Published Weekly by
AMERICAN INSTITUTE
for ECONOMIC RESEARCH
Great Barrington, Massachusetts 01230

RESEARCH
REPORTS

Vol. XLVIII No. 39 September 28, 1981

A Market Alternative To A Legislated Gold Standard

Nearly everyone agrees that the U.S. money-credit system requires revision, but nearly everyone disagrees with each other about which specific revisions would be helpful. The Free Market Gold Coinage Act is intended to provide a free-market test between gold monetary units and fiat monetary units. If such a fair test could be conducted, the more useful unit would be revealed by the choices of market participants – who after all are the users of the monetary unit. Although the aim of the Free Market Gold Coinage Act is useful, the Act as it currently stands does not seem adequate for ensuring a fair test. But it still can be revised, and it surely is a major step in the right direction.

In last week's issue of these *Reports* we discussed the renewal of interest in gold as the monetary unit, the inadequacy of discussion on that question to date, the many essential aspects of a sound gold-based money-credit system, and the small chance that such a system could be implemented by authorities even if the political will could be summoned to do it. Accordingly, we suggested the U.S. Gold Commission might perform its most useful service by formulating a detailed statement of the problem in order to indicate directions for further inquiry. To do nothing about restoring gold would be to continue saddling the economy with its current fiat money. Inaction in this instance could be a dangerous act.

One course of action with limited risk is to demonopolize Government's power over the monetary unit, or in Friedrich Hayek's language, "to denationalize money." By so doing, decentralized experimentation with various types of private monetary units and banking practices in the market would be possible *without* the politically difficult (impossible?) requirement that Government give up its access to and control of paper money. If paper money advocates are confident that a properly managed fiat monetary unit is superior to possible alternatives, they should welcome the test, for it would confirm their position if it is sound. Furthermore they need not fear that a private monetary unit of gold would wreck the economy, because the present paper system still would be available to "carry" the economy if it were needed.

We highly doubt that fiat money ever can be the basis of a sound money-credit system and of a growing free society. All of history indicates that governments destroy the monetary unit when they have exclusive control of it. Thus, we should expect that, in a fair test, a monetary unit of gold would be, over time, the revealed preference of market participants. Moreover, in the course of experimentation we should expect that bankers would relearn the prudence of creating new purchasing media only in connection with bona fide commercial loans, or self-liquidating loans. Such was the origin of gold money and sound commercial banking in the past: they evolved in free markets. No group of economists designed the gold-standard system. No governmental body decreed it until *after* free persons acting voluntarily developed the elements of the system. That outcome could be expected again if the ingenuity of the American people is unleashed and applied to the problem of providing the public with a long-term reliable monetary unit.

A bill (H.R. 3789) has been introduced in the U.S. House of Representatives by Daniel Crane and Ron Paul that has the objective of permitting the free-market re-evolution of gold money and gold-based banking. Called the "Free Market Gold Coinage Act," it would make available for use in the form of gold coins the reported U.S. stock of 264 million ounces of gold. More importantly, its Section 5 would, among other things, prevent government from interfering with banking conducted in units of gold. Here is the text of this proposal:

97th Congress
1st Session
H.R. 3789

FREE MARKET GOLD COINAGE ACT*
IN THE HOUSE OF REPRESENTATIVES
(June 4, 1981)

Mr. Daniel B. Crane (for himself and Mr. Ron Paul) introduced the following bill; which was referred to the Committee on Banking, Finance, and Urban Affairs.

A BILL

To provide for the minting of United States gold coins.

Be it enacted by the Senate and the House of Representatives of the United States of America in Congress assembled.

Short Title

Section 1. This Act may be cited as the "Free Market Gold Coinage Act."

Policy of the United States

Sec. 2. (a) It shall be the policy of the United States to *recognize the right of* free coinage of gold at a free market price.

(b) Nothing in this Act shall be construed to prohibit or to discourage the manufacture or circulation of gold coins by persons or organizations, nor to restrict the free importation or exportation of gold coins for either monetary or nonmonetary purposes.

Public Coinage

Sec. 3. (a)(1) The Secretary of the Treasury shall offer the gold bullion reserves of the United States for sale to the public, except that such sales shall only be in the form of

* Ed.- Italicized portions are revisions included in a draft version being circulated for introduction in the Senate. This text also reflects some deletions from the original H.R. 3789.

gold coins that are minted in accordance with the provisions of this Act.

