Gold by Alice Roth

Will the GOP victory boost gold?

Reagan's advisers don't like the idea, but European pressure will be substantial.

One of the most important questions Ronald Reagan will have to deal with in the first year of his administration is whether the United States should reverse its policy of opposing gold remonetization. A little-known amendment, passed by Congress last month as part of a bill authorizing funding for the International Monetary Fund, compels the White House to come to grips with the issue.

The rider, sponsored by pro-gold senator Jesse Helms (R-N.C.), directs the Executive Branch and Congress to establish a special commission to study gold's role in the monetary system and make recommendations on U.S. policy. The new treasury secretary will chair this commission, which is required to issue a report by next October.

At first glance, the prospects for a major public shift appear slight, since Reagan has surrounded himself with many of the same people who helped engineer the delinking of gold from the dollar in the early 1970s (see article page 48). Much of Reagan's conservative constituency favors gold remonetization but one of its principal spokesmen, economist Arthur Laffer, was bounced as a Reagan adviser late in the campaign.

Moreover, Laffer's widely-publicized "blueprint" for restoring dollar-gold convertibility was incompetent, because it represented gold remonetization as something which could be undertaken by the U.S. unilaterally—regardless of the views of America's Western European and Japanese allies. The European Monetary System (EMS) did not exist as far as the Laffer proposal was concerned.

The EMS represents a major step toward remonetization of European gold reserves. Unlike the Laffer plan, the EMS does not attempt to restrict the availability of credit but to restore confidence and stability to an important segment of the world credit system.

Reagan's gold policy, as well as his international economic policy generally, may depend heavily on the outcome of his consultations with West German Chancellor Helmut Schmidt, who will visit the U.S. this month. Reagan and his advisers will probably be searching for ways to mend fences with Western Europe, following a serious deterioration of relations under Carter.

This makes it unlikely that Reagan will follow through with the extreme monetarist scenario suggested by some Wall Street analysts, who expect, on this basis, that gold will fall through the floor. James Sinclair, a founder of the New York-based precious metals firm, Sinclair and Company, is projecting an initial runup in the gold price between now and January to $700 an ounce or more, based on Soviet efforts to consolidate their geopolitical position prior to Reagan's inauguration.

After that, gold could decline sharply to around $500, or even $400 in a "worst case" scenario, because of a tight domestic monetary policy. This would be expressed in two interest rate peaks, one early in 1981 and a second "surprise" interest rate jump in the spring, causing an even more severe U.S. recession.

Although many of Reagan's present advisers would no doubt favor such a scenario, it seems an unlikely outcome for many reasons—not least, the fact that Reagan's victory rested heavily on his attack on Carter's economics and the false notion that depression is a solution to inflation.

A further runup in dollar sector interest rates would wreak havoc with European currencies and prevent West Germany from lowering its own rates, precluding an early recovery in the Western European economies.

Moreover, the EMS central banks would never stand for a drastic reduction in the international gold price, since gold has become a major component of their reserves and an important source of liquidity to the weaker European economies, such as Belgium and Italy.

During the summer, gold purchases by leading Western European central banks prevented the gold price from slipping below $600. The central banks can be expected to swing into action again if gold comes under pressure. In short, Reagan will have to listen very carefully to what Helmut Schmidt and France's Valéry Giscard d'Estaing have to say on economic policy if he is not to risk another open break on a par with the Carter administration.