From Gold to Token Money–II

by MITCHELL S. LURIO

This is the second and final installment comprising contents of a five-lesson course on "Money, Gold and Devaluation" recently completed at the HGS in Boston by Mitchell S. Lurio, its director.

We regret that several errors occurred in Mr. Lurio's article last month. Savings and life insurance values have depreciated by *thirty* billion dollars, not ten (p. 15, par. 1). After "baleful influence" (p. 15, par. 2), read economic *rent* for interest. And chaotic situations force man's *descent*, not dissent, into the depths of despair (p. 16, par. 1).

THE current furore has brought into focus the role of gold throughout history. As outlined last month, tokens came into use to represent gold many centuries ago, because of confidence in their convertibility upon demand. Such tokens now include not only currency but checking accounts, that is, demand deposits. Theoretically convertibility limits the token money supply so long as each token dollar must be backed by a fixed amount of gold. When gold reserves are just sufficient to support a certain amount of token money, the Federal Reserve System has to stop adding to its loans and investments and to its issuance of Federal Reserve notes. This in turn holds its member banks down from adding to their loans and investments. Increases in the token money supply are the result of increases in bank loans and investments.

If the rules remained unchanged by law, inflationary forces would be restrained. But the insatiable undertakings of our government have not been restrained, and the rules have been changed step by step, first by eliminating domestic convertibility, then by reducing the percentage of gold required as backing, and recently by doing away with the requirement for any gold backing.

Our extravagance began long before the Vietnam conflict. As our deficits piled up the government had to borrow. If the public and the commercial banks could not or would not buy all the paper offered by government, the Federal Reserve banks had to buy it. At this writing, the FRS holds the fantastic amount of $49 billion worth of government obligations. These create "high-powered" dollars, for they increase the reserves of member banks (where government checks are deposited) and permit those banks to lend several times that amount. The token money supply goes up accordingly, gold backing diminishes as a percentage, confidence in the dollar is eroded, and gold is called for by foreign holders of dollars, making matters worse. Hence the last move in the oft-repeated process is complete removal of gold backing.

A climax was reached on Friday, March 15, 1968. The London gold market was closed. Representatives of seven leading nations (France is not included) met to avoid further disruption. They have come up with a stopgap arrangement, a two-price system for gold. Gold holdings of governments will be kept intact and inter-government dealings will continue at $35 an ounce.

A free market will exist for newly-mined gold and for gold already in private hands. To seal off violations of this arrangement by all countries is almost impossible. It is now up to the United States to raise taxes, lower expenditures and restore confidence in the dollar.

In my first draft of this article written before March 15th I wrote that the conservative gold standard school still maintains that it is not too late to build up adequate gold backing without devaluation. To do so requires more than the tax increase and expenditure cut now contemplated. The Federal Reserve System will have to raise member bank reserve ratios, increase the rediscount rate and, most effective of all, sell off its government holdings gradually, without too much regard for the effects on bond prices (which would fall) and interest rates (which would rise). These are Draconian measures which would cause temporary unemployment and retard home building. Followed through, they would restore confidence in the dollar and bring gold into our treasury. Because this is an election year, it is possible that we may take this route. The alternatives may be dollars selling at a discount, repudiation of our commitment to give other nations gold for dollars, and world disorder in exchange rates.

Several other courses have been advocated. We have exerted much pressure on certain countries to establish what might be called an international reserve system which would issue "special drawing rights." It would simply be a device for deficit nations to postpone the day of reckoning. So far the others have resisted our pressure, but there is a likelihood that such an international organization will be established on a modified basis. If that comes about it can be stretched only so far and will bring another crisis.

Many responsible people have recommended devaluation. Some look upon that course with horror because it would give large windfall profits to the Soviet Union which is supposed to own much gold, to France which increased its gold holdings and reduced its dollar holdings, and to South Africa which is the principal free-world gold-mining country. It would reward all the gold speculators and hurt all the friendly nations that held our dollars at our request.

But most of the principal nations would devalue in the same proportion, thus maintaining the same relative positions in foreign exchange. Some are beginning to say that the consequences of devaluation are not so bad—the disturbance would soon be overcome.