(2) All such gold coins shall be minted from .900 fine gold of a standard coin alloy which shall be determined by the Secretary.

(3) The weight of each such gold coin, as specified in subsection (b)(1)(A), refers only to the gold content of such gold coin and not to the weight of the standard coin alloy involved.

(b)(1)(A) The Secretary shall mint –

(i) gold coins that weigh 1 troy ounce (31.103 grams);

(ii) gold coins that weigh one ounce (28.349 grams);

(iii) gold coins that weigh 10.0 grams (154.321 grains); and

(iv) gold coins that weigh 5.0 grams (77.161 grains).

(B) Not less than half, as measured by weight, of all such gold coins minted and sold under this Act shall be of the weight specified in clauses (iii) and (iv) of subparagraph (A). After conducting public hearings, the Secretary shall determine the proportion of gold coins described in clauses (i) and (ii) of subparagraph (A) that shall be minted under this Act.

(2) One side of each gold coin described in paragraph (1)(A)(i) shall bear the likeness of John F. Kennedy in left-profile, an inscription of the year in which such gold coin is minted, the inscriptions "Liberty" and "In God We Trust," and an appropriate mint mark which shall be determined by the Secretary. On the other side of each such gold coin, the inscriptions "E Pluribus Unum" and "United States of America" shall surround the inscription "One Troy Ounce Gold" which shall be not less than one-half of the diameter of such gold coin in both height and width.

[Ed.- Paragraphs (3), (4) and (5) provide for likenesses of Abraham Lincoln, Thomas Jefferson, and Adam Smith for the coins described in, respectively, paragraphs (1)(A)(ii), (iii) and (iv), being 1 ounce, 10 gram, and 5 gram coins.]

(c) The edges of all gold coins minted pursuant to this section shall be milled in a manner that will discourage shaving of the edges of such gold coins.

(d) No seigniorage shall be charged by the Secretary for any gold coin minted under this Act, except that the Secretary shall charge a production fee whenever a gold coin that is minted by the Secretary under this Act is sold by the Secretary for the first time in an exchange under section 5(a) for gold bullion or gold coins.

(e) Gold coins *with similitude to official United States gold coins minted under this Act may be minted by any person, or organization,* except that such gold coins shall not bear the inscription "United States of America."

Free Market Price of Gold

Sec. 4. (a)(1) In accordance with regulations that shall be prescribed by the Secretary, the Secretary shall establish a formula for determining on an hourly basis the *Official Conversion Rate* of gold.

(2) The Secretary shall collect information on gold sales from the organized gold exchanges in London, England, Hong Kong, New York, New York, Chicago, Illinois, San Francisco, California, and the standard metropolitan statistical area in which Los Angeles, California, is located. The Secretary shall use such information together with such formula to determine the competitive market price of gold.

(3) In using such information with such formula, the weight given to the information received from any such gold exchange shall be equal to the ratio, expressed as a percentage, which the total amount of gold sold on such exchange during the period involved bears to the total amount of gold sold on all such gold exchanges during such period.

(b) The competitive market price of gold as determined under this section shall be the Official Conversion Rate *between dollars and gold.*

Purchases and Sales of Gold

Sec. 5. (a) The Secretary shall exchange gold bullion or gold coin from any source for its equivalent weight in gold coins minted under this Act. At the election of the person offering such gold bullion or gold coin to the Secretary, any difference in units of weight shall be paid in dollars at the Official Conversion Rate.

(b) All purchases and sales of gold by the Secretary shall be made at the Official Conversion Rate prevailing at the time of entering into the agreement to buy or sell gold even if the delivery of such gold does not occur at the time of entering into such agreement.

(c) *The Secretary shall use the proceeds of the sale of gold coins to redeem and cancel the gold certificates held by the Federal Reserve System, but payment for such certificates shall be at their par value. The Secretary shall make payments for purchases of gold coins and gold bullion from the Exchange Stabilization Fund. When all gold certificates held by the Federal Reserve System have been redeemed and cancelled, the Secretary shall use any additional proceeds from the sale of gold coins to redeem and cancel United States Government obligations held by the Federal Reserve System.*

(d) Neither the United States nor any State –

(1) shall impose an excise or transaction tax upon the use of gold or upon banking services that involve the promise to pay with gold; or

(2) shall restrict the convenient transfer of any ownership or equity interest in gold, such as checking or savings accounts, or certificates of deposit or promissory notes stated in terms of gold.

