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Gold Standard, a Jealous Goddess

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Deep discontent with President Obama's policies has strengthened conservative sentiments in America. This week in the Republican National Convention (RNC) in Tampa, Florida, speeches were made criticizing Obama's unsuccessful fiscal policies, as four years added US\$ 5 trillion (F\$ 9 trillion) to national debt reaching US\$ 16 trillion (F\$ 28 trillion).

The Republican Party, which stands for less government, spending cuts and no rise in taxes, has officially nominated their candidates, Mitt Romney for President and Paul Ryan as Vice President.

End of the Fed?

Generally, politicians refrain from criticizing the US Federal Reserve (the Fed), which is held high above politics.

However, ultra-conservatives do not spare the Fed. Amongst them is Ron Paul, an unsuccessful Republican aspirant for Presidential nomination. A medical doctor by profession, Dr. Ron Paul is an expert in monetary economics, since his entry into politics in 1997, as a Congressman.

In his *End of the Fed*, one of New York Times Best Sellers of 2009, Ron Paul advocated the abolition of the Fed. He argued that "In the post-meltdown world, it is irresponsible, ineffective, and ultimately useless to have a serious economic debate without considering and challenging the role of the Fed".

Paul accuses the Fed that by increasing money supply, it has debased the US dollar and fears it would lead to inflation. People will look to safe havens, including gold.

The RNC drafts of the party platform included an audit of Fed's monetary policy and a commission to look at restoring the link between the dollar and gold.

Exactly 30 years ago, in 1981, President Reagan appointed a Gold Commission for restoring the gold standard. Only ten years earlier, Republican President Nixon cut the link between gold and the dollar during the 1971 oil crisis. The Reagan appointed commission rejected the return to gold standard.

Why fascination with gold?

The ultra-conservatives believe the Fed's hands can be tied only if fixed amounts of gold were directly convertible to the U.S. dollar and vice versa and money supply can be limited by the amount of gold backing it.

The Republicans believe the ability to create fiat (paper money by decree) money out of thin air is a form of taxation and they oppose taxation. So gold standard is logically appropriate, as it makes it hard for the Fed to print more money.

Steve Forbes, the free market guru says the Fed was responsible for housing bust, the commodities boom and the sovereign debt crisis in Europe because of its uncontrolled money creation ability during the last ten years. So, he argues one way for stabilizing money is to have a gold backed dollar.

Jealous Goddess

Experts estimate the current monetary base of America is US\$2.56 trillion (F\$4.6 trillion) and the US has only 262 million ounces of gold. If the US returns to gold standard, bullion prices would rise as high as \$10,000 (F\$18,000) an ounce. That would destroy the dollar's credibility as reserve currency and international trade balance would be in jeopardy.

The world's official stock of gold is estimated at around 29,500 tonnes, or 17 percent of the world's above-ground stocks. This compares to 19 percent held by private investors and nearly half of the stocks made into gold jewellery.

Return to gold would restrict money creation by the Fed. Strict rules of gold standard required trade imbalances between nations are settled in movements of gold, if countries prefer their "pound of flesh". Trade surplus brings in gold and adds to stock; and deficits reduce stock. Money supply will go up and will go down, as surplus and deficit happen and fluctuate with changes in gold stock.

The Fed has to sit and watch. It cannot have independent monetary policy.

Geoffrey Crowther wrote in his classic, *Money*: "Gold standard is a jealous goddess. She needs exclusive devotion."

Opponents have a strong point: gold standard is deflationary, more often than not. No government in the modern world can afford to wait and see. Monetary policy has to be pro-active.

For increasing money supply, the Fed has to acquire more gold and the price of gold will soar. Only gold miners in South Africa and Canada will be benefitted.

The Republicans know the difficulties. Returning to the rejected idea after three decades is only a political ploy: to convince the electorate of their level of seriousness about the U.S. dollar, monetary policy and the budget deficit.

The middle path

Between the harsh reality and dreamy rhetoric, the middle path seems expedient.
Cut non-essentials and raise resources through taxing the ultra rich.
Maybe that is the Golden Mean?

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