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Under A True Gold Standard The Free Market Does Not Fix The Price Of Gold*

Now that the fiat, no-thing dollar is more widely perceived as an inadequate monetary unit, increasing serious attention is being given to the possibility of re-adopting the gold standard or adopting some other single- or multi-commodity standard. Many of the proposals for a commodity standard simply masquerade as such. Examples are proposals providing for changing the price of the monetary commodity(ies) in accordance with changes in some general price index.† In this article, Dr. Donald Kemmerer, clearly discusses the essential aspects of a gold standard, including the need for the "price" of the monetary commodity to be fixed. For progress to be made toward finding a more useful monetary unit, these fundamental factors must be generally recognized and accepted.

A common criticism of the gold standard is that it calls for a fixed price for gold. Monetarists in particular are emphatic about this. This is not a valid criticism for it is based on a misunderstanding of the gold standard or any other commodity standard.

"Keep your eye on the ball," is the advice an instructor gives when you play golf or tennis or almost any game involving a ball. The same principle applies when one discusses money standards. One must keep one's thinking on the standard he is considering.

The colonists in 17th century Virginia used tobacco as money. A pound of tobacco was the unit of account, that is, the standard money. Would free market proponents of the 20th century say that the market should somehow determine how many ounces a pound should weigh, with the weight varying from one day to the next? If the pound is the measure, it must remain constant.

Would the advocates of the free market then let the market determine how much a pound of tobacco will sell for? That makes no sense, for since the money unit itself is a pound of tobacco, surely a pound of tobacco will sell for a pound of tobacco. What else? The cost of other commodities, valued in pounds of tobacco, may vary. Indeed, if the prices of most of these tend to rise, any economist will tell you that the buying power of the money is falling. That too happened with the tobacco standard in Virginia.

* This discussion originally appeared in a monograph with the same title published by the Committee for Monetary Research and Education, Inc., P. O. Box 1630, Greenwich, Connecticut 06830. We have provided the summary.

† See our *Research Reports* dated April 20, 1981 and our *Economic Education Bulletin* dated October 1980 for discussions of two such plans.

Dollar Defined as a Weight of Gold

Just as under the tobacco standard, the money unit under the gold standard of the 1834-1933 era was what 23.22 grains of pure gold, called a dollar, would buy.** That might vary for most commodities and services but a dollar would buy only a dollar.††

Up to 1933, the Mint could coin 20.67 dollars from an ounce of gold because a troy ounce contains 480 grains. The $20.67 unfortunately came to be called the Mint "price" of gold but it was not a price at all in the market sense of the word price. It was just a quotient in a long division problem, that is, 480 divided by 23.22 equals 20.67. This is not fixing a price; it is simply the number of dollars the Mint can coin from an ounce of gold. Of course, the Mint has to make sure that the gold content of the coins – 23.22 grains per dollar – does not vary. Imagine that a gold miner brought 100 ounces of gold to the Mint and asked that the metal be struck into coins so that he could spend it. It was his gold; he mined it. The Mint would have given him $2,067 in gold coins for his metal – until 1933.

When a nation is on the gold standard, gold has no market price. It is the material in which all prices are quoted. All other monies, i.e., bank notes, checking accounts, and a few others, are directly or indirectly redeemable in gold dollars on demand.

Gold Does Have Market Price Under a Paper Standard

Today the United States is on a fiat paper money standard. There can be no further doubt about it since August 15, 1971. What is the price of the paper dollar bill? It is another paper dollar. Now, gold is just a commodity, like tobacco, soybeans, coffee, oil or lettuce. The market place determines the price of gold in terms of paper dollars just as it determines the prices of those other commodities in paper dollars. Also, as the buying

** Article 1, Section 8, Paragraph 5 of the U.S. Constitution gives Congress the power "To coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures." "Regulate the value" of money meant determining the weight and fineness of the coin, thereby its value. All this was provided in the same sentence that gave Congress authority to establish the standard of weights and measures. Just as Congress legalized 5280 feet, called a mile, as a measure of distance and 480 grains, called a troy ounce, as a measure of weight, so in 1792 it made 24.75 grains of pure gold or 371.25 grains of pure silver, called a dollar, the measure of value.

