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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Dollar "Price" of Gold and "Free Market" Fallacies

In a recent bulletin we mentioned that the witnesses at the Senate hearings on the Gold Redemption Act of 1954 could be classified in three groups. One of the groups advocated a so-called "free market" for gold and ultimately a higher dollar "price" for gold. Each of these proposals involves a basic fallacy, and an attempt to implement them probably would have most serious consequences.

The basic fallacy in the higher *dollar* "price" of gold is hidden in the semantic confusion that has developed in the use of the word "dollar." Contrary to popular usage, the statutory dollar is not a piece of paper engraved with green ink, nor is it found in the bank deposits that are said to contain dollars.

Unless one uses language with precision, one is almost certain to fall into semantic "boobytraps." A basic rule for those who wish to talk sense instead of nonsense is to have one referent (thing referred to) and only one referent for each word symbol. Especially important is it to avoid confusing claims to things with the things claimed. For example, no one in his right mind probably would have difficulty in remembering that the baggage check in his pocket was not the same thing as his trunk at the railway terminal; but many people, even some monetary economists, seem to forget that a piece of paper currency bearing the promise of the United States Government to " * * * pay to the bearer on demand ten dollars" is not ten dollars. What, then, is the dollar for which paper currency and demand deposits are, in effect, claim checks?

Unfortunately, semantic confusion about the "dollar" has been fostered for more than a hundred years. In 1849, Congress passed a statute in which the word "dollar" referred to a specified amount of gold without repealing a prior statute that used the word "dollar" to refer to a specified amount of silver. Since that time there has been a statutory basis for saying that "dollar" refers either to an ounce of silver or to a specified amount of gold, as one may prefer. However, the practice of the Government for many decades has been to redeem claims on "dollars" with gold (whenever such claims have been redeemed) unless the claim specified *"silver* dollars."

Of course, the legal definition of "dollar" was changed when the dollar was devalued (reduced in weight) in 1934. The word symbol "dollar," by statute and by well-established Government practice, now refers to 1/35 ounce of gold. In other words, $35 means (that is, is the symbol for) an ounce of monetary gold today.

From the foregoing, readers presumably will readily see that to talk seriously about raising the "dollar price of gold" is to talk nonsense in a disarming way. As long as "dollar" is the symbol for 1/35 ounce of gold, the "price" of a piece of gold in terms of dollars must be measured by the number of ounces in the piece of gold times 35.

Those who understand this fact may nevertheless be puzzled by the so-called quotations for gold in black or "free" markets. Prices of an ounce of gold ranging from $40 to $50 or even higher have been widely quoted in financial news items during recent years. However, only the abbreviated statement of the situation is at all confusing. What actually happened in such markets were numerous exchanges of paper promises to pay dollars for gold. Sometimes those paper promises to pay dollars were in the form of United States currency, and sometimes they were checks drawn on bank balances computed in dollars but actually neither consisting of dollars nor convertible into dollars; they were mere promises to pay dollars at some indefinite future date.

Evidently, anyone who wishes to be technically accurate (there seems to be little use in discussing these matters in any other way) would not speak or write of the price of gold in Tangier (for example) in terms of dollars but of the price of irredeemable claims on dollars in terms of gold. Naturally, such exchange ratios fluctuate with the hopes and fears of the parties involved in such transactions.

Less confusing and therefore perhaps more enlightening would be discussion of such matters in terms of the exchange ratio between gold and irredeemable promises to pay specific amounts of gold. Evidently, what the proponents of a "higher dollar price" for gold want is a change in the exchange ratio between irredeemable promises to pay gold and gold. In other words, they want to have the statutory definition of the dollar changed by reducing the weight of gold specified. In technical terminology, this is devaluation.

The principal argument offered in favor of another devaluation is to the general effect that prices have risen greatly since the dollar was last devalued and that the

gold miners are thus placed at a disadvantage because the number of dollars into which an ounce of gold is divided has remained unchanged for 20 years.

Such comparisons depend on the base year chosen. If, instead of the depression year 1934, one chooses 1925-26 as the base period, the percentage rise in wholesale commodity prices and the percentage increase in the number of dollars specified by statute in each ounce of gold are almost precisely equal. At the other extreme from the comparison based on 1934 preferred by the gold miners would be one based on the 1920 peak of commodity prices. By using that relationship, one can demonstrate statistically that each ounce of gold should now be divided into only 20 dollars, all of which serves to emphasize that there are "lies, damned lies, and statistics."

The "Free" Market Fallacy

Most of the witnesses who advocated another devaluation of the dollar also urged that what they chose to call a "free" market for gold be tried in order to establish a sound exchange ratio between "dollars" (meaning irredeemable promises to pay dollars) and gold. In order to "free" gold, they suggest as part of the scheme that the United States holdings be "frozen" or kept off the market until the new "price" in a "free" market has been determined by the play of supply and demand.