(e) If any party to a legal action before any court or administrative agency of the United States or of any State or territory within the jurisdiction of the United States elects to receive any judgment, award, or penalty in gold, the rate of conversion of gold into dollars or dollars into gold shall be the rate that prevailed at the time that the claim or cause of action accrued. The Official Conversion Rate on public record at such time shall be conclusive evidence of such rate. *In all claims or causes of action accruing prior to the effective date of this Act, the plaintiff shall have the burden of proving by a preponderance of the evidence the appropriate conversion rate of gold into dollars or dollars into gold. Neither gold nor dollars shall be an exclusive lawful tender in payment of debts.*

Promotion of Gold Coins

Sec. 6. The Secretary shall take all appropriate actions to encourage the public to recognize and use the gold coins minted under this Act.

Regulations

Sec. 7. Not later than six months after the date of the enactment of this Act, the Secretary shall promulgate such regulations and take such other actions as are necessary to carry out the provisions of this Act.

Definitions

Sec. 8. For purposes of this Act –

(1) the term "production fee" means a fee equal to the

cost of minting and selling a gold coin, including labor, materials, dies, use of machinery, overhead expenses, and the current market value of any metal, other than gold, contained in such gold coin; and

(2) the term "Secretary" means the Secretary of the Treasury.

Essential Elements

Although the Free Market Gold Coinage Act has much to commend it, some changes seem essential. We shall not give here all the details of possible improvements, but brief discussion might illuminate some important economic relationships that must be dealt with in legislation intended to provide a market test of various monetary units.

One basic problem with the bill as drafted involves the provisions for establishing the Official Conversion Rate (Sec. 4) for the Treasury Secretary's buying and selling gold at that Rate (Sec. 5). Subsection 5(b) is not clear about the amount of gold the Secretary must sell or buy. The possibilities are that the Secretary shall have the option to decide maximum quantities or that he must buy all offered or enter sell agreements in unlimited quantities (even though enough coins might not be available for immediate delivery). If he must sell or buy gold coins at the Official Conversion Rate in any amount demanded or offered, there would be a strong tendency for the "free market" price to remain at the first hour's Official Conversion Rate. Because the Treasury would buy in any quantities, no potential seller of gold would sell for less than the Conversion Rate at which the Treasury would buy.* Furthermore, most potential buyers would offer no more than the Conversion Rate at which gold would be available from the Treasury.† The initial Official Conversion Rate thus would be virtually a fixed rate.

The foregoing reflects the fact that in economic exchanges, quantity supplied, quantity demanded, and price are established simultaneously; they all affect each other. Thus, for there to be a free-market price for gold, the Treasury cannot be required to accept all quantities offered or fill all quantities demanded at a given price. The alternative of permitting the Treasury to determine from hour to hour the quantity it will supply or demand would provide the Secretary with a temptation and a method to influence the market price, or the Official Conversion Rate. Surely if the Secretary offered substantial quantities of gold coins at the Official Conversion Rate of one hour, the free-market price would not rise above the Conversion Rate. This would preclude a free-market test of gold.

To remedy this potential problem and yet to mobilize the U.S. official gold stock, the Treasury could be required to establish a weekly or monthly schedule for minting and selling at auction all of its gold (other than a Congressionally established security reserve amount) over a period of 10 or 20 years. The Treasury would not be required to buy back any of its gold coins, similar private gold coins, or gold bullion. In time, the Treasury would be completely out of gold and no longer a factor in the gold market. Only then could there be an actual free-market gold price. In the meantime, the fixed schedule of Treasury sales would be a known supply factor in the gold market, a known factor the private sector could cope with.

Another potentially fatal flaw in the Free Market Gold Coinage Act is its failure to deal explicitly or adequately with the Federal and State tax consequences of gold monetary units and fiat dollar units. We emphasized earlier that a test between gold monetary units and fiat dollars would be useful *only if it is fair.* Because tax liabilities constitute a substantial part of virtually all financial transactions, the test could not be fair unless all tax consequences (income and estate as well as excise and sales) are the same for accounts and assets denominated in gold units and paper dollars. Designing such a system will be most difficult, but it must be provided for in the legislation establishing the choice in monetary units. Surely if the task is left to the IRS, the resulting system would favor paper dollars. It is the only monetary unit IRS officials understand, if they understand any. Obviously, a tax system favoring paper dollars would preclude a fair market test between gold monetary units and fiat dollars.