†† Ed. – Another way of saying this is, "The goods and services that 23.2 grains of gold (a dollar) could be exchanged for might vary over time, but 23.2 grains of gold (a dollar) would always exchange for 23.2 grains of gold (a dollar).

power of the paper dollar dwindles as a result of currency inflation growing out of chronic deficits, the prices of gold and other commodities tend to rise.

During the American Civil War, 1861-65, and for some years afterwards, when the nation was temporarily off the gold standard and on a fiat paper money standard, the market place also determined the price of gold in terms of Greenback (fiat paper money) dollars. That market place was the then renowned Gold Room, an adjunct of the New York Stock Exchange. But when the country returned to the gold standard on January 2, 1879, the price of a gold dollar was again a gold dollar or else a bank note convertible into a gold dollar. The Gold Room had no more business, and it closed.

Why the Confusion About the Gold Standard?

All of the above seems clear, if not obvious. How could so many intelligent people, among them many distinguished economists, become confused?

The confusion arose from the hybrid kind of money standard that this nation had from 1934-71. The government left the gold coin standard in March, 1933 and said that it returned to a gold standard in January, 1934. Upon returning, the government "devalued" (lowered the gold content of) the dollar from 23.22 grains to 13.7 grains. The Mint "price," or better said, the new quotient, became 35 (480 divided by 13.7 equals 35). Thus the former Mint "price" of $20.67 was replaced by $35.

However, the United States did not return to a gold *coin* standard in 1934 – some say that we did not return to a gold standard at all. Personally, I would agree. In 1934, a restriction was put on the individual's right to redeem paper dollars in gold. No longer did individuals or businesses have the right to redeem Federal Reserve notes or other paper dollars in gold on demand. The money standard is not a true gold standard if the government limits anyone's right to present paper dollars for redemption in gold ones. For example, back in 1917-1919 when the government forbade selling gold abroad, that limitation was said to have taken the country off the gold standard. No one then disputed it, and when the government removed that war-time prohibition in June, 1919, the country was said to have returned to the gold standard.

In 1934, however, had the country really returned to a gold standard? There was some dispute at the time as to what kind of a standard the country had. Some called it a gold exchange standard. It was not. A renowned expert described it as a "qualified gold bullion standard." If so, the emphasis should be laid on the word, *qualified*. It certainly was not any traditional type of gold standard or any kind the world had previously known.

A Hybrid Standard – Foreign vs. Domestic

Three conclusions are sure: First, for most of the years, 1934-1971, the United States maintained its standard nearer to the traditional gold standard than did any other nation. Second (and the basis of the first statement), to settle foreign payments balances, this country followed traditional gold standard rules: the government transferred or shipped gold to foreign treasuries or central banks. Third, in domestic trade, however, which is many times the size of foreign trade, the nation did not follow gold standard rules, instead, it was on a fiat paper money standard. Any American entitled to own gold – and there were relatively few who were – had to pay at least $35 an ounce for it. By the 1960's, the dollar looked weaker and many individuals lost confidence in it. Gold was sought as a "hedge" against inflation, with the result that the price of gold on the gold markets in England, France, Germany and elsewhere rose above $35 an ounce. None of those countries was on the former type of gold standard as closely as was the United States, although their treasuries had accumulated gold reserves. All this led to further complications, high prices for gold and government efforts to depress those prices.

As the people of the United States saw it, or were told to see it, gold had a market price. Many experts had said that the nation was on a gold standard, although a type of gold standard that was new to the world. This is the origin of the confusion.

One nation's money, of course, always has a price in terms of another's money. Also, in any nation not on a gold standard, gold is only a commodity and the market price for it fluctuates. But, as was demonstrated when the Gold Room was closed in 1879, as soon as a nation adopts the gold standard, there cannot be an internal market place for gold because gold dollars have become the measure in which all prices are quoted.

