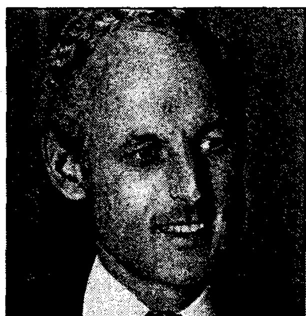
Pro and Con

Time to Return to Gold Standard?

YES—"A gold standard would encourage one of the greatest economic booms ever"



Interview With Lewis E. Lehrman

President of the Lehrman Institute and a Member of The United States Gold Commission

Q Mr. Lehrman, why do you favor returning to the gold standard and defining the dollar's value in terms of gold?

A The main reason is that the present managed paper-dollar standard has failed. Throughout history, all paper currencies have been destroyed. The manipulation of the paper dollar by the Federal Reserve System has caused inflation recently, and in the past, 1930-32, has caused serious deflation.

A paper dollar without any anchor in a real article of wealth is unstable.

Q How would gold be different?

A We know gold from the laboratory of history. The gold standard in one form or another gave us reasonable price stability from about 1792 until 1971, except for some periods such as the Civil War and the Great Depression—almost the entire history of the United States.

Q What did the price stability have to do with the gold standard? Couldn't other factors have been responsible?

A Everything is possible in the abstract. But when you have a gold dollar and a stable dollar, and it lasts for approximately 170 years with brief interruptions, then you have to conclude that it was more than an accident.

Q Wouldn't a gold standard limit economic growth since money growth would be tied to gold production?

A No. A gold standard would, in fact, encourage one of the greatest economic booms ever. Under the managed paper currency of today, nobody saves any more. People stop saving because the future purchasing power of the currency is in doubt.

What the gold standard does is give working people confidence in the future purchasing power of their saved wages. I would predict that true savings committed to productive investments would double within one year after the establishment of a gold standard.

Therefore, businesses would have an enormous pool of savings from which to draw the capital to invest in new plants and new equipment. This investment would create a huge demand for labor, end unemployment and lead to the creation of new wealth and economic opportunity for the poor.

Q And you believe that this boom would not be accompanied by inflation if there were a gold standard?

A Every great boom in Western Europe and in North America, from the turn of the 19th century until very recently, experienced no real long-term inflation. Under the gold standard, for example, the highest average rate of inflation during the most expansionist periods—between 1896 and 1913, specifically—never exceeded 2 to 3 percent

NO—"It cannot be done because the price of gold will prove too unstable"

Interview With William Fellner

Member of the President's Council of Economic Advisers, 1973-75

Q Mr. Fellner, why don't you think a return to the gold standard would work?

A I feel strongly that it cannot be done in the now foreseeable future, because the price of gold will prove too unstable. That is another way of saying that in the present circumstances you can't have stability in the dollar price of gold and a stable general price level at the same time. If you try to keep the price of gold stable, the general price level will change.

Q Why do you say that?

A The idea behind the gold standard is that it is a simple technique by which you hold the price of gold constant, and this results in holding the general price level reasonably stable because the price of gold does not change much relative to goods in general.

An essential point to remember about the days when the gold standard worked is that it was not considered respectable for governments to change the gold price. It really happened very rarely.

Whenever conditions are such that the gold standard can operate well, it is very desirable. For instance, the gold standard worked satisfactorily in a period before the first World War, when prices of goods in general changed only very gradually relative to the fixed price of gold. But much of the time it didn't work well after that war, including the '30s and after World War II.

Q Why not?

A The system involving a fixed gold price was not made to withstand war inflation and its aftereffects. On the whole, if you look at the period when it worked, the price of gold relative to other commodities didn't change very much because of supply conditions in the gold market. Gold output was responsive to the real price of gold—that is, to any tendency of gold to rise in relation to the price of other things.

Q Gold production increased as the real price went up?

A Yes, though often with substantial lags. The great discoveries of the middle and the late 19th century in California, Australia, South Africa, Alaska and Canada all came after tightness in the world gold market. Substantial technological improvements also came at that time.

Q Wouldn't that happen again?

A That might indeed repeat itself, and this is why we should keep an open mind on the role of gold in a more distant future. But recently the gold output has reacted perversely to price.

The price of gold relative to goods in general rose very steeply over the past decade, but gold output has been

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per year. It was the essence of stability compared to the catastrophe of the last 10 years.

Q Couldn't this assurance of future value for money be provided by strong limits on the growth of the money supply set by the Federal Reserve instead of by the supply of gold?

