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The case for the gold standard

An exclusive interview with Lewis Lehrman

Lewis Lehrman is one of today's most articulate advocates of the gold standard — a hard-money spokesman with a direct pipeline into the new Reagan Administration.

Mr. Lehrman, 42, is an extremely successful businessman, and the founder of a small but influential hard-money think tank called, appropriately enough, the Lehrman Institute. He's become a popular conference speaker and a frequent contributor to major mainstream publications including Harper's *and the* Wall Street Journal.

Granted, SGR *doesn't support the gold standard — except perhaps as a halfway measure towards the privatization of money. See our recent interviews with Dr. F. A. von Hayek and Jerome F. Smith.*

And granted, we don't expect a return to the gold standard during the next four years. (See our Late December 1980 issue: "How Reagan will affect silver and gold prices.") Nonetheless, with Reagan's sweeping electoral victory, the gold standard is clearly no longer merely a subject for dusty academic treatises. It's now a real issue with a real possibility of coming to pass.

So, in this exclusive interview, we turned to Mr. Lehrman for a thorough-going discussion of why he favors the gold standard, how to return to it, and what effect it would have on the economy.

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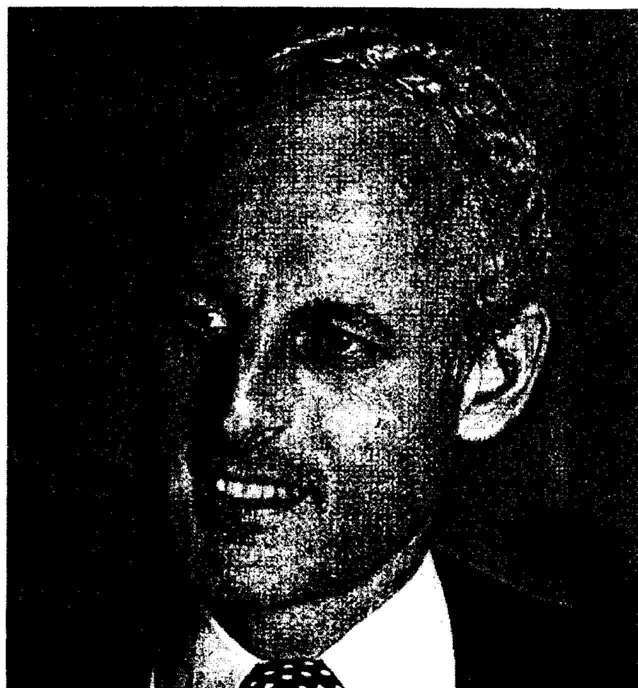

Mr. Lewis Lehrman

SGR: Mr. Lehrman, why do you support the gold standard? Why do you think it would be better than what we have now?

LEHRMAN: I don't have to tell your readers that it'd be hard for the gold standard *not* to be better than what we have now.

Thousands of years of history show that the most effective way to stabilize a currency over the long run is to define its value as a specific weight of gold.

Right here in America, for example, look at the price level since the late 18th century. For almost 150 years, prices were quite stable. This price stability was accompanied by a monetary

system linked to a real standard of value — the gold standard.

Professor Roy Jastram, of the U. C. Berkeley economics department, in his book "The Golden Constant" made a painstaking study of American gold and commodity prices back to 1800. He found that the US wholesale price index, when this country finally left the gold standard in the 1930s, was exactly the same as it was in 1800.

But as soon as we went off the gold standard, our cost of living jumped. By Prof. Jastram's reckoning, the American wholesale commodity index jumped almost 500% during the first 43 years after we left the gold standard.

And much the same pattern was evident in England, where Prof. Jastram was able to track prices all the way back to 1560. The only long-term period of price stability occurred when the UK was on the gold standard.

Yet there's nothing mystical about the gold standard. It's not a talisman for gold bugs. In fact, it's a political institution, pure and simple. Therefore, it should be evaluated strictly for its efficiency.

Throughout history, the evidence shows that the gold standard is more efficient in producing price stability than any other method.

SGR: Why?

LEHRMAN: The gold standard rules out excessive manipulation of money by politicians and bureaucrats. It's a guarantee that the purchasing power of money will be just about the same in 10 years as it is today.

Therefore, it facilitates long-term business planning. It also helps give people the confidence to keep saving money. And this promotes long-term economic growth because consistently high savings by the public is necessary in order to provide capital for ongoing industrial modernization and expansion.

"The gold standard automatically keeps the growth of money supply closely equal to the real growth of production."

SGR: We know that one of your key concepts is the link between gold production and the growth of real productivity. Would you please explain this for our readers?

LEHRMAN: Statistics show that all through history the production of gold has tended to grow at the rate of about 2% per year. Despite all of mankind's technological ingenuity, the real costs of gold production cause it to have a relatively inelastic supply curve.

And over the long-term, this 2% annual growth in gold production holds closely to the long-term 2% annual growth rate of world population, and to the long-term 2% annual growth rate of real economic output in healthy civilizations.

That's why the gold standard works. It automatically provides an effective framework of discipline for keeping the growth rate of money supply closely equal to the growth rate of population and the growth rate of real economic output.

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That's why gold, and gold-backed currency, have evolved naturally as the most universally accepted money throughout the world. Gold has proven itself to be the sanest and most efficient standard of stable monetary value. And it still is.

SGR: Do you honestly think there's a real chance of the US returning to the gold standard under Reagan?

LEHRMAN: It's true that the gold standard is still out of fashion at the moment. And it's also true that the gold standard isn't presently being considered by the Reagan Administration.

But despite this, I forecast that the US will return to gold within the next 10 or 15 years.

That's because eventually any serious movement for monetary reform must recognize that a gold-backed currency has no equal for effective long-term monetary stabilization. There is simply no alternative that's proven itself to work anywhere near as well as the gold standard.