THE EMPLOYMENT SITUATION

Although there has been little change in the total unemployment rate during recent months of this business-cycle expansion, employment conditions have apparently continued to improve for established workers. This improvement has been offset by an apparent influx of housewives into the job market both because of increased job opportunities and because of broken homes. This has been reflected in some deterioration of employment conditions for all "marginal" workers, deterioration that may have been exacerbated by last January's increase in the minimum wage and Social Security taxes. These developments have retarded the cyclical improvement of the employment situation. Cyclical improvement, nevertheless seems to remain intact.

Note: All data are seasonally adjusted.

Employment conditions for American workers changed little, on balance, during the 3 months ended in June. The widely followed total unemployment rate (which is the number of persons seeking employment as a percent of the civilian labor force) averaged 7.4 percent during this quarter, lower than its recessionary peak of 7.8 percent last July but slightly higher than that during the first quarter of this year.

Within the last quarter, the total unemployment rate was 7.3 percent during April, 7.6 percent during May, and 7.3 percent again during June. The May increase is believed to reflect an inadequate seasonal adjustment for college and high school students entering the labor force then, and the June decrease may reflect a similar statistical anomaly. The Bureau of Labor Statistics (BLS) annually revises its seasonal factors to reflect the prior year's actual experience and they may be inadequate to deal with the current year's developments. Thus the May total unemployment rate probably overstated and the June level probably understated underlying unemployment conditions. By July, all students and recent graduates who want jobs are presumably in the labor force, and the rate reported for that month may be expected to better reflect the basic situation.

Selected employment data are shown in the accompanying table. These data are based on two different surveys. The first, the establishment survey, is based on questionnaires completed by a sample of employers. According to this survey, the average workweek for production workers in manufacturing, and the average of overtime hours for such workers, have continued to increase from their cyclical lows of last summer, indicating a continued improvement of employment conditions. The average workweek is a primary leading indicator of business-cycle changes and is appraised as expanding cyclically. However, the number of persons on nonagricultural payrolls, which is a primary roughly coincident indicator of business-cycle changes, has decreased recently, indicating some deterioration of employment conditions. This series fluctuates greatly from time to time, and it remains appraised as expanding cyclically. The estimate of payroll employment excludes self-employed persons (or employment "off the books") and it double-counts those who hold two payroll jobs. Moreover the sample may reflect only belatedly the creation of new jobs at new business firms.

The number of employed persons estimated from the household survey continued to increase during the second quarter. This estimate is derived from responses of a sample of households to questions about the employment status of each household member. It is the basis for most employment data. In the past when the establishment and the home employment estimates have diverged, the household estimate often has proven to more accurately reflect the general trend.

That the total unemployment rate has decreased little during this business-cycle expansion reflects growth of the labor force that has nearly kept pace with increases in the number of jobs. From the second quarter of 1980 to the second quarter of 1981, the noninstitutional population aged 16 and over increased 2,890,000, or 1.7 percent, to 168.8 million persons. The employment status of this population during the second quarter of 1981 and the change from a year earlier (in thousands of persons) was as follows:

	Avg. for Q II 1981	*Change from year ago*	
		Number	*Percent*
Civilian employees	98,808	+2,176	+2.3
Looking for work	7,900	+92	+1.2
Civilian labor force	106,768	+2,268	+2.2
Armed forces	2,127	+38	+1.8
Keeping house	29,259	−624	−2.1
Retired	11,594	+1,056	+10.0
All other*	19,034	+152	+1.7
Total Population Age 16 or more	168,782	+2,890	+1.7

* Students, ill, disabled, or not in the labor force for no specific reason.

The result of these changes was an increase in the participation rate (the percentage of the population over the age of 16 in the civilian labor force) to 63.4 percent, a postwar record. The employment ratio (the percent of the working age population employed) of 58.8 percent during the second quarter of 1981 was larger than that during any postwar quarter prior to the fourth quarter of 1978. This series reached a record level of 59.4 percent during the first quarter of 1979, and it subsequently decreased to 58.2 percent during the 1980 recession. The second quarter level of the employment ratio was exactly half way between its most recent cyclical peak and its recessionary trough. In short, the "sluggishness" of the unemployment rate is not attributable to fewer available jobs but to more job seekers.

