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THE WEEK IN REVIEW

To Move Forward, Go Back to Gold

By Lewis E. Lehrman

The damage inflicted on our workers and industries by the overvalued dollar has demonstrated that free trade without stable exchange rates is a fantasy. The trade crisis caused by overvaluation has also given us a clear choice: Either we continue to live with floating exchange rates, in which case we will face bitter trade wars and the gyrations of inflation and deflation, or we can choose a stable currency based on the gold standard. The argument for gold has rarely been stronger than it is today.

During 1985, almost 200,000 blue-collar jobs, mostly in manufacturing, and an equal number of farms disappeared from the economic landscape. Our budget deficit rose above $200 billion. Our trade deficit with Japan climbed to almost $50 billion, up from $1.7 billion in 1974. The trade deficit was largely the result of an overvalued dollar that made foreign imports cheaper and our own exports more expensive — and left our industries gasping for relief.

President Reagan's effort to persuade the Group of Five industrial nations — the other members are West Germany, Britain, France and Japan — to restore balance among the leading currencies has managed to deflect some protectionist sentiment in Congress. But this is only the first step toward thorough, equitable monetary reform.

To achieve such reform, and thereby stabilize exchange rates, we must re-examine the postwar Bretton Woods system, which lasted from 1944 to 1973, as well as the system of floating currencies begun in 1973. The common flaw in both dollar-based systems is the official reserve currency status of the dollar, a role that jams the natural market mechanisms needed to regulate currencies and trade. Both a burden and a privilege, the world dollar standard creates an extra demand for the dollar to supply the reserves of foreign central banks, which tends to keep the real value of the dollar higher than it would otherwise be. Gradually, overvaluation has reduced the competitiveness of American industries, helping to increase our trade deficit from small figures in the late 1960's to a staggering $148 billion in 1985.

A lasting and just solution to the dilemma of the world paper dollar standard would require the leading nations to share a common monetary standard, a reserve currency independent of any national currency and not controlled by any self-interested sovereign government. The solution to the trade problems caused by unhinged currencies requires key currencies to be directly convertible into an impartial monetary standard. Indeed, a common monetary standard underlying the different convertible currencies is precisely the international market mechanism needed to coordinate and discipline the global balance of payments and bring about the convergence of national fiscal and monetary policies.

The only secure approach would be a system of fixed exchange rates based on the convertibility of key currencies into gold, a neutral and independent monetary reserve. No other commodity will do: Governments have accumulated a billion ounces of gold, not pork bellies or bricks.

Conceivably, we could instead create a World Central Bank, whose independent credit would serve as neutral reserves for all national central banks — a system proposed by John Maynard Keynes in 1944 at Bretton Woods. But such a bank could not be expected to exercise impartial discipline on the international monetary system any more than its counterpart, the United Nations, acts impartially on the world political scene. Therefore, we must consider the gold standard, which has been tested by the commercial experience of advanced civilizations for 3,000 years.

If we also ask that the world monetary system be neither inflationary nor deflationary over the long run, history shows there is no practical alternative to the convertibility of key currencies at fixed rates into a common monetary standard, defined by law as a weight unit of gold. Each disruption of convertibility, such as the currency float of the 1930's, led to financial turbulence similar to our volatile inflationary and deflationary experience since 1971. Today, some commentators sincerely but mistakenly associate the gold standard with the causes of the Great Depression. This notion is false. Among others, the economist Milton Friedman has shown that Government mismanagement and the Federal Reserve System caused both the Depression and the destruction of the gold standard.

A comprehensive plan for monetary reform based on an international gold standard could be established during the remainder of President Reagan's second term.

First, he should arrange for the Treasury and Federal Reserve to cooperate with the Group of Five to stabilize the value of key currencies — which essentially means agreeing upon the relative purchasing powers of these currencies on world markets. Indexes of currency purchasing powers can be agreed upon at the forthcoming economic summit meeting in Tokyo in May.

Second, the President should send legislation to Congress establishing a gold dollar coin as this country's constitutional monetary standard. Convertibility would take effect in May 1987, one year from the Tokyo meeting.

The price of gold must be set at a level that will cover the cost of producing the gold that goes into the monetary standard. Otherwise there is no incentive to produce that gold. Under current market conditions, and given a Federal Reserve policy consistent with stable economic growth, I estimate that the gold price should be approximately $400 to $500 per ounce — the marginal cost of production of gold in the United States.

Third, the President should convene an international monetary conference to agree upon the reciprocal value of all major currencies and to abolish official reserve currencies. The conference agenda should then move to the question of dismantling protectionism.

One must emphasize that the new international monetary system could accommodate generous social policies in every country. But social policy would be based on the essential justice and mercy of a constitutional order, not on the present tendency among governments to finance social policy by inflationary means.

Moreover, currency convertibility alone could end the varying dollar premiums now awarded Soviet and South African gold through speculation on future inflation. Far from helping the South Africans and the Soviet Union, the gold standard would end the speculation in gold and put them in their place.

The results of international monetary reform would be dramatic. By pinning down the future price levels, it would create compelling incentives to channel savings away from short-term speculation into long-term capital markets. Long-term interest rates would fall, encouraging investment and creating worldwide demand for unemployed labor to man the new plant and equipment. Domestic and foreign debtors would service their debts at lower interest rates in expanding world markets. Federal budget deficits would become more manageable — because of lower interest rates and an expanding tax base — and be contained by the external discipline of a sound but elastic monetary system. A balanced budget amendment would finish the job.

While the world would have many problems yet to solve, our legacy to future generations would be the best monetary system known to free peoples who live under the law. The truth is, government-manipulated currencies today are the monetary equivalent of the unacceptable 19th century doctrine of Social Darwinism — the triumph of unrestrained competition over justice.

Here we should not be confused by those who sincerely but wrongly think that this represents an arbitrary "fixing" of the price of gold. On the contrary, free people voluntarily establish objective standards. Like the 36-inch yardstick, the gold monetary standard is an agreed-upon measuring rod of economic value. Who would give any board of governors authority to manage the value of the yardstick — to depreciate it to 30 inches one year, to augment its value to 40 inches another?

The gold monetary standard is a symbol of justice because convertibility is a constitutional rule of equity to which all are voluntarily bound. While the First Amendment wisely prohibits Government censorship (that is, the devaluation) of speech, the gold standard prohibits Government devaluation of money — the currency of honest labor. □

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