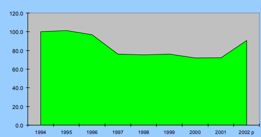
The Gold Standard



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 M_2Multiplier is 8. M_2 = \$8,000.
- For some reason people want to hold more cash and the M_2Multiplier falls to 4.

With a Gold Standard

- Under a gold standard, nothing the government can do.
  - M_2 will fall to \$4,000
  - A sharp decline in M_2 usually means a decline in GDP

With a Gold Standard

- Happened in the US in 1929-33.
- Great Britain abandoned Gold Standard in 1931 precisely because the money multiplier was falling and the gold standard made it impossible for them to offset the decline in the money supply.

With Fiat Money

- With fiat money, the government can offset decline.
  - M_b is increased to \$2,000
  - M_2 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.

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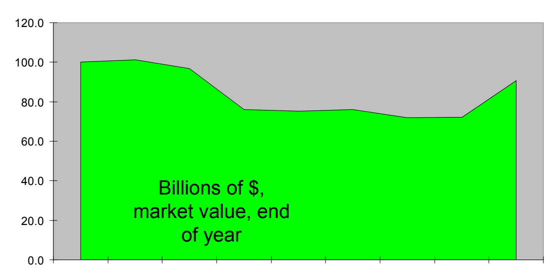
- Most economists, remembering the lessons of the Great Depression, oppose the return.
- Yet: many countries are essentially adopting the gold standard by use of the US dollar as their monetary base.

US Gold Reserves



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