As the table of selected employment data reveals, there has been considerable variation in the trends of employment conditions among different groups of workers. Between the second quarter of 1980 and the second quarter of 1981, unemployment rates decreased for adult men and for married persons living with their spouses. During that span, unemployment rates increased for teenagers, for nonwhite persons, and for women who maintain families. These latter categories include a relatively small number of persons. Thus far during the current business-cycle expansion, the job market has improved for established, experienced workers and has deteriorated for others.

The increase shown in the above table for the number of retirees and the decrease in the number of housewives (presumably the major component of the "keeping house" category) may be related to these divergent trends between established workers and others. The recent changes in retirees and housewives, both of whom are not included in the labor force, are as follows:

	Retirees	*Housewives*
Jul.-Dec. 1979	+229,000	−461,000
Jan.-Jun. 1980	+332,000	+6,000
Jul.-Dec. 1980	+400,000	+136,000
Jan.-Jun. 1981	+656,000	−797,000

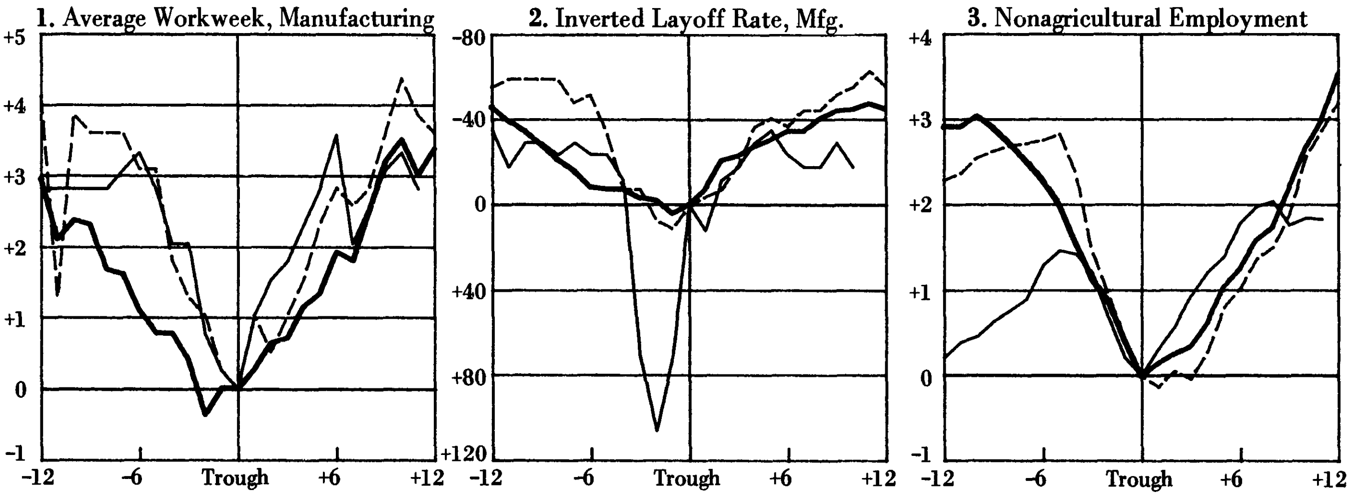
The recent marked increase in the number of retirees, particularly during the past 6 months, may have created opportunities for advancement and employment of established workers. The surge in the number of retired persons may reflect some retrenchment by firms that encourage early retirement to meet reduced employment needs. Unlike persons laid off, such early retirees leave the labor force, even if only temporarily in some cases. In contrast, the influx of housewives into the labor market may have resulted in greater competition for entry-level jobs. Inasmuch as this influx virtually stopped during the first half of 1980, when employment conditions were clearly deteriorating, the recent trend may reflect improved conditions. At the same time, however,