To talk about "freeing" a market for a commodity by freezing two-thirds of the world supply and holding it off the market is an interesting exercise in gobbledegook. However, exposure of this semantic "boobytrap" reveals only one of the two major flaws in the scheme.

The other major flaw and the great potential danger become evident when one compares the situation that would exist with the situation that did exist during and for several years after the Civil War. Then, as now, the paper currency was not redeemable in gold. In order to help finance the war effort, a few hundred million dollars, face value, of "greenbacks" had been issued. These were simply promises to pay dollars on demand at an unspecified future time, like much of the currency in circulation today.

As with any paper currency, when fulfillment of the promise to pay something specific is indefinitely postponed, that is, when the currency is irredeemable for the time being, the exchange value fluctuates from day to day. The two principal uncertainties with reference to any temporarily irredeemable promise to pay are as follows:

1. *When* will the specified payments be resumed?
2. Will the payments be *as specified* (or will something else be substituted) when payments are resumed?

During the Civil War and afterward until passage of the Resumption Act of 1875, the date when payments of specie would be resumed remained in doubt. But at no time during that period was serious consideration given to substituting something else, such as a smaller dollar, for the dollars promised by the "greenbacks." Nevertheless, the uncertainty with reference only to the *time* of resumption was sufficiently great to permit fluctuations in the exchange value of a dollar claim in "greenbacks" to as low as 35 cents in terms of gold.

Why, if the situation is somewhat similar today, has not our present paper currency likewise fallen to a low exchange value in terms of gold? (Or to state the same question from the opposite point of view, Why has not the price of an ounce of gold in terms of paper promises risen to nearly $100 face value of our irredeemable currency?) One answer lies in the fact that the United States has continued, in spite of domestic inconvertibility, to redeem the paper currency offered by foreign central banks at the statutory definition of "dollar." In this respect the situation differs from that during and shortly after the Civil War.

In view of the foregoing it should be apparent that the proponents of a so-called "free" market for gold are urging, first, that we set the clock back to the Civil War experience by making the currency irredeemable abroad as well at at home and that, second, we not stop there but continue moving the hands of the clock back to the "shinplaster" era of the Continental currency by raising a question as to what will be offered ultimately as payment when specie payments are resumed.

Moreover, they propose to answer the question as to what will be paid ultimately by reducing the weight of the dollar in inverse proportion to the rise of the price of gold in terms of the irredeemable paper currency. Keeping in mind that the two-thirds of the world's gold now at Fort Knox would be frozen there during the "free" market period of test, one needs no crystal ball to foresee the probable outcome.

Gold producers would have every reason to withhold newly produced gold from the market during the several months or few years that the experimental "free" market is operating. The less gold they put on the market, the higher the ratio at which the limited supply presumably would exchange for paper currency and therefore the greater would be the ultimate devaluation. Of course, the greater the devaluation the greater the profits from gold mining, at least for a few years until costs readjust to the new situation.

Working toward the same end would be the fears of everyone who holds paper currency, bank deposits, or any other assets having a value fixed in terms of paper promises to pay dollars. With the virtual assurance that the higher the price of gold in terms of paper currency the greater will be the devaluation, the incentive to get rid of claims on dollars would be great. Fear of further loss in buying power of currency, deposits, savings bonds, etc., would be a powerful influence.

Thus the proponents of the greatly restricted "free" market would align two of the strongest motivations of human behavior, fear and greed, to support the drive for a higher price for gold. The Nation's irredeemable paper currency, thus cut loose from any tie to a definite quantity of any tangible and valuable substance, would then be adrift under conditions that no currency in the history of the world to date has yet survived for long. In short, if recorded history can be considered a useful guide, the experiment proposed would be one of the worst monetary ventures that the mind of man has as yet conceived; it has an unbroken record of dismal failures.

Such considerations raise the question, How can intelligent men be found who will advocate such a scheme? Granting the good intentions of those concerned, there seems to be only one answer: the advocates of a "free" market and a "higher dollar price" for gold simply have stumbled into some of the semantic "boobytraps" that are scattered through the jungle of money-credit theory. They were not the first and probably will not be the last to get caught in those traps.

What the Indicators Say

The number of new incorporations increased further during March according to Dun & Bradstreet. The March figure was the largest for any month since January 1948. Thus our seasonally adjusted index was revised upward in March to 3 percent above the 1953 high reached in July. According to the arbitrary limits chosen by the National Bureau of Economic Research, the minimum duration of a specific cycle (period between two high or low points of a series) is 15 months. Consequently, the downturns of this series in August, November, and January apparently should be considered temporary interruptions of the upward trend that started in October 1951.

The number of business failures, which decreased during the 3 consecutive weeks prior to April 15, increased substantially during the week ended April 22.

