moribund SDR plan by American Treasury and Federal Reserve, as well as the *New York Times*, which reiterated the theme again in a Sept. 27 editorial.

What de Vries wants is a kind of gold-backed SDR! He proposes that the IMF *re-monetize* its gold stocks, worth $30 billion at the market prices, to provide the required exchange rate guarantee. The problem in this proposal is, if the IMF is going to go to the trouble of remonetizing gold, why bother with the SDR in the first place. Even de Vries is not sanguine about the acceptability of this plan in Western Europe.

The question of dollar support operations is intensely problematic. Many American banking economists are now concerned that a further rise in interest rates would not only deepen the recession, but provoke dangerous and perhaps uncontrollable problems for parts of the credit system (see Domestic Credit). There had been speculation that with Bundesbank vice-president Karl-Otto Poehl's forthcoming accession to the presidency of Bundesbank, the Bundesbank might become more willing to accept a greater DM reserve role at the expense of the dollar, and to accept a further downward drift of the dollar. Indeed, the *New York Times'* editorial of Sept. 24, "A Leaden Foot on the Monetary Brakes," argued strongly against tighter money which traded off American economic ills for a temporarily stronger dollar. This position is also held by Rep. Henry Reuss, the chairman of the House Banking and Currency Committee. Bundesbank staffers loyal to Poehl say they are in basic harmony with this outlook, as opposed to the imputed "Volcker-Emminger" approach to tight money on both sides of the Atlantic.

However, in a Sept. 26 press conference, Emminger stated bluntly that "West Germany will not become the dumping ground for unwanted dollars." The viability of such a policy drift is strongly in doubt.

Well-informed economic commentators also believe that there is no basis to expect a short-term push for exports to have any effect. "Especially if there is a major legislative initiative involved," said a senior advisor to the U.S. Treasury, "there is no chance of anything happening." This view was also reiterated by a top-ranking Senate aide. "It's not just a matter of exchange rates or export credit, the aide said. "The U.S. economy is not in shape for an export drive."

The danger is one of panic and retrenchment in the United States. "We are moving from an era of multilateralism to an era of bilateralism," the Senate aide said. "We've got to start going big with Canada and Mexico."

—*David Goldman*

A European-Arab

World currency and gold markets were in a state of panic as of our Sept. 27 deadline, with gold trading at over $400 an ounce in New York. The subject of the panic is the OPEC finance ministers' meeting in Vienna and the possibility that Arab oil-producing nations will join European Monetary System (EMS) members in initiating a new gold-based monetary system.

The manic sell-off of dollars was apparently precipitated by leading New York and London banks and oil

GOLD

multinationals as a last-ditch gambit to destabilize the EMS through a new dollar crisis. The dollar's instability is the major remaining obstacle to the success of the EMS.

Among informed financial circles, there is little question now that gold has been returned to "the center of the monetary universe." The state of mind of the Anglo-American faction jeopardized by the EMS is perhaps best exemplified by Morgan Guaranty economist Rimmer de Vries's hasty proposal that the IMF use its $30 billion in gold holdings as "backing" for the proposed Special Drawing Right "substitution account." In reality, no continental European government will tolerate the use of the SDR as an alternative reserve currency, whether it has a gold component or not, because perpetuation of the IMF's severe austerity policies is seen as too great a threat to world economic growth and trade. What is under consideration is the creation of a gold-backed European "super-currency," perhaps through the further evolution of the European Currency Unit (ECU), or alternatively, a revival of the U.S. dollar based on the U.S. government's still substantial gold holdings.

The crisis among top policymaking circles in Washington and London was underscored by the Sept. 26 *Sunday Telegraph*'s report that the U.S. Treasury is about to abandon its eight-year campaign to demonetize gold. According to the *Telegraph*, more than a cessation of the Treasury's monthly gold auctions is at issue. The British newspaper went so far as to report that the Treasury will oppose SDR substitution at the upcoming Belgrade IMF conference and will float instead a plan to promote gold's role as an international monetary reserve.

