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The Nation Continued

Should We (and Could We) Return to the Gold Standard?

WASHINGTON

KEYNES called it the "barbarous relic." Lenin said it was fit only to adorn the latrines of the world. Ten years ago President Nixon, in effect, tore the world's currencies loose from it by pulling the dollar away from a gold peg. Still, gold has lost neither its romantic allure nor its practical attraction.

President Reagan recently appointed a commission of 17 experts, mostly Government officials, to review the issue again. Its specific task is to determine whether the metal should once more play a dominant role in the domestic and international monetary system.

The Week in Review asked two members of that commission, Henry C. Wallich and Lewis E. Lehrman to talk about the gold standard. Mr. Wallich, a former economic professor at Yale, has been a governor of the Federal Reserve Board since March 1974. Mr. Lehrman, chairman of the executive committee of the Rite Aid Corporation, a discount drug chain, was one of the inner core of supply-siders in the Reagan transition team. Excerpts of their separate interviews with Clyde H. Farnsworth, a reporter in The New York Times's Washington bureau, follow.

Lehrman

Question. Is the gold standard, as some advocates argue, a cure-all or is it a patent medicine?

Answer. My argument has always been that the gold standard is an imperfect institution. All institutions are imperfect. But it's the least imperfect institution that's been tested in a laboratory of history to yield reasonable price stability and to provide for a stable dollar.

The dollar would have a permanent fixed value. Think of it the following way. The dollar is the monetary standard, and the monetary standard is defined permanently as a weight unit of gold.

Q. But there can be gold strikes, or shortages.

A. Well, with respect, the truth about the production of gold is very different from some of the mythology. The rate of gain in gold stocks has averaged around 2 percent, particularly since the industrial revolution.

Q. The severe shortages and booms of the late 19th century had great economic consequences.

A. The consequences were all very beneficial. From 1875 until about 1912, the average rate of variation of the price level never exceeded 2 percent. Compare that to the last 10 years of the manipulated paper currency system, where the price level has varied as much as 13 percent above the previous year several times.

Q. How would going on a gold standard affect wage increases locked into contracts?

A. We all want to see the rate of gain in wages be approximately equal to the rate of gain in productivity. The gold standard gives people today confidence in the future purchasing power of the dollar. As a result, working men believing in an honest dollar begin to ask for reasonable wage increases, proportional, that is, to the gain in the productivity in their own labor.

It's almost as if the gold standard were an insurance policy, an actuarial reminder to all who participate in the market that the dollar in 10 years instead of being 50 percent of what it is worth today would be approximately equal in purchasing power as it is today.

Q. If you're going to establish a gold standard, you have to set a price. What happens if the price is too high? All the gold would come to the United States. If it's too low, the United States would lose gold, or go into some kind of economic contraction.

A. Under the gold standard there *is* no price for gold. The dollar is the monetary standard, set by law equal to a weight of gold. The price of gold does not exist. As a matter of fact, you may even look at the gold standard as the end to the speculation in gold in terms of paper dollars.

Q. But in the real world, you would be using paper dollars and you could turn them in to the Treasury for so much gold. So the gold does have a dollar value.

A. And I live in the real world. I'm a businessman and I'm very concerned about just the character of our monetary standard. Under the gold standard, the paper dollar is a promissory note. It is a claim to a real article of wealth defined by law as the standard.

Let us say, for example, that in January 1982, we would announce that two years hence the monetary standard of the United States would be established as a dollar equal to a weight of gold. About 90 days before the period in which the price, as you call it, would be fixed, the gold markets would be tending to stabilize because they would know that the President and the Congress, under statute, would be about to fix (the dollar) equal to a weight of gold.

Chuck Reich
Lewis E. Lehrman

'Under the gold standard, bank reserves were provided rationally'

Q. In other words, that's the market price and that would be the fair price for gold.

A. The market price would be the lead indicator. On the other hand, other indicators are important — the assignment of the experts assembled around the President in writing a statute. There's no substitute for judgment. . .

Q. Wouldn't we be mortgaging our future by founding our whole monetary system on the amount of gold coming out of, say, South Africa?

A. Generally that criticism is made by people who have never bothered to study the statistics of gold production. South Africa and the Soviet Union first of all would act in their own self interest because in order to obtain foreign exchange to buy Western technology and Western grain they would want to sell the gold in an orderly manner. On the other hand, if they chose not to sell their gold for foreign exchange they do not produce enough to disrupt the market, of which they are less than one percent.

Q. But why should we guarantee the price of the chief source of foreign exchange for them?

A. We are not guaranteeing a price for them. We are establishing a monetary standard for us.

We've all learned that we don't cut off our nose to spoil our face. If something is good for the United States, namely a monetary standard, a dollar and a price level that's stable, we don't worry too much about other countries who may get a minor benefit. Indeed, I would argue that South Africa and the Soviet Union have a stake in

inflation, because they get a high price for gold when the United States inflates.