Steel-scrap prices, not included among the National Bureau's statistical indicators, rose further in the week ended April 20 for the fifth consecutive week. As of April 20, steel-scrap prices were 23 percent above the low reached during the week of March 16.

The foregoing reinforces the belief we expressed last week to the effect that any extension of the recession now under way probably will not result in a severe depression in the near future.

SUPPLY

Industrial Production

Steel-ingot production, scheduled at 68.4 percent of capacity for the week ended May 1, 1954, was slightly less than that in the preceding week and was 28 percent less than production in the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1953*	*1954*
Percent of Capacity†	101	24	91	32	100	68p
Weekly Cap. (million tons)	1.38	1.52	1.51	1.54	2.25	2.38
Production (million tons)	1.39	.36	1.37	.49	2.25	1.62

Automobile and truck production in the United States and Canada during the week ended April 24, 1954, was estimated at 156,839 vehicles, compared with a revised total of 148,559 vehicles during the previous week.

	1929	*1932*	*1937*	*1938*	*1953*	*1954*
Vehicles (000 omitted)†	143	37	133	61	195	157p

Electric-power production in the week ended April 24, 1954, decreased to 8,257,000,000 kilowatt-hours from 8,345,000,000 kilowatt-hours in the previous week.

	1929	*1932*	*1937*	*1938*	*1953*	*1954*
Billion Kilowatt-hours†	1.70	1.47	2.23	2.01	8.02	8.26

Lumber production in the week ended April 17, 1954, increased. *The New York Times* seasonally adjusted index was 3 points above that for the preceding week but was 4 points below that for the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1953*	*1954*
The New York Times Index†	135	41	84	91	118	114

†Latest weekly data; corresponding weeks of earlier years
p=preliminary

New Consumer Goods Per Capita

The 3-month moving average of our index of new consumer goods per capita (plotted at the third month) increased 1 percent during March from our revised figure for February. Thus the downward trend of the index that had continued since May 1953 has been halted at least temporarily. The March figure was 7 percent below that for March last year and 9 percent below the 1953 high reached in May.

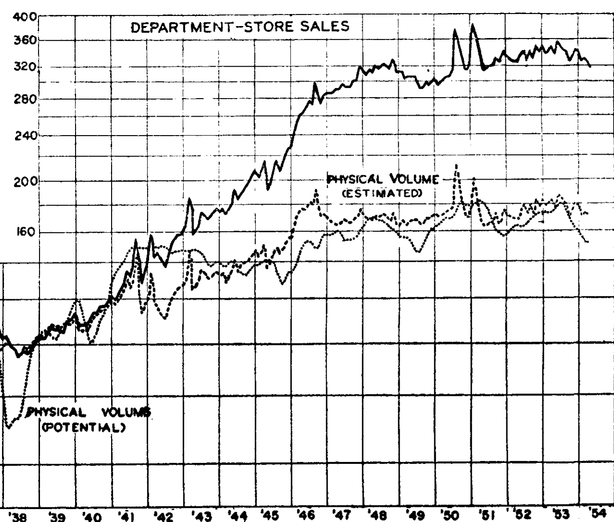
Production of consumer goods increased 2 percent in March after remaining virtually unchanged during February. Mainly responsible for the increase was the gain of 16 percent in automobile production. Residential construction and furniture production decreased 4 percent and 1 percent respectively; textile production increased 1 percent.

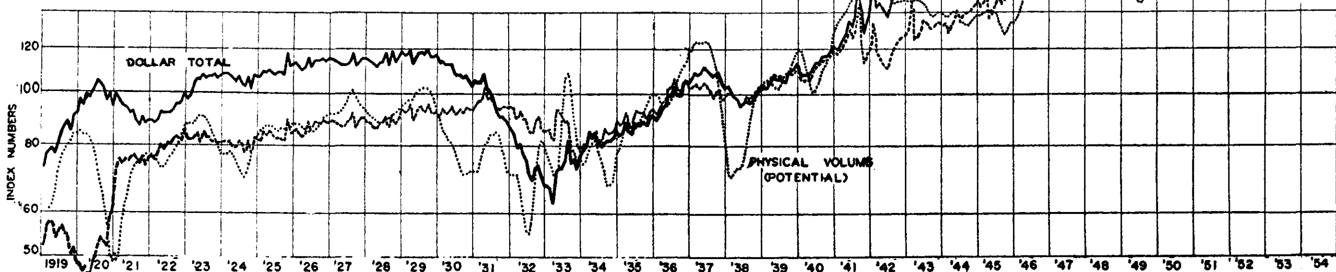
Residential construction appears to be at a rate somewhat less than that of last year, but the decrease has been small to date.

