Gold by Montresor

Mr. Volcker's cross of gold

The Federal Reserve chairman lays certain plans for the yellow metal, explained by an obscure document.

It was early this week that a document of some 40 pages, replete with extensive mathematical formulae and carefully hand-drawn diagrams, came into my hands. The circumspect title, "Gold Monetization and Gold Discipline," drew my attention less than the authorship and point of publication. These were Robert P. Flood and Peter M. Garber, two young professors of finance lately of the University of Virginia. The publication, however, came from the Board of Governors of the Federal Reserve in Washington, where Mr. Flood currently resides in the Division of International Finance.

In spite of all protestations by its chairman, the central bank is planning a return to gold. Spokesmen for that bank may attempt to dismiss these documents as academic studies for the newly formed Presidential Commission on Gold; and Governor Wallich, a member of the Gold Commission, may acknowledge that Mr. Flood serves upon his staff, but he will deny the study is for his board. It is Mr. Flood's private affair, he will say.

These studies were begun as early at the Fed as 1978, by members of Mr. Wallich's staff who frequent Basel, and know its thinking. They aim, as the present document at hand states with clarity, to utilize gold as a fixed point upon which to nail the growth of credit in the American banking system, to fix such deflation as will halt the economy we know.

Some at the Fed will admit to their designs, will admit that the Bank for International Settlements at Basel, Switzerland does seek to in fact impose its own peculiar "discipline" upon the United States at some point, a discipline that Paul Volcker can as yet only dream of. The Basel bank, which directs the Fed board in Washington, seeks to know whether my readers will suffer such insolence in silence.

Gold, the board writes, is to be fixed in advance as to both price and the date by which said price must be attained. Only from that fixed point "must government seek the implied paths for the government's currency issue and gold stock holdings." Whatever drastic reduction in the supply of credit to the economy is necessary to attain this immovable point must be carried out regardless of economic cost.

The purpose of the exercise, the board states, is to give total political control over the economy to the central bank, which is to enforce the standard gold fix by strictest "monetary control." "The monetary system . . . can readily be characterized as a 'gold-paper-gold' cycle," they write disparagingly of the mere "paper" known as the U.S. dollar. "Since the current 'paper' phase has allowed price-level instability, there has been some agitation to return to the gold standard. . . . The basic point of this paper is that such policies will lead to price-level stability only in the presence of very specific monetary control."

The board derides the recent proposals of University of California Prof. Arthur Laffer and New York financier Lewis Lehrman, both members of the "supply-side" cult, to let the "free market" fix the price of gold. What childishness, say Volcker's men. We may talk in public of the "free market" but that is not how we make policy.

Our goal, writes the Fed, is a fixed level of general *price deflation* throughout the economy. "Since the goal of policy is *not to monetize gold per se, but to stabilize the nominal price level,* the actual policy target is a given path of prices.

"Since merely fixing the gold price at some market-determined level will not produce price-level stability and may indeed be quite inflationary, it is reasonable to study gold monetization . . . specifying desired paths for the nominal price level."

The board's elaborate econometric computer model then proceeds to fix the real rate of interest in the economy, which is assumed to be quite high. It also fixes a low price level. Then, "once gold's price is fixed, the money supply becomes" a fixed formula-range equation linearly based on a summation of currency and gold stocks outstanding at the time of gold-price fix.

That is not deflationary enough, they conclude, for an even narrower range of gold price and monetary constraint is necessary to keep the gold standard from eventually collapsing.

"We refer," they conclude, "to this constraint as the *discipline of the gold standard.*"

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