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A de facto gold standard?

Apparent intervention in the gold market by central banks suggests a forced return to gold.

On Thursday, Oct. 15, as Wall Street had barely begun its big slide, Treasury Secretary James Baker sat in his Washington office, listening to a visitor's advice that the Treasury sell gold on the open market as a means of maintaining market confidence. Baker made no response to his visitor's suggestion. However, market observers from Johannesburg to Tokyo believe that the hand of the U.S. Treasury, and perhaps the European central banks, was in the market, depressing the gold price, after "Black Monday," Oct. 19.

Contrary to all expectations, the gold price fell sharply from its Monday high point, by about $20, to roughly $464 late in the week of Oct. 19. Conditions of global financial panic, combined with a drastic loosening of monetary policy by the Federal Reserve, would normally have sent the gold price through the ceiling.

The market price of demonetized gold has no direct bearing on the liquidity of the banking system, let alone the stock exchanges. Yet the U.S. monetary authorities were sufficiently fearful of the consequences of a rapid rise in the gold price, to take the risky and wasteful step of selling gold (through intermediaries) on the open market. Why?

It appears that among the other "confidence-building measures" adopted by Washington in order to support Wall Street's confidence game, the Treasury sold gold in order to make the markets appear much calmer than they were.

In effect, the United States is stumbling backward into the remonetization of gold, but in the worst of all possible ways. Less than 300 million ounces of gold at Fort Knox can do little to support America's combined public and private debt of $9 trillion, much less underwrite an annual trade deficit approaching $200 billion per year. Indeed, the faintest harbinger of America's present financial condition persuaded President Nixon to stop paying America's foreign official liabilities in gold in 1971. It were the greatest of absurdities to employ the gold reserve to support the present financial bubble.

Yet that is what Baker proposed at the International Monetary Fund meeting, and it appears that he is doing precisely that. The notion of a commodity basket including gold, whose price would determine monetary growth, represented Baker's promise to America's creditors that he would not devalue the dollar in order to reduce America's debt burden, either on the foreign exchange markets, or through inflation.

Following "Black Monday," the creditors' committee, headed by the Bundesbank of West Germany and the Bank of Japan, declared a respite to the tight-money regime which it had imposed upon the United States at the Oct. 1 International Monetary Fund annual meeting. Supposedly, the renewal of the February "Louvre Accord," under which foreign central banks bought $78 billion of unwanted dollars during the first half of the year, underwrites the Federal Reserve's recourse to the printing presses.

The gold sales demonstrate that a general crisis of confidence in the dollar might erupt at any moment. Neither Baker, nor America's creditors, are confident that their bravado of Oct. 19 will dissuade foreign holders of dollars from stampeding. Almost certainly, official gold sales were specified in the Bonn meeting between Baker and his German counterparts Oct. 19. Possibly, the Bundesbank made American gold sales a condition for renewing support for the dollar.

Gold sales to support the Wall Street bubble will do much more harm than good. The bubble itself is unsupportable. America's gold reserves are trivial relative to its foreign obligations. Mere confirmation that the Treasury has sold gold to maintain confidence will undermine confidence. Should Washington, in its madness, sell gold in public, a run would ensue exceeding Nixon's worst nightmares of 1971.

Remonetization of gold becomes essential at the point that Washington is prepared to use gold-backed currency to finance an expansion of exports to traditional American markets in the developing sector, and permit the collapse of the securities-market bubble to reflect the modest circumstances of the U.S. economy. Once the bubble bursts, and both domestic and foreign investors have absorbed the inevitable losses in their U.S. portfolios, the U.S. could (and must) restore gold backing to the dollar's foreign official liabilities, as the reserve for a general reorganization of the monetary system.

Now the Treasury has been thrown back onto its gold reserve haphazardly, in its vain effort to postpone the crisis of confidence, the worst of all possible alternatives.

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