SELECTED EMPLOYMENT DATA

	Average of 3 Months Ended		
Establishment Survey	*Jun. 1980*	*Mar. 1981*	*Jun. 1981*
Number of persons on nonfarm payrolls*	90,489	91,610	91,501p
Avg. workweek for production workers in mfg.	39.4	40.1	40.2p
Avg. overtime hours in mfg.	2.6	3.0	3.0p
Household Survey			
Employed persons*	96,692	98,012	98,868
Participation rate	63.0	63.1	63.4
Employment ratio	58.3	58.4	58.8
Nonagricultural empl. ratio	56.5	56.5	56.8
Unemployed persons*	7,808	7,788	7,900
Unemployment rates (%):			
All civilian workers	7.5	7.3	7.4
Adult men (age 20+)	6.4	6.0	6.1
Adult women (age 20+)	6.5	6.6	6.6
Teenagers (ages 16-19)	18.0	19.1	19.2
White persons	6.6	6.6	6.6
Nonwhite persons	13.4	13.2	13.7
Married men**	4.6	4.1	4.0
Married women**	6.0	6.0	5.8
Women who maintain families	8.7	9.8	10.2
Avg. duration of unemployment†	11.2	14.3	13.7

p Preliminary. * In thousands. ** Spouse present. † In weeks.

RECOVERY COMPARISONS FOR EMPLOYMENT SERIES



Business-cycle trough months: ——— March 1975 ——— July 1980 ——— Average

The averages were calculated from the six postwar recessionary periods by dropping the highest and lowest figures for each comparable month and taking a mean of the remaining four figures. The curves show the percentage differences (vertical scale) in the serie's values from the value of that series at the trough of the respective business cycle. These differences are shown for each of the 12 months before and after each business-cycle trough.

it has raised participation rates and slowed decreases in the total unemployment rate.

About 1.6 million of the 2.3 million net increase in the civilian labor force between the second quarters of 1980 and 1981, were women over the age of 20.* Precise data are not available, but it appears that roughly two-thirds of this 1.6 million increase in women participating in the labor force were women who lived with husbands or with dependents, i.e., women who might have been housewives. Although there are many reasons why housewives enter the labor force, it seems clear that, in general, married women living with their spouses have more options than women who maintain families.

Thus the influx of housewives into the labor force may be divided into married women and women with children who have parted from their mates. The latter category has been growing rapidly. Differences in motivation may account for the different trends in the unemployment rates for these two categories. Married women in general might enter the labor force only when jobs are readily available. Women who maintain families have less choice. They must seek a job even when conditions are not "good."

Unemployment is higher among younger persons than among older workers. Nearly half of the persons counted as unemployed are under 25 years of age. Youthful workers often work part-time or only seasonally while they are still students, and most people try several jobs before settling down to a career. Although higher unemployment rates among younger persons would thus be likely even under the best conditions, during recent years their large numbers have exacerbated the employment problems of teenagers. Roughly one million of the persons counted as unemployed have never been employed, i.e., they are looking for their first job. This accounts for the very large unemployment among teenagers, over 19 percent, overall, and reportedly as much as 40 or 50 percent in some locations, such as the "inner cities." There are some grounds for optimism, nevertheless. The 16-19 year old population peaked in 1979, and it will decrease markedly during the years ahead. However, the hopes of teenagers, and indeed all marginal workers, received a setback on January 1. That is when increases in the minimum wage and Social Security taxes raised the minimum hourly labor cost of their prospective employers by 8.6 percent, to $3.57.

Many commentators have expressed concern that high unemployment among youths fosters crime and violence. Although this may seem plausible, holding a job, particularly one of the "make work" sort usually prescribed as a remedy for teenage unemployment, may not be a deterrent to participation in urban rioting and looting such as is now occurring in Great Britain or as has occurred in U.S. cities several years ago. Indeed it could be argued that make-work jobs foster a "something for nothing" attitude that could not aggravate the situation.

The business cycle is the major determinant of trends in employment conditions. The accompanying charts show comparisons of the recent trends of three employment series with those during other business-cycle recoveries. Despite recent fluctuations, the charts suggest that the employment situation in the United States differs little from previous periods when we were in the early stages of a business-cycle expansion. Such being the case, marked deterioration of employment conditions seems improbable during the near future months, and changes in indicators such as the total unemployment rate are likely to continue to be dominated by demographic rather than cyclical developments.

* All reported changes of employment status are net changes. The number of persons entering or leaving a category during a given period is much larger than the net change in the total.

PRICE OF GOLD

	1980	1981	
	Jul. 17	Jul. 9	Jul. 16
Final fixing in London	$627.25	$406.25	$418.25

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