The Gold Standard, 1876-1933

- Gold was part of Monetary Base
  - Public, domestic and foreign, could demand gold at will for dollars
  - Government essentially had no control over monetary base.

Implications

- Suppose the Monetary Base is $1,000 and the M₂Multiplier is 8. \( M₂ = 8,000 \).
- For some reason people want to hold more cash and the M₂Multiplier falls to 4.

With a Gold Standard

- Under a gold standard, nothing the government can do.
  - \( M₂ \) will fall to $4,000
  - A sharp decline in \( M₂ \) usually means a decline in GDP

With Fiat Money

- With fiat money, the government can offset decline.
  - \( Mₜ \) is increased to $2,000
  - \( M₂ \) remains at $8,000
  - No money-induced decline in GDP
With Fiat Money

- Nothing stops the government from increasing the money supply any time it wants to. Clearly inflationary.
  - 1789-1913: Prices essentially stable
  - 1913-present: 14-fold increase in price level.

Return to the Gold Standard?

- Some recommend return to Gold Standard, as a means of imposing monetary discipline.
- Most economists, remembering the lessons of the Great Depression, oppose the return.
- Yet: many countries are essentially adopting the gold standard by use of the US dollar as their monetary base.

End