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Federal Reserve's disciplinary plan

Under the direction of Federal Reserve Chairman Paul Volcker and International Finance Division Director Edwin Truman, during June 1980 the Federal Reserve began a series of in-house studies on "possible gold remonetization scenarios," one Fed official told *EIR*. These, the official stated, were "feasibility studies" on the February 1980 gold proposals of Lewis Lehrman and his protégé Arthur Laffer.

The first such published study, "Gold Remonetization and Gold Discipline," was revised and published in August 1981. While the Fed claims it is not pushing a gold standard, in fact this is a proposal for an extremely tight-money version of the Lehrman proposal. "The purpose of this paper is to provide a framework suitable for analyzing various gold monetization policies," Flood and Garber write. "And . . . we analyze a transition to a gold standard of the Laffer-Lehrman type."

The Fed makes one objection: Lehrman has not provided for cutting enough credit to the economy.

The first goal, writes the Fed, is to fix a general level of price deflation. They therefore endorse all aspects of the Lehrman model with the exception of Lehrman's plan to allow the *markets* to fix the gold price after the central bank has drained credit from the economy.

Instead, the Fed must fix both the gold price and a general price deflation level in advance, and cut back on credit creation to enforce both.

After the price level has been fixed, the credit to the economy cut enough to enforce this, then the gold price may be fixed at the lowest rate possible, forcing the monetary authorities to continue to tighten credit, the Fed study writes.

The purpose of the exercise is to give total political control over the economy to the central bank, which is to enforce the gold standard by the strictest "monetary control." "The monetary system can be readily characterized as a 'gold-paper-gold' cycle," the Fed writes disparagingly of the paper U.S. dollar. "Since the current 'paper' phase has allowed price-level instability, there has been some agitation to return to the gold standard. . . . The basic point of this paper is that such policies will lead to price-level stability *only in the presence of very specific monetary control.*" [emphasis added]

From the August 1981 study, "Gold Monetization and Gold Discipline" by Robert F. Flood and Peter M. Garber, published by the Federal Reserve Board of Governors.

We must expand on some of the proposals [for government fixing of the gold price], which are incomplete as presently specified....

There are a number of ways to specify a complete policy. First, the government may designate the time for fixing the nominal gold price and the paths of its currency issue and of its gold reserve holdings. Such a specification will imply paths for the nominal price level and the relative price of gold, particularly the market value of gold at the time of fixing. . . .

Ostensibly, this approach appears different from the policy recommendations of those who wish to monetize gold by fixing its price at some market-determined level on some future date. However, since the goal of such a policy is not to monetize gold *per se* but to stabilize the nominal price level, the actual policy target is a given path of prices. Since merely fixing the gold price at some market determined level will not, in general, produce price level stability and may, indeed, be quite inflationary, it is reasonable to study gold monetization in the context of a policy specifying desired paths for the nominal price level. In this way we can readily determine a policy for currency and reserve gold holding which is consistent with price level stability....

Even the seemingly innocuous policy of zero discretionary money growth can lead to the collapse of a gold standard. . . . We will derive a constraint on gold price and on the path of the money supply such that a gold standard will not collapse. We refer to this constraint as *the discipline of the gold standard.* [emphasis in original]. . . .

The sequence of items upon which the monetary system has been based in modern times has been so limited that it can readily be characterized as a "gold-paper-gold" cycle. Since the current "paper" phase of the cycle has allowed price level instability, there has been some agitation to return to the gold standard. Proponents of such a return presume that simply allowing the market to determine the price at which gold will be fixed is sufficient to produce an "appropriate" price. The basic point of this paper is that such policies will lead to price level stability only in the presence of very specific monetary policies. . . . In the absence of such monetary control, specifying a policy to set the gold price according to a given day's market price may lead to a situation even more inflationary than that produced by the current system. . . .

All the analyses of gold remonetization proposals contained in this final section of the Special Report were contributed by Kathy Burdman.

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