A fair test also would require the total elimination of government deposit insurance on paper dollar deposits. Unless this is done, such deposit insurance would give an unfair advantage to the paper dollar. Depositors who had claims in paper dollars would be relieved of the risk of loss due to the possibility of banks failing, but depositors who had claims in gold units would bear that risk. The alternative to removing deposit insurance on dollar accounts might appear to be to provide quasi-government insurance on gold-denominated deposits as well as dollar deposits. But that would relieve depositors of the responsibility to be selective in the gold bankers they do business with, a responsibility they must have to induce them to assess bankers' policies and thereby to force bankers to adopt sound lending practices.

The foregoing critical issues must be accounted for in the Free Market Gold Coinage Act if the aim of the Act – a re-evolution of a sound money-credit system – is to be achieved. Otherwise, the field on which gold would compete with the fiat dollar would be tilted steeply against gold, ensuring that the paper dollar would emerge victorious. But that would be a Pyrrhic victory.

You Can Help

A new nonprofit tax-exempt charitable organization has been created to promote freedom for Americans to offer and use private currencies, as the Free Market Gold Coinage Act would do. This new organization, The Choice in Currency Commission (325 Pennsylvania Avenue, S.E., Washington, D.C. 20003), has James U. Blanchard III (of the National Committee for Monetary Reform) as Chairman and Joe Cobb (of the Council for a Competitive Economy) as Executive Director. Since the Choice in Currency Commission is in its infancy, we cannot judge how it will function in fact. Its stated goal, however, is worthy of the support of all who believe that free markets and gold money are essential for a free and prosperous United States. Readers who would like to receive information about this crucial topic and who would like to help the Choice in Currency Commission, can do so by sending $10 or more to the Choice in Currency Commission for a 1-year membership that will entitle members to the Commission's monthly newsletter.

Joe Cobb has played a key role in drafting the Free

* This strictly applies only to gold in the fineness and forms the Treasury would buy and sell, but the differences between the price of gold in those forms and all other forms would be simply a function of processing, transportation, and insurance costs for converting among the various forms and finenesses.

† Some exceptions are imaginable, but these are few. Just for one example, if demand were larger than the Treasury could meet with immediate delivery, some buyers might prefer to pay somewhat more in the private market in order to get immediate delivery.

Market Gold Coinage Act, and he is still soliciting suggestions for improving its chances of being passed and accomplishing its intended objective. We shall send him ours, and we are sure he would welcome yours.

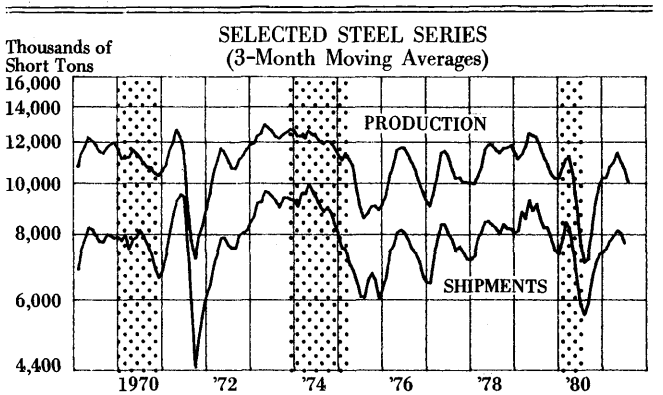
STEEL PRODUCTION

Steel production has decreased somewhat during recent months but remains substantially above its recessionary levels of last year. The recent decrease may only reflect seasonal factors. The recent trend of scrap prices, as well as markedly increased capital spending plans, suggest that steel producers expect shipments to increase. Although steel executives cite President Reagan's economic program as grounds for optimism, they may also be relying on continuation of protectionism (the trigger price mechanism) started under President Carter.