SGR: How would you suggest that a return to the gold standard be put into effect?

LEHRMAN: Let's imagine ourselves into the future. Suppose it's 10 years from now, 1991. And let's say that the value of gold in relation to paper dollars is $600 per ounce.

Certainly that price would be one key indicator of the ultimate value determined for the dollar, to be fixed by Congress in a statute. But it wouldn't be the only determinant, because much will depend on economic conditions at the time.

For example, if the economy was contracting, it might very well be that the gold price was falling precipitously. If the economy was expanding very rapidly, or if inflation was very intense, these rising price levels would be reflected in the price of gold.

Anyway, let's imagine that in January 1991 the President announces that exactly two years later, in January 1993, he will propose to Congress a statute similar to the Gold Standard Act of 1900.

During that two-year interim, the market would remove from gold prices the excessive inflationary value caused by so many people hedging in order to protect themselves. Inflationary expectations would tend to decline.

SGR: Then the return to the gold standard would stabilize and ultimately lower the price of gold?

LEHRMAN: Yes.

The price of gold during the final, say, 90 days before the fixing would be reasonably stable. And that price would closely approximate the fixed value that would ultimately be proposed in the statute.

"I'm sure the US can return to a gold standard smoothly and successfully — because we did it once before."

SGR: How can you be so sure it would really work out that way?

LEHRMAN: There's an exact historical precedent. The reason I can be so sure of myself on this point is the the US did it once before, and it worked out exactly as I've described.

In 1862, during the Civil War, this country suspended the dollar's convertibility into gold. Inflation became catastrophic during the war and remained very disturbing during the period of Reconstruction. By around 1875 the process of resuming the gold standard began.

In fact, the gold standard was fully re-established by 1879 and it went into effect quite smoothly. I believe this could be done even more smoothly now because of our wider understanding of economic forces.

By the way, people are constantly asking at what price gold would have to be exchanged for dollars to make a new price fixing work.

But I don't believe that's the correct way to put it. What we mean by the gold standard is that the paper currency is *defined as a specific weight of gold.* The question should be: How much gold to the dollar?

And the answer would depend on market conditions during the period when the gold standard is re-established.

"I want to emphasize the importance of this program: If inflation isn't stopped, it will destroy our social institutions as well as our economy."

SGR: We've heard you speak and we've read your articles. We know that gold is the cornerstone of your program for ending inflation. But we know it's

not the whole thing. Would you briefly go into that for our readers?

LEHRMAN: Sure. I think the gold standard is a necessary element of any workable plan to end inflation. But I definitely don't think it's the *whole* answer. Other policy changes are necessary.

I think we need to take five big steps. These are all essential for resolving our economic problems. And they're all simple. But unfortunately they're not easy politically. You couldn't expect them to be put into effect overnight with a stroke of the President's pen.

First of all, we must reduce the federal budget deficit as rapidly and humanely as possible. Until that's done, no other meaningful monetary reforms are possible.

Second, we must reform the tax structure and restore incentives for working and saving, in order to raise the production of new goods.

Third, we have to dramatically deregulate industry. The decontrol of energy prices and President Reagan's other regulatory rollbacks are a good beginning here.

Number four, the Federal Reserve System must be restrained from creating excessive money and credit. I believe that the best way to do this would be to phase out the Fed's daily open market operations — which have been so conspicuously unsuccessful at curing inflation for the past 20 years. Also the Fed's discount rate — its price for credit to commercial banks — should be raised to real market levels instead of being the subsidy that it is now.

And fifth, the US should commit publicly and unequivocally to the gold standard and freedom of trade. After the US announces its intention to restore a stable dollar with gold backing, the President should call for an international conference to make the gold standard worldwide and to lower trade barriers.

I want to emphasize the importance of such a program. If inflation isn't stopped in America, it will destroy our social institutions as well as our economy. Inflation is our greatest crisis now. I can't believe our country faces any more profound threat, except for nuclear warfare and Soviet invasion.

Inflation today is the most fundamental problem of every American household and every American business. Along with all its other malignant effects, not only is it wrecking all pensions that aren't inflation-indexed, it's also wrecking the very investments which are supposed to produce the funding for the pensions. And there isn't a working man or woman in the country who doesn't realize this.

"There's just one thing wrong with all the other commodity standards of value that've been suggested instead of gold. They wouldn't work."

SGR: Obviously, you're aware that the two Nobel Prize-winning free market economists, F. A. von Hayek and Milton Friedman, both think the gold standard is unworkable today. Professor von Hayek discussed his objections to the gold standard in a *SGR* interview last year (Late October 1980 issue).

LEHRMAN: I'm happy to reply to their objections.

Professor von Hayek believes in the denationalization of money — privately issued currencies competing in the free market. That's a viewpoint I'm very sympathetic with. I wouldn't have any doubt that denationalized gold-based currencies could compete successfully in the marketplace.

Dr. Friedman and Prof. von Hayek also share the idea that any commodity with real value could serve as a monetary standard. This is a fairly widespread concept among economists.

Prof. von Hayek suggests that a basket of commodities be used. Dr. Friedman, who opposes the gold standard, facetiously talks about pork bellies. Alfred Kahn makes a tongue-in-cheek recommendation of bananas as a monetary standard and Jude Wanniski nominates cinder blocks.

There's just one thing wrong with all these proposed commodity standards — real or humorous.

Pork bellies, bananas, cinder blocks, and a basket of varied commodities are all subject to production economies of scale. In other words, it's possible to devise ever more efficient ways of raising hogs, growing bananas, or manufacturing cinder blocks.

As a result, the cost per unit for producing these commodities would drop. And there would be an enormous overexpansion of the money supply.