Central bank intervention continues

Gold and global security: That is the underlying theme of the crisis.

It is now widely acknowledged by financial news services that central banks sold heavily into the gold market between Oct. 19 and the first week of November, in order to avoid the appearance of a panicked flight from currencies into precious metals. That is no surprise; the leitmotif of the central bankers' crisis management since Oct. 19 consists of the assertion, "Inflationary expectations were broken by the stock market crash," even while the Federal Reserve and other central banks create money faster, perhaps, than at any other time in history.

During the first half of 1987, all metals prices, led by the precious metals, rose sharply, by factors ranging from 25 to 50%, in what portended to be a flight from all currencies. European central banks' stupendous volume of money-creation in the course of supporting the dollar provoked the move to metals; and the collapse of all the world's stock markets in Wall Street's wake, makes clear how vulnerable the dollar has made the entire world monetary system.

However, a more profound, and disturbing, chain of events may force the industrial nations back to the exchange of gold in settlement of overseas balances. Those in Washington who complain that gold backing for currencies would benefit the Soviet Union, a leading gold producer, should consider what Washington's strategic withdrawal from Western Europe will bring about in this regard.

During all of known monetary history—from the time of the Roman Empire through the Byzantine Empire, the rise of the Italian city-states, the ascendancy of the Spanish Hapsburgs, the French kings, and the British Empire of the 19th century—there exists only one, anomalous instance of the circulation of a reserve-currency without gold backing, namely, the U.S. dollar after Aug. 15, 1971. (We exclude the special case of the 1933-45 reichsmark in areas under Nazi occupation: There, as Hitler remarked, the value of the reichsmark was supported first of all by the concentration camps.)

Neither Philip II of Spain nor Victoria of England succeeded in persuading the rest of the world to accept unbacked obligations. Washington did, under the special circumstance, that America guaranteed the defense of the free world. Europe and Japan paid, through a clumsy and inefficient mechanism, for the strategic nuclear umbrella, by accepting the low-quality paper of the United States, dollars not backed by gold, in their reserves.

Those who recall the bitter exchanges between then-Treasury Secretary John Connally and his European counterparts following the closing of the gold window in 1971, know that the Europeans had no choice whatever in the matter. American officials then, and for years subsequently, bragged that America held all the cards; the existence of the North Atlantic Treaty Organization compelled the Europeans to accept whatever terms America might dictate.

In vain, President de Gaulle of France, and his principal economic adviser, the late Jacques Rueff, warned of the consequences for the United States of a license to circulate unbacked dollars. From 1965 on, they proposed a dollar devaluation against gold to give the United States breathing room to contain its payments deficits.

Washington followed the extreme consequences of the economic blunders of the 1960s and 1970s, with the consequence that America now imports about one-fifth of its physical consumption net, and borrows nearly $200 billion p.a. to afford this. It is one thing to demand an economic and financial subsidy from one's reluctant allies, however, and quite another to do so while destroying the alliance.

It may be no coincidence that the stock-market crash occurred barely two weeks after Washington confirmed its intention to withdraw the Pershing-II missiles from West Germany, rendering NATO's most important European member defenseless against overwhelming Soviet conventional superiority. I assert no mechanical relationship between these strategic and financial events. However, the world after the Dec. 7 Reagan-Gorbachov summit threatens to become a much different place.

If Europe is forced into a reluctant accommodation with Moscow's empire, and renders tribute in the form of a huge volume of industrial exports to Soviet overlords, the monetary arrangement most appropriate to the new strategic division of the world would be a European currency bloc, matched perhaps by a Japanese currency bloc in Asia. These blocs would no longer require their bloated dollar reserves, and would eventually institute some means of gold exchange to replace the dollar.

Under such circumstances, the monetary benefit arising from the reintroduction of gold would be the least of those accruing to Moscow.