Q. Why is dependence on 'the barbarous relic' better than the rational creation of reserves by rational men?

A. Your phrase — quote, the rational creation of reserves, unquote — is precisely the technique that the Federal Reserve and central banks all over the world during the last 10 years have been using. Not only have they succeeded in destroying almost all currencies; they have succeeded in disrupting the trade patterns based upon a stable exchange rate.

Q. So you don't trust the Fed or the politicians?

A. Well, not that. I do trust them. I do not believe they have the proven techniques to rationally provide for reserves by manipulating the money supply.

In the abstract, especially in the classrooms of Yale where I went to school, it was always easy for professors to draw on a blackboard equations which showed why bank reserves could be provided rationally to the market. As a businessman I have learned that under the gold standard these reserves were provided much more rationally by virtue of the operations of markets.

Wallich

Question. Advocates say that returning to a gold standard would cure inflation and high interest rates without recession. Is there justice to the argument?

Answer. That was the situation in the dim past — the 19th century, then in a modified way after World War II. But to get from our present situation to that blessed condition will take much more than some mechanical decision to implement a certain standard.

The transition to stability would be just as difficult as it would be without the gold standard. You have high inflation, you have expectations, you have wage contracts, you have interest rates that were high and built into the system, and to get away from all that will just require substantial adjustments no matter how you do it.

If you got back to stable conditions it would be more feasible to have a gold standard. But I still am very doubtful that a gold standard would allow us to maintain that stability.

Q. Some have argued that moving to the gold standard immediately would reduce the inflation rate.

A. Do you think that a wage contract to pay a 12 percent increase for three years running would automatically change? Do you think that a Treasury bond issued for 30 years at 13 percent would automatically change?

I would foresee simply a sequence of events that follow from the kind of mechanism you've set in place. We're standing ready to sell gold at (a certain price) and we'll buy it at (that price). If there is a strong, private world demand for gold we'd lose gold. That will contract our money supply, work against inflation. But it might work much more strongly than we would want, and so we might then get very large unemployment and recession.

Alternatively, that price might turn out to have been too high. Then other countries or private holders will unload the gold they have. Then we would have to buy all that gold. We would issue money against it. We would get a big inflation.

Q. What about the argument that the gold standard is the natural regulator of monetary growth that the monetarists seek and fail to find in the Federal Reserve?

A. I doubt that very much.

Those who tell me we're going to slow down the growth of the money supply by half a percent a year as the Fed is doing — that says something to me about the rate of inflation that you can expect over time. It will go down. Eventually, hopefully, it'll go to zero. But if you tell me that we're going to issue money or extinguish money depending on whether gold flows in or out, then I can't predict anything about inflation except that it will be totally unpredictable.

Q. How about the point that gold is a unique and stable standard of economic value?

A. We all know that you can say that gold is better than some other things. But it's certainly not a stable standard in the short run. You can show that because the supply of it increases only slowly, if you use that as money or as the base for money, prices can't vary very much.

But they can vary quite substantially nevertheless. We've seen that during the 19th century. You saw over the century prices didn't change much, but you had big waves of rising and falling prices.

Q. There is the argument that the return to the gold standard would be a major stimulus to savings?

A. It might be some stimulus to saving. However, today you can buy gold all you want to, and historically its price has increased. So if you fix the price of gold you certainly wouldn't want to increase your saving in order to buy gold and get no interest on it. So the only benefit to saving that I would see is that people would have more confidence in the currency and for that reason might save more. But I don't believe that in the days of the gold standard saving was higher than it is today.

The New York Times/Teresa Zabala

Henry C. Wallich

'I doubt that a gold standard would allow us to maintain stability'

Q. What do you think the role of gold today should be in the international system?

A. To serve as a kind of last-ditch sort of liquidity. Countries that lack foreign exchange or are not sure that they can also earn or borrow foreign exchange, if they have a gold supply would be able to borrow against it. Several countries did that during the 70's. Some countries sold off some of their gold, including the United States.

Q. Do you see some kind of standard, such as the special drawing right (S.D.R) of the International Monetary Fund or a combination of that with the dollar as becoming the major international standard, or do you see some kind of future role for gold in the standard?

A. Well, to me the evolution towards S.D.R.-systems, that is, a basket of currencies, seems plausible.

Q. Do you think there is enough public confidence behind the S.D.R. to warrant its move to the forefront?

A. That really depends on the confidence that exists in the five currencies that constitute the S.D.R. You know the S.D.R. is simply a composite of dollars, and Deutchesmark and yen and francs and pounds. If there's confidence in those, then the average of them presumably will be stabler than any one of them. That is the philosophy of the S.D.R.