One-third of world reserves

What disturbs the Atlanticist grouping most is the

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gold deal in the making

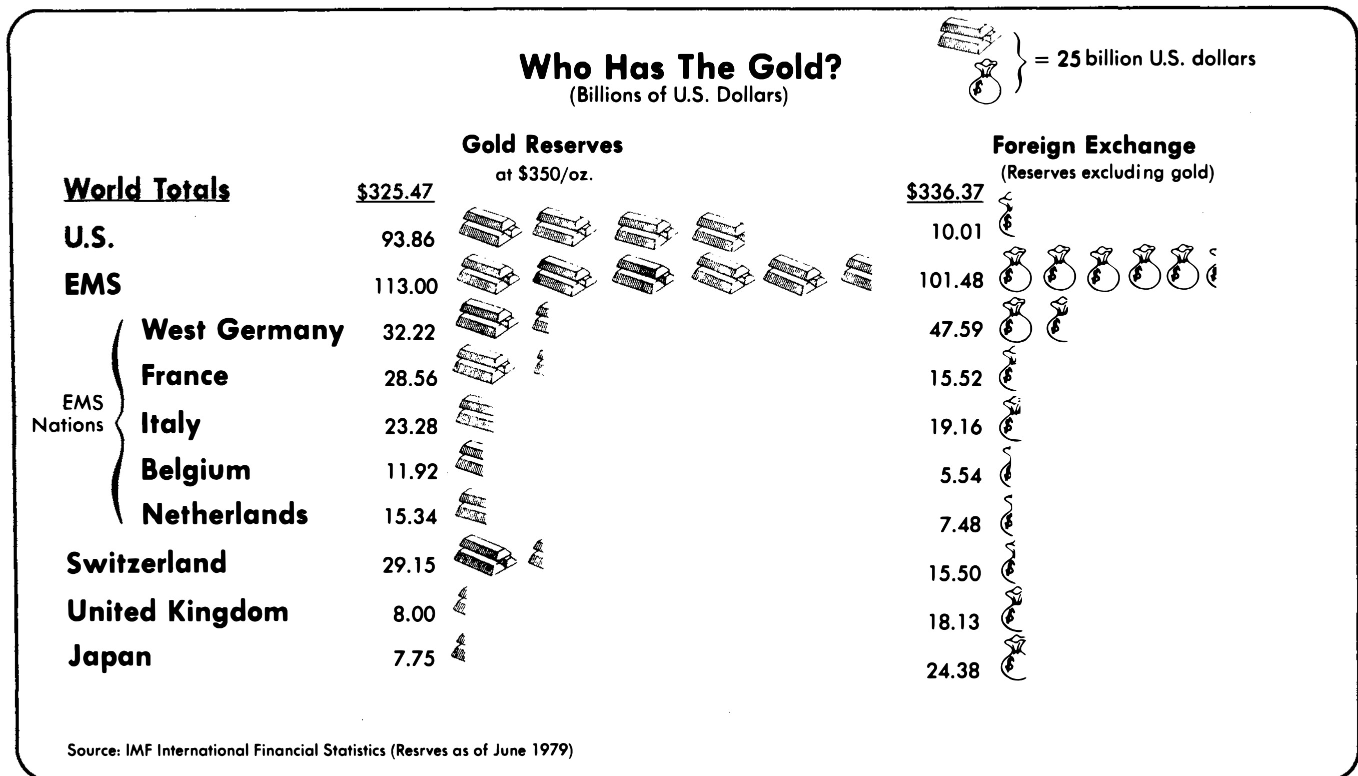
impact gold's steady appreciation has had on the world strategic lineup. For the first time in decades, the value of gold reserves held by the world's governments is approximately equal to world foreign exchange reserves (see table). The eight EMS member countries together control one-third of the world's monetary gold and one-third of the world's non-gold reserves. While the U.S., with $94 billion in gold, is still the single largest Western-government gold holder, recent administrations have chosen to fritter away this resource in public auctions designed to prove that gold is "just another commodity"—and have lost billions in the process.

Business Week reported Oct. 1 that European central banks had recently purchased gold in a deliberate effort to "put the squeeze" on speculators who were selling short. This is the first public admission by a major U.S. news medium that more than just "private market forces" have been behind the gold price run-up. Although the international agreement that prohibited major central banks from increasing their gold holdings expired in March 1978, there has been an informal understanding that leading Western governments would avoid accumulating more gold. Not only are European governments abandoning their decorum on this score, but recent developments indicate that they are attempting to actively police the gold market. Will the central banks next intervene in the present casino-like atmosphere to place a ceiling, as well as a floor, on the gold price?