Little emphasis is given to the fact that devaluation is reorganization in bankruptcy—settlement at a fraction of debt. But worse, it does not affect the underlying practice, "monetizing government debt." This is government counterfeiting brought about in part by new economic theories that play right into the hands of ambitious political leaders. It opens the way, as it has elsewhere, to successive devaluations.

Some have suggested that if the tie between the dollar and gold were completely severed the token dollar would float in a vacuum. The prophecy that gold would then sell at $6 an ounce would seem to have been contradicted by the recent market action, though the tie to gold has not yet been completely broken.

It is true that with or without gold reserves, government may change the rules whenever Congress can be persuaded to do so. With mandatory gold reserves it is more difficult to go through the public process of devaluation. Without reserves no special legislation is needed—the process is invisible until the token money supply is again stretched to the breaking point.

Gold has served remarkably well over long periods of time. Even though its production bears absolutely no relation to population or commerce, its scarcity and costs of production have been such as to cause only minor price level adjustments. It has the remarkable virtues, as stated by President de Gaulle, of "immutability, impartiality and universality." Shall we rely upon the discipline of gold or the discipline of politicians?

Despite vigorous assertions that austere measures will be taken, I am afraid I must conclude that because there is no informed protest of sufficient force to dampen our profligacy, successive devaluations will take place. Savers are confronted with an insoluble problem—that of hedging against continuous deterioration of the purchasing power of the dollar. Lenin may have been right when he said capitalism would destroy itself by debauching its currency, and if our government refuses to live within its means we will go the way of the Roman Empire.

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Gilbert M. Tucker

GILBERT M. TUCKER, who was for many years, in his writings and lectures, a concise and well informed patron of Henry George, slipped away in his sleep on February 26th in Carmel, California. He was the author of *The Path to Prosperity, For the Good of All, Common Sense Economics, Your Money and What to Do with It* and numerous booklets. His best remembered book is probably *The Self-Supporting City,* which was revised in 1958. It is still in use, quoted, and circulated. Marshall Crane reviewed it for HGN in August, 1958, quoting this paragraph as characteristic of the author's prophetic views:

"By whatever agency our taxes are levied, we ourselves must keep filled the pork barrel from which we would grab, and by and large, the taxpayers lose more from subsidies than they gain. All such schemes are open to another grave objection: he who pays the piper calls the tune, and trying to shoulder off onto state or nation obligations which are ours means the loss of self-government and the destruction of our liberties. We clamor for subsidies for schools, roads, public improvements, housing, the relief of destitution, and for many a supposed benefit, and for this mess of pottage — and a mess it is! — we sell our freedom. Remember Franklin's warning: 'They who can give up essential liberty, to obtain a little temporary safety, deserve neither liberty nor safety.' "

Mr. Tucker inherited The Country Gentleman, a magazine of renown published by his father. His lifetime roots were in Albany, and he and Mrs. Tucker reluctantly closed their home there only a little more than a year ago, when they sought a warmer climate in California. There he lived as he always had, true to his inheritance, a gentleman in manner and appearance.

Few of those who stepped aboard the sumptuous Titanic on its ill-fated voyage with a socially prominent passenger list, survived the tragedy. Mr. Tucker did. Rescued on a lifeboat, he lived to tell the story, though he seldom mentioned it. What engaged his conversation much more was his strong belief in and clear understanding of tax reform.

He was associated with the HGS from the beginning and was a member of Oscar Geiger's committee of founders. Active as an officer in the Henry George Foundation, he later financed the Economic Education League and remained for years a contributor to the Pennsylvania efforts to establish a test LVT city. It was hoped for a time that Erie would choose that honor.

He provided generously for the Albany Academy for boys, which he attended before graduating from Cornell University. It will endure as a fitting and affectionate memorial. He will be sadly missed by his wife, Mildred, whom he adored, and affectionately remembered by many whom he befriended. He was gentle and considerate, and he loved his country. "I am certainly among those who will miss him," wrote Rhoda Hellman on hearing of his death. There are many who would say the same.