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To What Extent is a Return to a Gold Standard a Desirable and Feasible Option for the United States of America?

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The purpose of this paper was to evaluate both the feasibility and desirability for the United States to return to a form of gold-backed currency, such as a gold standard. It was first necessary to provide a definition of a gold standard, as well as explain how one functions, before exploring some of the contemporary arguments as to why a return to a system such as this would be a good policy decision. The typical benefits that proponents of a gold standard cite are increased price stability, decreased inflation, and a decrease in the federal deficit through reduced spending. This investigation yielded the findings that not only do these benefits typically fail to materialize under a gold standard, but such a system can actually be detrimental to price stability in the consumer price index. Among other reasons explored that calls a gold standard's feasibility into question, the consensus of eminent economists and journalists points to a political climate inhospitable to a return to a gold-backed currency. It is for these reasons that I conclude a return to a form of gold standard to be neither desirable nor feasible for the United States.

Introduction

Despite having been one of the most prolific globally economic systems in history, today no country abides by the gold standard and few, if any, major countries use commodity money. The abandoned system of gold-backed money is not however without its supporters. In this paper I will explore the call by certain actors in the United States, namely former Congressman Ronald "Ron" Paul, to return to some form of gold-backed currency and evaluate the feasibility of this policy with respect to both economic and political considerations, dispelling counterarguments where they arise. I will conclude that due to the exaggerated merits of gold-backed money, the advantages of the flexible monetary policy of a fiat money system, and a current political climate inhospitable to gold, that a return to the gold standard is neither desirable nor feasible. Before I begin my analysis however, I must first provide a basic history and definition of the gold standard.

Background – The Gold Standard

Beginning in 1879, the United States took part in the nearly global economic system known as the gold standard.[1] Through the gold standard, a single US dollar was pegged at "0.04838 of an ounce of gold", and holders of US dollars could exchange their currency for a corresponding number of ounces of the precious metal from the central authorities (a rate of about $20.67/oz at the time).[2] Because the standard provided a *de facto* common currency of gold for trade between states participating in the standard, the primary focus of the system was international trade.

The gold standard relied on a particular mechanism, which its constituent governments had to uphold, in order to fulfil this role, which was that in the event a particular country ran a trade deficit, that country would have to settle the difference by exporting a corresponding amount of its gold reserves to the debtee country.[3] Reducing the gold supply in this manner requires the circulating bank note supply connected to gold to be reduced correspondingly, which causes domestic prices to fall (deflation), in turn lowering the price of their exports and making the debtor country export-competitive again and balancing international trade.[4] Due to the direct linkage between money and gold supplies in this system, the amount of circulating currency in a given country cannot exceed the amount of gold in national reserves. This means that the money supply can only increase when more gold is mined and added to the system, which prevents the federal use of monetary policies such as adjusting interest rates or increasing the money supply to stoke a slowed economy into activity. In this regard, one of the chief roles of the gold standard was to ensure the balance of international trade. The United States has not been on the classic gold standard since 1933, when the Great Depression made it politically and economically disastrous to implement the deflationary policies the gold standard called for.[5] It was at this time that most countries were abandoning the gold standard.

The Contemporary Gold Movement

In recent years, however, there have been several proponents of gold-backed currency reform; the most noteworthy of them is former Congressman Ronald "Ron" Paul. In his video series, Liberty Report, Ron Paul frequently argues that an "honest gold standard" is the solution to the perceived problems of fluctuating prices, excess inflation, and deficit because he believes that gold has inherent value.[6] Under a gold standard, the money supply would be restricted to the amount of gold in US holdings, and because this only increases as gold is mined and refined, the rate of yearly inflation would therefore be low and out of government control.[7] This would prevent governments from spending beyond their means by running deficits. He argues that these factors would limit the possibility for serious economic depressions or recessions to materialize.[8] The primary argument Ron Paul reiterates is that gold can guarantee long-term price stability in a manner which fiat currency cannot.[9] Ron Paul has also called for the creation of private, competing currencies, and that raw gold and silver should be among them, a hallmark of a gold specie standard. [10] Ron Paul is not the only voice calling for some form of a return to gold-backed currency. Although advocacy for this reform is largely confined to the Republican and Libertarian Parties, such advocacy, while not the norm, is not necessarily rare among conservative-minded politicians, such as Steve Forbes, Larry Kudlow, and Paul Ryan.[11]

Feasibility

Having outlined the contemporary case for a return to some form of gold standard, the economic and political feasibility of this policy will now be examined. In this section I will first argue that gold's stability and the degree to which it provides stability is highly exaggerated by Ron Paul and similar figures before examining the damaging implications of switching from the fiat money system to a gold standard. I will finish my analysis by exploring the broad extent of a gold standard's unpopularity in politics.