Automobile production of approximately 625,000 cars and trucks in April compares with approximately 630,000 units produced in March. Greater production in March and April is seasonally expected. However, the index of automobile production has not been seasonally adjusted since World War II. Now that the demand to make up for lack of production during the war years presumably has been satisfied, the prewar seasonal pattern may be resumed. In that event, marked decreases in automobile production during the third quarter are to be expected. Until such time as computation of new seasonal factors becomes possible, the decreased production in the third quarter will be reflected in our index of production of consumer goods.

Although textile production increased slightly during March, it remained at a rate 13 percent below that for March last year; and there are few signs indicating an early upturn in textile production to the levels of the first half of 1953.

The recent leveling-off of the downward trend of the index of new consumer goods per capita is largely attributable to the seasonal increase in automobile production. Presumably, decreasing automobile production will tend to lower the general index after next month, and it now seems doubtful that improvement in the other components will counteract this influence. Therefore, we do not expect a marked upward trend of consumer-goods production during the next several months.





DEMAND

Department-Store Sales

Our estimate of the seasonally adjusted index of department-store sales (based on dollar value) for April is about 3 percent below the revised index for March. The April index is nearly 6 percent below that for April last year and 11 percent below the 1953 peak reached in May. Moreover, in April the index reached its lowest point since April 1951.

Our index of prices of goods sold in department stores, which has been quite stable, remained unchanged during March.

The index of the physical volume of department-store sales (calculated by dividing the dollar-value index of sales by the index of prices) decreased nearly 2 percent during March. The March figure is nearly 8 percent below that for March 1953.

Our March index of the potential volume of department-store sales continued downward. (The potential-volume series, which is based on the production of goods sold in department stores, reflects the estimated physical volume of goods available for sale in department stores.) This series has been declining steadily since June 1953.

The increase in sales during the weeks immediately preceding Easter this year was slightly greater than the average increase during corresponding pre-Easter periods in the preceding years. It is impossible to determine how much sales during this period were affected by lower prices resulting from reductions in the excise tax.

Trade reports indicate that buyers have responded to aggressive promotions; sales of apparel have been most favorable, whereas sales of household goods and appliances have been least favorable.

Although the lower excise taxes may be a supporting factor in department-store sales, we expect department-store sales to trend downward in the near future.

Latest Weekly Data

Department-store sales for the week ended April 24, 1954, were 4 percent less than sales in the preceding week and were 2 percent less than sales in the corresponding week last year.

PRICES

Consumers' Prices

The Bureau of Labor Statistics' index of prices of goods and services bought by moderate-income city families decreased two-tenths of a point during the month ended March 15 for the second consecutive month to a level one-half of 1 percent below the alltime high reached in October 1953. The March index was slightly more than 1 percent above that of March 1953 and was 13 percent above that of June 1950.

Increases in costs of housing, services (medical and personal care), and reading and recreation were more than offset by decreases in the costs of foods, transportation, and apparel. The rise of the housing component was attributable to a further increase in rents; but the increase was slight, one-tenth of a point, for the second consecutive month. Moreover, some "scattered decreases" were reported in rents for the first time in several years. According to the Bureau of Labor Statistics, "The rate of increase in rents has slowed considerably since November 1953 as the effects of decontrol have largely been dissipated."

The March food component decreased four-tenths of 1 percent to a level four-tenths of 1 percent above that of mid-March 1953 but nearly 4 percent below the peak of August 1952. Primarily responsible for the lower food index were reduced prices of eggs, milk, butter, cheese, and potatoes. Prices of all cuts of beef, veal, and pork (except pork chops) decreased also. Coffee prices rose again.

Apparel prices receded for the fourth consecutive month to a level 1 percent below that of October. The transportation component decreased three-tenths of 1 percent during March. Lower prices for both new and used cars accounted for the decline.

Commenting on the probable effect of recent reductions in excise taxes on consumers' prices, Mrs. Aryness Wickens, deputy commissioner of labor statistics, declared that excise cuts alone "could produce a drop of five- to seven-tenths of 1 percent in the index," depending on whether "the maximum benefit of the excise reductions was passed on to the consumer." However, "this decline would not show up until the April index or perhaps later."

Conclusions

Recent reductions of excise taxes may cause some further decreases in prices of consumer goods. Moreover, prospective decreases in disposable personal income as a result of reduced business activity and lower farm net income on the one hand and a high level of supply of consumer goods on the other indicate continued downward pressure on the prices of consumer goods. Consequently, continuation of the downward trend of the consumer price index during the next several months seems the most probable development.

Commodities at Wholesale

(August 1939=100)	*1953* *Apr. 29*	*1954* *Apr. 22*	*1954* *Apr. 29*
Spot-Market Prices (22 basic raw materials)	269	285	285
Commodity Futures Prices (Dow-Jones Daily Index)	343	373	375