Not a classical gold standard

Although the details of the emerging Euro-Arab gold arrangement are not yet clinched, our French and West German sources indicate that a return to the gold standard in the classical sense is definitely not under consideration. Rather, the plan is to use the liquidity created by the revaluation of European and Arab gold reserves to finance large-scale industrialization projects in the Third World.

Underscoring the difference between Franco-German gold policy and that of the monetarist Mont Pelerin Society, a source at the Rothschild-linked Banque Bruxelles Lambert remarked recently that Federal Reserve Chairman Paul Volcker is considering gold remonetization as a tool for imposing "monetary discipline." That is, the Fed would reduce U.S. credit growth in accordance with some formula establishing a fixed relationship between the number of dollars in



circulation and the quantity of U.S. gold holdings, a basic recipe for economic depression.

A classical, Mont Pelerin-style gold standard was also recently recommended as a possible policy option by an international monetary advisory board sponsored by the newly-formed New York investment bank Securities Group. Under a gold standard, their report states, "excessively expansionary or contractionary monetary policies would be countered by gold flows ... in actual practice, the disciplines imposed by the link to gold do a better job in controlling U.S. monetary conditions than a discretionary policy."

What the monetarists ignore is that the value of a given currency is not determined by the quantity of money in circulation but by the rate of growth of real tangible output in the national economy. Credit expansion is non-inflationary when funds are systematically reinvested in productive sectors, especially those employing advanced technologies which tend to lower unit costs. When government tax and credit policy favors productive capital formation, the investor has little incentive to resort to the gold window and there is no need to limit credit growth to the supply of gold.

Toward a rational gold price

Why is it that so many influential Western Europeans see gold's remonetization as a necessary precondition for the revival of confidence in world financial markets and for the promotion of world trade? The answer is that, unlike paper currencies, the price of gold must ultimately bear some relationship to the actual costs involved in producing the metal.

In June 1977, U.S. Labor Party economist Kathy Burdman conducted a study on the real costs of mining gold in South Africa in conjunction with a proposal by the party's chairman, Lyndon H. LaRouche, Jr. for a private International Development Bank. According to her 1977 report, "real economic costs are defined in terms of the necessary capital inputs and human educational development programs required to bring South African production up to the North American standards of capital-intensive mining. Specifically, this includes raising the abysmal wage of South African miners to $18,000 a year.... To put in new mechanization and train the entire 400,000-man workforce involved in South Africa's gold production will require a one-time international development loan of $39 billion."

The report concluded that in order to cover the costs of such a mechanization and training program, the price of gold—then at $140 an ounce—would have to be raised to about $300. Since inflation in the dollar sector has risen by about 20 percent since the report was written, the real cost of gold today should be about $360.

—Alice Roth

Press ponders gold's emerging monetary role

From the *Sunday Telegraph* (U.K.), Sept. 23: ... The real news from the American camp will be the floating of a new policy on gold as an international monetary reserve. In brief, the United States is moving to a live-and-let-live policy, 180 degrees from its historic drive to force gold from the centre of the monetary universe.

***Business Week*, Oct. 1:** In an effort to dampen the manic trading in the gold markets, several major Western European central banks have begun a program that aims to burn the speculators that have turned the gold market into a casino. Several weeks ago a number of large gold traders started selling gold short in the hope that they could get the price down and make profits on the decline. To prevent this, central bankers went into the gold market and bid up the price whenever it showed signs of falling. This squeezed the short-sellers, who lost fortunes in scrambling to buy gold at any price to cover their positions.

Losers weepers

Gold trading circles are abuzz with rumors about hefty financial losses thought to have been incurred by leading gold bullion dealers who sold short just before the recent price run-up. Here are some sample speculations which recently surfaced in the New York financial press:

From the *New York Post*, Sept. 26, 1979: The fast rise in the price of gold has started rumors that some major dealers here and abroad have misjudged the market and are hovering on the brink of financial disaster as a result....

But one of the firms mentioned, Mocatta Metals [New York affiliate of Mocatta and Goldsmid—ed.], one of the largest bullion dealers in the U.S. and Britain, flatly denied that it is in any difficulty.

***Barron's*, September 24, 1979:** .

At the same time, there's speculation that some banks that are financing the short positions may be drawn into the liquidity crunch by the billions at stake in the precious metals market if it continues its headlong advance. In that case, it could take the cooperation of the Fed to provide relief.