During the 6 months ended in August 1981, raw steel production in the United States (ingots, castings, and other first-stage forms of steel) totaled 64.7 million tons, or 23 percent more than that during the same period of 1980. As the chart shows, raw steel production peaked during the spring of 1979, at about 12.5 million tons per month, decreased to a trough of about 7.1 million tons during the summer of 1980, and recovered to about 11.5 million tons per month last spring. Since March 1981 when 11.7 million tons of raw steel were produced, this series has decreased 21 percent to the August 1981 level of 9.7 million tons. This does not represent a serious deterioration for this series, however. Raw steel production has peaked during May in 8 out of the past 11 years. During 1975, 1980, and 1981 steel production peaked for the year during March. This strong seasonal pattern makes the recent downward trend in steel production seem a lot less alarming.

Like the steel production series, total steel mill shipments by domestic producers reached a post-recession peak during March 1981. During March, domestic steelmakers shipped 8.4 million tons of steel. Since this time, steel shipments have decreased by 18.3 percent to the July monthly rate of 7.1 million tons shipped. Again, this decrease reflects seasonal factors.

In the past, the price of No. 1 steel scrap has been a good indicator of near future trends of steel production. Scrap steel is a necessary requirement in the steelmaking process. If steel producers plan to increase production levels, they will begin purchasing greater amounts of scrap. Increased demand for scrap is reflected in higher scrap prices. The price of steel scrap fell to $69.70 a ton during June 1980 (the recession trough and the low for steel production occurred during July 1980). As steel production expanded to the March 1981 post-recession peak of 11.7 million tons, the steel scrap price increased sharply to $105.23 a ton, but then decreased to a low of $89.37 in June. In recent months, the steel scrap price has increased to $95.33 a ton during August 1981. This would suggest steelmakers are anticipating further production increases in coming months.



Latest plots: production, July 1981; shipments, June 1981.

The August increase in the steel scrap price is not the only optimistic sign within the domestic steel industry. *Iron Age* (a steel industry trade publication) reports a new burst of capital investment within the industry. In 1981, they estimate the industry will spend nearly $5 billion on new plant and equipment compared to about $3 billion spent during 1979 and 1980.

Perhaps the managers of the large steel companies believe that the new tax rules will encourage and stimulate demand for steel products used in machinery and equipment and in nonresidential buildings. (The new write-offs and credits will be little use to the steelmakers directly as their aggregate tax liabilities have been very small during recent years.) Stepped up capital spending may simply reflect the improvement in the steel producers' cash flows during 1981 relative to 1980. They may be spending now simply because they can afford to do so as a result of higher operating ratios and the likelihood that they will continue to operate behind the protection of the trigger price mechanism (TPM).

Foreign steelmakers are not permitted to price their steel for sale in U.S. markets lower than the Government's "trigger price." If they do, they will be subject to possible anti-dumping investigation and possible imposition of costly penalty duties on future steel imports. The Commerce Department establishes the TPM price based on the production costs of Japanese steelmakers (plus 8 percent). Japanese steelmakers are used because they are considered to be the world's most efficient steel producers. Commerce Secretary Malcolm Baldrige vowed, "The present trigger-price mechanism will remain."

One interesting TPM development has been that for 3 consecutive quarters the trigger price has remained fixed at $422.95 a ton. During this period the U.S. dollar has been very strong in relation to the other world currencies. Without the TPM, the strength of the dollar should have made foreign imports *more* attractive to U.S. steel buyers. Since the TPM is an estimate in U.S. dollars of Japanese production costs and because it has *not* been changed, it is no longer an accurate reflection of Japanese production costs, if it ever was to begin with. Japanese steel production costs are of course "measured" in yen in Japan, and not in U.S. dollars. If the trigger price was indeed the level below which steel imports constitute "dumping" by foreign producers, the TPM should have been reduced. Keeping the trigger price at its current dollar level reveals the TPM for what it is: outright protectionism.

PRICE OF GOLD

	1980	*1981*	
	Sept. 25	*Sept. 17*	*Sept. 24*
Final fixing in London	$697.98	$459.00	$446.25

Research Reports (ISSN 0034-5407) (USPS 311-190) is published weekly at Great Barrington, Massachusetts 01230 by American Institute for Economic Research, a nonprofit, scientific, educational, and charitable organization. Second class postage paid at Great Barrington, Massachusetts 01230. Sustaining membership: $9 per quarter or $35 per year.