Can the U.S. Return to a Gold Standard?

By ALAN GREENSPAN

The growing disillusionment with politically controlled monetary policies has produced an increasing number of advocates for a return to the gold standard—including at times President Reagan.

In years past the desire to return to a monetary system based on gold was perceived as nostalgia for an era when times were simpler, problems less complex and the world not threatened with nuclear annihilation. But after a decade of destabilizing inflation and economic stagnation, the restoration of a gold standard has become an issue that is clearly rising on the economic policy agenda. A commission to study the issue, with strong support from President Reagan, is in place.

The increasingly numerous proponents of a gold standard persuasively argue that large budget deficits and large federal borrowing requirements would be difficult to finance under such a standard. Heavy claims against paper dollars cause few technical problems, for the Treasury can legally borrow as many dollars as Congress authorizes.

But with unlimited dollar conversion into gold, the ability to issue dollar claims would be severely limited. Obviously if you cannot finance federal deficits, you cannot create them. Either taxes would then have to be raised or expenditures lowered. The restrictions of gold convertibility would therefore profoundly alter the politics of fiscal policy that have prevailed for half a century.

Disturbed by Alternatives

Even some of those who conclude a return to gold is infeasible remain deeply disturbed by the current alternatives. For example, William Fellner of the American Enterprise Institute in a forthcoming publication remarks ". . . I find it difficult not to be greatly impressed by the very large damage done to the economies of the industrialized world . . . by the monetary management that has *followed* the era of (gold) convertibility. . . . It has placed the Western economies in acute danger."

Yet even those of us who are attracted to the prospect of gold convertibility are confronted with a seemingly impossible obstacle: the latest claims to gold represented by the huge world overhang of fiat currency, mainly dollars.

The immediate problem of restoring a gold standard is fixing a gold price that is consistent with market forces. Obviously if the offering price by the Treasury is too low, or subsequently proves to be too low, heavy demand at the offering price could quickly deplete the total U.S. government stock of gold, as well as any gold borrowed to thwart the assault. At that point, with no additional gold available, the U.S. would be off the gold standard and likely to remain off for decades.

Alternatively, if the bid price is initially set too high, or subsequently becomes too high, the Treasury would be inundated with gold offerings. The payments for the gold drawn on the Treasury's account at the Federal Reserve would add substantially to commercial bank reserves and probably act, at least temporarily, to expand the money supply with all the inflationary implications thereof.

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Monetary offsets to neutralize or "earmark" gold are, of course, possible in the short run. But as the West German monetary authorities soon learned from their past endeavors to support the dollar, there are limits to monetary countermeasures.

The only seeming solution is for the U.S. to create a fiscal and monetary environment which in effect makes the dollar as good as gold, i.e., stabilizes the general price level and by inference the dollar price of gold bullion itself. Then a modest reserve of bullion could reduce the remaining narrow gold price fluctuations effectively to zero, allowing any changes in gold supply and demand to be absorbed in fluctuations in the Treasury's inventory.

What the above suggests is that a necessary condition of returning to a gold standard is the financial environment which the gold standard itself is presumed to create. But, if we restore financial stability, what purpose is then served by a return to a gold standard?

Certainly a gold-based monetary system will not necessarily prevent fiscal imprudence, as 20th Century history clearly demonstrates. Nonetheless, once achieved, the discipline of the gold standard would surely reinforce anti-inflation policies, and make it far more difficult to resume financial profligacy. The redemption of dollars for gold in response to excess federal government-induced credit creation would be a strong political signal. Even after inflation is brought under control the extraordinary current political sensitivity to inflation will surely remain.

Concrete actions to install a gold standard are premature. Nonetheless, there are certain preparatory policy actions that could test the eventual feasibility of returning to a gold standard, that would have positive short term anti-inflation benefits and little cost if they fail.

The major roadblock to restoring the gold standard is the problem of re-entry. With the vast quantity of dollars worldwide laying claim to the U.S. Treasury's 264 million ounces of gold, an overnight transition to gold convertibility would create a major discontinuity for the U.S. financial system. But there is no need for the whole block of current dollar obligations to become an immediate claim.

Convertibility can be instituted gradually by, in effect, creating a dual currency with a limited issue of dollars convertible into gold. Initially they could be deferred claims to gold, for example, five-year Treasury notes with interest and principal payable in grams or ounces of gold.

With the passage of time and several issues of these notes we would soon have a series of "near monies" in terms of gold and eventually, demand claims on gold. The degree of success in restoring long-term fiscal confidence will show up clearly in the yield spreads between gold and fiat dollar obligations of the same maturities. Full convertibility would require that the yield spreads for all maturities virtually disappear. If they do not, convertibility will be very difficult, probably impossible, to implement.

A second advantage of gold notes is that they are likely to reduce current budget deficits. Treasury gold notes in today's markets could be sold at interest rates approximating 2% or less. In fact from today's markets one can construct the equivalent of a 22-month Treasury gold note yielding 1%, by arbitraging regular Treasury note yields for June 1983 maturities (17%) and the forward delivery premiums of gold (16% annual rate) inferred from June 1983 futures contracts. Presumably five-year note issues would reflect a similar relationship.

A Risk of Exchange Loss

The exchange risk of the Treasury gold notes, of course, is the same as that associated with our foreign currency Treasury note series. The U.S. Treasury has, over the years, sold significant quantities of both German mark- and Swiss franc-denominated issues, and both made and lost money in terms of dollars as exchange rates have fluctuated. And indeed there is a risk of exchange loss with gold notes.

However, unless the price of gold doubles over a five-year period (16% compounded annually), interest payments on gold notes in terms of dollars will be less than conventional financing requires. The run-up to $875 per ounce in early 1980 was surely an aberration, reflecting special circumstances in the Middle East which are unlikely to be repeated in the near future. Hence, anything close to a doubling of gold prices in the next five years appears improbable. On the other hand, if gold prices remain stable or rise moderately, the savings could be large: Each $10 billion in equivalent gold notes outstanding would, under stable gold prices, save $1.5 billion per year in interest outlays.

A possible further side benefit of the existence of gold notes is that they could set a standard in terms of prices and interest rates that could put additional political pressure on the administration and Congress to move expeditiously toward non-inflationary policies. Gold notes could be a case of reversing Gresham's Law. Good money would drive out bad.

Those who advocate a return to a gold standard should be aware that returning our monetary system to gold convertibility is no mere technical, financial restructuring. It is a basic change in our economic processes. However, considering where the policies of the last 50 years eventually led us, perhaps there are lessons to be learned from our more distant gold-standard past.

Mr. Greenspan, of the economic consulting firm of Townsend-Greenspan & Co., was chairman of the Council of Economic Advisers, 1974-77.

A Conversation With the French Foreign Minister

By KAREN ELLIOTT HOUSE
and FELIX KESSLER

PARIS—When the Socialists came to power in France this spring, the government's first emissary to the White House was Claude Cheysson, this country's remarkably outspoken minister of external

support leftists; hence their joint declaration over the weekend with Mexico that they recognize leftist guerrillas in El Salvador, though the U.S. refuses to. These priorities and policies, so sharply at odds with the U.S., puzzle and annoy many Americans.

In a recent interview, Mr. Cheysson

"In the beginning it seemed that you were only interested in South Africa because South Africa has minerals, a strong strategic position, a very bright industry and a developed society. Why bother with the rest? But progressively, one could see the rest of Africa coming into the picture."

and the Caribbean, and this is what we shall say all over the world. Our position is much clearer than any previous government."

For all these reasons, Mr. Cheysson says, France will push hard at the meeting of leaders from industrial and developing nations in Cancun, Mexico, next month for