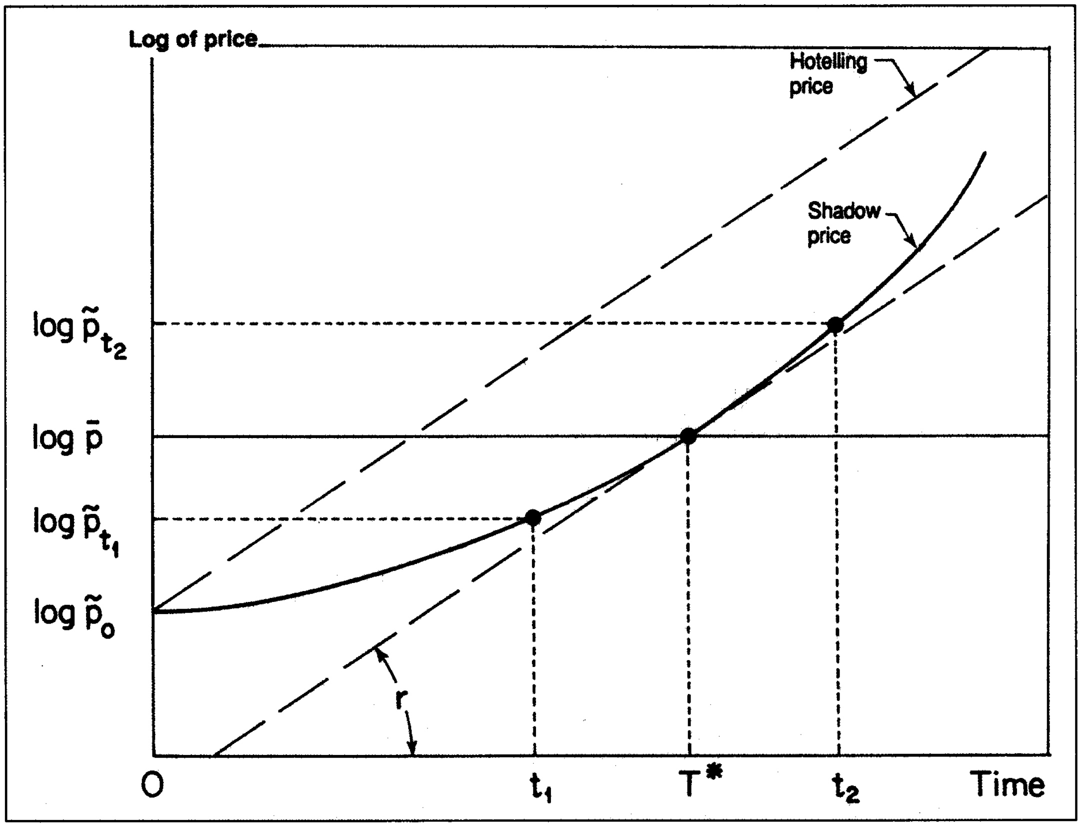
The price $\tilde{p}_t$ is interpreted as the shadow free-market price of gold given a price hypothetically fixed at $\bar{p}$ between dates 0 and $t$, but not after; it is the competitive market price that would prevail in the absence of future price fixing, given the economy's remaining stock of gold, $S_t = S_0 - D(\bar{p})t$, when the price has been fixed at $\bar{p}$ in the past.

**Figure 1**




When $\tilde{p}_t < \bar{p}$, $\tilde{p}_t$ is rising at a proportional rate below the real interest rate $r$ because the economy is using gold more slowly than it would were $\tilde{p}_t$ the actual price. When $\tilde{p}_t > \bar{p}$, $\tilde{p}_t$ is rising at a proportional rate greater than $r$ because gold is being consumer more quickly. Since $\dot{S}_t = -D(\bar{p}) = -(\bar{p})^{-\sigma}$ under price fixing, equation (3) discloses that

$$\frac{\dot{\tilde{p}}_t}{\tilde{p}_t} = r\left(\frac{\tilde{p}_t}{\bar{p}}\right)^{\sigma},$$

which confirms the intuitive argument just given [1].

The date $T^*$ at which the two price lines intersect is the date on which the price-fixing scheme collapses; it does so after a speculative attack in which private market participants acquire all of the remaining official gold stock at price $\bar{p}$. Thereafter a *laissez-faire* equilibrium prevails, with market price rising at rate $r$ until the (perhaps infinite) choke price is reached and the economy's gold stock is

(1) Notice in particular that $\tilde{p}_t \neq \tilde{p}(S_0)e^{rt}$, where the latter (shown by the upper dashed line in the figure) is the *laissez-faire* or *Hotelling* price prevailing (given an initial gold stock of $S_0$) if the government never intervenes in the gold market. In contrast, in the equilibrium under study now, demand is at $D(\bar{p})$ for dates $t$ prior to the date of the crisis, not at $D[\tilde{p}(S_0)e^{rt}]$. Thus, $S_t$ under the price-fixing-cum-collapse scenario generally won't equal the gold stock the economy would have had on date $t$ had *laissez-faire* prevailed since date 0, even though the gold stock on date 0 was $S_0$ in both regimes.