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A Way Out of the Gold Commission's Dilemma

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Late last year, Congress established the Gold Commission to recommend whether gold ought to have a greater role in the U.S. monetary system. The political price pro-gold people had to pay for its enactment was to agree that the panel be "balanced." The result is a commission made up of several zealous and articulate gold-standard advocates and several equally zealous and articulate gold-standard opponents.

The trouble is that both policymakers and the common citizen will be more, rather than less, confused as to what to do about our monetary system by whatever paper the commission manages to produce.

All of this would not have come about if inflation had remained in a comfortable, low, single-digit range. According to the textbooks, the Federal Reserve is supposed to keep the money supply growing at a rate to keep up with the additional production of goods and services, and credit demands of the economy. But not at a rate that produces excessive inflation.

Looking at the Fed's record the past decade, many would conclude it has not been particularly successful. Since the late 1960s, we have had three waves of inflationary monetary policies, during the Vietnam War and subsequently in 1971-73 and 1976-79. Even though these were discretionary decisions on the part of the Fed, some have gone so far as to argue the persistence of inflation is evidence that our central bank is politically—and perhaps institutionally—incapable of enforcing stable monetary policies.

But it isn't clear that a gold standard would be the best way to restore monetary stability. During the past century, the economy did not always operate all that well when we or others were on the gold standard. There were periods of inflation, deflation, boom and bust under gold. Nonetheless it seems clear that a gold standard would have prevented the excessive growth in the money supply that occurred in the past decade. Given that neither economic theory nor history provides most of us a definitive answer as to the best monetary system, why not let the market decide?

There is no reason why an economy cannot have competing currencies. Under free competition, the market will determine, as with any product, which is the superior currency, and eventually it will drive other currencies out of existence. This should not be confused with Gresham's Law, "Bad currency drives out good," which refers only to systems where debtors have a choice of payment.

Hayek, among others, has warned of the dangers of a government's monopoly control of money. He observed that the notion that money has to be legal tender is a myth imposed on the economists by the lawyers. Legal tender is required only in payment of taxes, receipts of monies from government or where a contract has failed to specify the form of payment.

The Gold Commission can satisfy both pro- and anti-gold people by recommending that gold be allowed to freely compete with Federal Reserve notes on a non-legal-tender basis. Those who are pro-gold ought to be satisfied if they are allowed to make all contracts in gold without penalty, since gold contracts and transactions can take place perfectly well without government guidance. Government's only role would be to insure the purity of gold, which can be accomplished under existing anti-fraud statutes.

Without government penalties, most members of the pro-gold crowd believe gold would soon wipe out the Fed dollar, particularly for long-term contracts.

Those who are anti-gold ought to be satisfied, since the cries of the gold advocates would become moot. If gold is indeed inferior as the anti-gold crowd says, it would be used by only a small fringe, with no harm to the existing system.

In December 1974, Americans were again given the right to own gold. In October 1977, Congress established the "Gold Clause," which makes contracts based on current gold values of the dollar legally enforceable. As a result, only one additional change in the law is needed to make gold fully competitive. That change is to remove all capital gains taxes from changes in the price of gold. Specifically, if Congress selected a date, such as Jan. 1, 1982, on which the purchase and any subsequent sale of gold would be freed from all short- or long-term capital gains taxes or loss deductions resulting from a change in the dollar price of that gold, it would then be free to compete fully with the dollar.

To avoid including gold art objects, jewelry and rare gold coins in the capital gains exclusion, Congress could limit the tax and loss removal to recently minted gold coins and gold bullion of specified gold content. Such a provision would then only affect "commodity" gold, which, over the long run, would be revenue neutral to the Treasury.

At any given time, the price of gold is as likely to fall as to rise, in the absence of inflation. Thus, capital losses and gains ought to net out, having no effect on Treasury revenues. By the future indexing of tax rates, Congress has indicated it considers tax liabilities stemming from price-level changes to be improper. In fact, taxing gold price level changes is likely to cost the Treasury revenue this year, since it appears gold losses will far outstrip gains.

To measure income for tax purposes, payments made or received for goods and services in gold could be converted on the day of the transaction to the dollar price of gold that day. Even if gold proved superior, it would be used only for high-value or long-term contracts. Day-to-day consumption spending would continue to be in dollars.

In summary, removal of capital tax treatment from "commodity" gold transactions would allow gold to compete freely with the dollar. If the gold partisans are right, gold would eventually become the basic money of commerce; if they are wrong, the Federal Reserve note will continue to reign. Market competition can put the argument to rest without any significant costs, but perhaps with great benefit to the economy.

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