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Goldbugs for Obama

On Election Day, weather permitting, the people will choose a president and a monetary policy.

A second term for Barack Obama would likely mean another term for Ben S. Bernanke, or at least for the Ph.D. standard of which Bernanke is dean and provost. It would point to more radical experimentation, more QE and more central planing under the guise of central banking.

On the other hand, a victory for Mitt Romney would set up the expectation for normalized interest rates and an end to discretionary money-printing. Without so much as waiting for an Obama concession speech, the market would begin to discount the end of the Bernanke method of "learning by doing," as the chairman candidly described his adventures in quantitative easing in an Aug. 31 speech at Jackson Hole, Wyo.

This publication supports the candidates who adhere to the price mechanism. We're for Adam Smith and his invisible hand, first and last, and for the system of monetary organization that gives maximum scope to the interplay of freely determined prices and interest rates. That system is the classical gold standard, in our opinion. We take it as a sign of progress that the Republican Party platform pledges a victorious Romney to form a commission to study the reinstitution of fixed exchange rates and a convertible dollar.

To be sure, the time-honored function of high-level commissions is not to study ideas, but to bury them. And in any case, a gold standard for the 21st century would unlikely find a place in the first Hundred Days agenda of a Romney administration. The chief whisperer-in-the-ear of the candidate on monetary matters appears to be John B. Taylor, himself a Ph.D. economist and a critic of the radical policies of the Bernanke Fed. To give him his due, Taylor pleads for a system of rules, not of discretion. In this respect, he brings to mind Edmund Burke, the 18th century British parliamentarian, who said that he wanted his country to be governed by laws, not by lawyers. Taylor is saying that he wants the Fed to be governed by the laws of economics, not by the whims of economists.

But Taylor is no less a fiat-money man than Bernanke himself. Not for the Stanford University professor a dollar defined as a weight of gold, or a funds rate set in the market or a dollar liberated from the role of "reserve currency" (a status that has facilitated America's plunge into indebtedness, both in its trade and public budgets, over the past half century). For Bernanke, the best policy is that which the mandarins decide. For Taylor, the best policy is a rule—he himself has famously written one—that binds the Fed to adjust its interest rate according to changes in the rates of inflation and economic growth. For neither man does the historical success and sheer simplicity of a convertible currency (choose the paper or choose the gold) seem to resonate. Rule is better than discretion, in general, but Taylor's rule is only incrementally less objectionable than Bernanke's non-rule.

Google "Taylor Rule," and you will see that the two important determinants of a Taylor-compliant funds rate are the so-called output gap and the measured rate of inflation. The output gap is the difference between what the country could be producing at full employment and what it is actually producing. It's a contrivance, a made-up number, and it may or may not give fair warning of looming trouble in prices or credit.

Inflation, for Taylor's money, is that which registers in the personal consumption expenditures price index, or "deflator." The PCE deflator, a variant on the CPI, is one measure of inflation, but only one. The levitation of house prices was another kind of inflation that the PCE failed to flag. About a decade ago, Norman Lamont, Britain's chancellor of the exchequer, defined an acceptable rate of inflation this way: "We wish to reduce inflation to the point where expected changes in the average price level are small enough and gradual enough that they do not materially affect business and household financial plans." And we can recall Alan Greenspan saying something very much like it. Nowadays, with zero percent interest rates, income-deprived savers are paying record-high prices for farmland ($21,000 an acre in Sioux County, Iowa recently) and "high-yield" bonds (which actually don't provide high yields). ZIRP and QE are indeed affecting "business and household financial plans," but the PCE deflator has hardly twitched. Of inflation, ergo, we officially have none. Anyway, plug the appropriate data into the Taylor Rule formula and you get a federal-funds target rate on the order of 2 ¼%, a very long way from zero.

In 2010, Paul Singer, Republican activist and hedge-fund investor, drafted a petition against QE2. He asked like-minded friends and colleagues to sign it (your editor was among them), and he had it published in the newspapers. One potential signatory was conspicuously absent from the list of protesting luminaries, however. That missing man was Mr. Market.

Republican investors will have to search their consciences on Tuesday. Exactly how adamantly opposed are they to free money? To the prospect of free money for years on end? To the prospect of someone just as open-handed as Bernanke—Federal Reserve vice chairman Janet Yellen, for instance—taking over from the chairman when the time comes to pass the monetary-policy torch? And to the many profitable uses to which free money can be put, if you happen to be a member of the 1/10th of 1%? For instance, funding a leveraged bond portfolio or financing a leveraged buyout?

How deep runs the Republicans' principled opposition to the Fed's program of raising up asset prices to coax a smile from the down-in-the-mouth American consumer? In their hearts, would the average Republican financier really prefer a 2 ¼% funds rate to the zero percent rate in place now and for possibly years to come?

Let us imagine the gold market on the morning after a Romney victory. Vice President-elect Paul Ryan has given interviews promising to bring the federal debt to heel. President-elect Romney has reiterated his determination to roll back Dodd-Frank and repeal ObamaCare. John Taylor, when asked if he has been given any sign that he will be nominated to the chairmanship of the Fed, flashes an enigmatic smile. Suddenly, America's prospects seem brighter than they have in years, and the dollar rallies. On that fateful Wednesday morning, a Republican gold bull might have trouble remembering why he or she pulled the lever marked Romney.

America's monetary and fiscal problems run deeper than either candidate acknowledged during the long campaign, and political promises will only go so far to solve them. If the GOP won the White House but failed to carry the Senate, Paul Ryan's pledge to roll back the entitlement state would hardly pack the same punch as it might if the Republicans could plausibly legislate their agenda.

A riddle: What portion of the stock market's post-2009 gains are attributable to corporate performance and what portion to free money? Or, to rephrase the question: Where would the S&P 500 trade on Wednesday if Chairman Bernanke announced he was rescinding QE and ratcheting up the funds rate to 2 ¼% over the next year or so, in compliance with the Taylor Rule? We think it would trade lower.

"Trade" is the operative word, however. The market would sooner or later push higher, perhaps much higher, if the next occupant of the White House could conquer America's fiscal problems, implement a low-rate, high-yield tax policy, re-instill the spirit of enterprise and thereby foster growth. As for the new gold standard, let it top the monetary agenda for the incumbent's second Hundred Days.

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