Economic Factors

Ron Paul's support of gold based on a dislike for inflation is logically coherent with his equal distaste for all forms of taxation; however his perception of gold as a stable medium of business and finance is less accurate.[12] Contrary to the belief that a gold standard would bring price stability, between 1919 and 1933 under the gold standard, the US Department of Labour reports that the Consumer Price Index (CPI) fluctuated by as much as 40%.[13] Since the Federal Reserve began targeting inflation in 2008, fluctuation in the CPI has not exceeded 10% between 2008 and 2013.[14] Gold prices themselves are even less stable, with economist and New York Times columnist Paul Krugman noting wild fluctuations in the price of gold between even 1968 and 2013.[15] Placing the responsibility of growing the US economy on gold mining companies would also have a destabilizing effect, as any shocks to that industry, such as a strike, would be amplified and transferred to the entire US economy.[16] It is for all of these reasons that a gold standard would not yield the price stability it advertises.

In order to sufficiently evaluate the feasibility of the gold standard, it is necessary to determine the economic consequences of adopting it over the fiat money system. The first and most notable difference would be the absence of federal control over monetary policy, since the money supply would be intrinsically tied to domestic gold reserves. Lacking control over money supply means that the government is incapable of stimulating the economy during economic depressions or recessions. Instead, the deflationary pressures of exporting gold to balance international trade payments only worsen domestic conditions; it is for this reason that even before 1919 when the United Kingdom was the main support of the gold standard that during economic downturns the gold standard was temporarily suspended to allow for economically uplifting deficit spending.[17] Another significant contemporary problem that would materialize under a new gold standard is that the current US gold reserves, despite being the largest in the world, could not afford to be used in balancing their most recent trade deficit, as the gold standard calls for. The United States ran a $500.361 billion trade deficit in 2015 and the market value of the entire US gold reserve was reported on September 30th, 2016 to be $345.8 billion by the US Department of Treasury.[18] This means that not only can't the United States afford to abide by the gold standard for a single year, in order to do so; the US would have to scale its imports back to their levels in the year 2000, or else deplete their entire gold reserve in balance payments.[19] There are doubtlessly additional economic reasons why an American return to a gold standard is not feasible, but further dissemination is beyond the scope of this investigation.

Political Factors

Having explored some economic reasons that a gold standard is currently unviable for the United States, it is now necessary to examine the inhospitable political climate towards the idea of a gold standard. The sheer unpopularity of the gold standard is truly remarkable. Matthew O'Brien of The Atlantic calls it "the worst economic idea in the world", writing that "Whether it′s 1896 or 2012, it doesn′t make sense to crucify our economy on a cross of gold".[20] Joe Weisenthal of Business Insider remarks that advocates of the standard comprise "a wing of conservatives [who are] willing to chance economic calamity to prevent any kind of budget deal that involves higher taxes".[21] Even in the 1980s when Ronald Reagan established a committee "to consider the feasibility of a metallic basis for U.S. currency", the proposal was broadly rejected.[22] Binyamin Appelbaum of the New York Times attributes contemporary support for the idea of a gold standard largely to nostalgia, noting that the concept for the system is roundly rejected by today's economists.[23] To summarize this negative consensus among experts, in 2012 a poll was conducted of the top economists by the University of Chicago, asking how much they agreed with the statement that a gold standard would improve employment opportunities and price stability for average Americans.[24] 40% disagreed with the statement and 53% strongly disagreed, which provides a useful scope of the sheer unpopularity of the gold standard.[25] Given the political consensus against the gold standard, it seems impossible for the policy to gain traction in a democratic country like the United States.

Conclusion

In this investigation, I have explored the feasibility of a return by the United States of America to a gold standard from the current fiat money system. Before scrutinizing the contemporary gold standard policy and advocacy by Ron Paul, I first provided pertinent background information on how the standard works and a brief history of US involvement with it. After outlining the contemporary arguments calling for a return to the gold standard, I then assessed the feasibility of returning to the system with respect to economic and political factors, specifically noting misconceptions surrounding the supposed stability of gold. I also explored the economic damage that such a system reform would cause, namely through lack of monetary policy control and the inability of the US gold reserves to cover the cost of their most recent trade deficits. Lastly, I provided a snapshot of the current negative political climate surrounding the idea of a new gold standard, most notably, the ire it draws from today's top economists. It is for these reasons, both economic and political, that a return to a gold standard, as advocated by former Congressman Ron Paul, is as unfeasible as it is undesirable.

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[7] *Ibid.*
[8] *Ibid.*
[9] "Ron Paul-Gold Standard and World Peace", Youtube video, 20:16, posted by "Jay Taylor Media", July 13, 2016. Accessed October 29, 2016. https://www.youtube.com/watch?v=lYLeq6hofI8
[10] *Ibid.*
[11] Weisenthal, Joe. "Why Conservatives Like The Gold Standard" Business Insider. 2012. Accessed November 01, 2016. http://www.businessinsider.com/why-conservatives-like-the-gold-standard-2012-8.
[12] Because inflationary policy devalues the currency held by citizens, reducing its buying power, while at the same time expanding federal government spending, it can be thought of as a form of indirect taxation.
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