A That is the theory of the monetarists. That viewpoint was invented in a classroom. Like most abstractions, it has failed wherever it has been tried. Monetarism was the policy that Prime Minister Margaret Thatcher announced as her very own in Britain. Britain now has 12 percent unemployment. The government of ex-President Giscard of France set monetary aggregates; the result was higher unemployment, inflation and the coming to power of the Socialists. Monetarism was the announced policy of the Likud Party in Israel when it was elected first under Menachem Begin; their inflation rates have exceeded 100 percent recently.

Q Since South Africa and the Soviet Union are the world's biggest producers of gold, wouldn't returning to the gold standard help them more than us?

A No. It would hurt them. The gold standard would end the inflationary premium we pay them for their gold. Every senator and congressman to whom I've talked has raised that point. No businessman, no statesman, no head of a household ever decides *not* to do something that is the most important element in the survival of the business or the state or the family just because it might have an incidental positive effect on somebody next door.

Secondly, the benefits that accrue today to the Soviet Union and South Africa come from the fact that we are not on the gold standard. They gain an advantage because of the instability of the dollar. Under the gold standard, the speculation in gold ends.

Thirdly, in the world today there are approximately 2½ billion ounces of gold stocks. About 1¼ billion ounces are in the hands of private holders and about 1¼ billion ounces in official hands. Today, South Africa produces approximately 22 million ounces of gold a year. The Soviet Union, by the best CIA and industry estimates, produces somewhere between 8 and 10 million ounces of gold. As you can see, the Soviet Union and South Africa could sell all of their production in a single instant, and it would constitute no more than 1 percent of total gold stocks. Annual production of gold relative to total stocks is like salt in the ocean.

Q If the gold standard were imposed today, where do you think the exchange rate between the dollar and gold would be?

A The gold weight of the dollar—or, as some call it, the price of gold—can only be established at a suitable time after the President announces his intention—say two years. What happens, then, is that the American people finally know they're going to get a stable dollar once again. As a result, they stop speculating in metals and antiques and furniture and second homes and all kinds of hedges against inflation. The market for gold tends to stabilize. Then, free people determine the value of the monetary standard.

During that period, the President will ask the Treasury Secretary and other economic specialists to examine under the new conditions the proper weight of gold by which the monetary standard is to be established. It is only during that period that both market experience and the judgment of experts will be able to establish it. □

declining while the output of goods in general has been growing. Some people believe that if the price is higher, the mines will continue to mine more ore and yet to produce less gold. That means that the mines will go to their poorer, higher-cost ore, so the gold that is then produced is costlier metal.

Q Do you think that this uncertainty about the continuing supply of new gold is enough to limit its ability to regulate the currency markets?

A Yes. That would be my position. Now, you could invent gimmicks. But then you would lose all the advantage of the gold standard—namely, that it is a mechanism that is simple, credible and the upsetting of which amounts to defaulting on the part of governments.

Q What kind of "gimmicks" are you referring to?

A One could start adjusting the gold price year after year, which some people talk about. Others say: "So there is a gold shortage? Central banks would start selling their holdings. Then there is no gold shortage." But if central banks start doing that, how much will they be selling every year? This would open the door for a great deal of political arbitrariness. The simplicity and credibility of the arrangement, which is its advantage, would be lost if you monkey around with it in some such fashion.

Q Advocates say that the gold standard would reduce inflation by regulating money-supply growth—

A You have to look at that in two phases. One is what has come to be known as the re-entry difficulty. What price do you set as the correct price of gold when you return to the gold standard? If you set it too high, other people with gold may throw an enormous amount at you, and that is highly inflationary because the base of your currency suddenly would have been expanded.

If you set it too low, they may stage a run on you, and then you are in difficulties from having too little gold.

Q But, say, you have solved this re-entry problem. Would the gold standard work then?

A Then the difficulty would be the following: You have set the "right" gold price according to market preferences at the time. But from there on, it is apt to become too low. The demand for gold will grow as world population and living standards increase. International uncertainty will create demand, too. Demand will increase faster than the current gold output would increase the gold stock.

Q Are you saying that the limited amount of gold in the world would tend to restrict the growth of our economies?

A Yes. Even if the "correct" price of gold were first set successfully, it would after a while turn out that, in relation to goods in general, that price would become too low unless the gold output should start rising again in response to economic growth.

If the authorities nevertheless tried to keep the dollar price of gold constant, they would from there on have to place a deflationary pressure on goods in general to keep the gold price right relative to the general price level. Or they could start raising the dollar price of gold, thereby introducing precisely that kind of political arbitrariness which one would try to avoid. □

Gold bars. For most of America's history, the country was on the gold standard.

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