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ECONOMY

The Good Old Days of the Gold Standard? Not Really, Historians Say

By **BINYAMIN APPELBAUM** DEC. 1, 2015

WASHINGTON — Republicans unhappy with the Federal Reserve are circulating an idea that long ago lost currency with most economists: a gold standard.

In an election season shaken by terrorism fears, immigration politics and economic anxiety, a shiny precious metal might seem like an odd fixation, but Senator Ted Cruz of Texas, a Republican presidential hopeful, said recently that the dollar should have a fixed value in gold, and some rivals for the Republican nomination said a return to the old standard was worth studying.

The rhetoric is rooted in concern that the Fed's efforts to revive economic growth have loosened its hold on inflation. A gold standard, proponents argue, would limit the Fed's ability to create money, thus ensuring prices remain stable.

But economic historians describe this as nostalgia for a time that never was. Proponents of the gold standard generally overstate the benefits of putting golden handcuffs on a central bank, historians say, and the costs of that reduced flexibility are considerable.

In 2012, the University of Chicago asked 40 leading economists whether a

gold standard would improve the lives of average Americans. All 40 said no.

"You can do a lot better than a gold standard," said Michael Bordo, an economist and director of the Center for Monetary and Financial History at Rutgers University. He described the political interest in the precious metal as "pretty crazy."

The gold standard was invented to constrain government spending. Nations that agreed to exchange money for gold thought twice before printing more money. And lately, Republicans have found themselves yearning for such restraint.

After the 2008 recession, the Fed began a campaign to stimulate economic growth. It has held short-term interest rates near zero since December 2008, and it put further pressure on long-term rates by creating trillions of dollars to buy Treasuries and mortgage bonds. Both measures aimed to spur risk-taking by investors and borrowing by businesses and consumers.

Republicans have warned since the outset that the Fed was losing control of inflation. During the 2012 campaign, Rick Perry, then the governor of Texas and a Republican presidential candidate, called the Fed's policies "treasonous" and warned that if Ben S. Bernanke, then the Fed chairman, came to Texas, "we would treat him pretty ugly." The party added a plank to its platform calling for a commission "to investigate possible ways to set a fixed value for the dollar," reviving language last seen in 1984.

Instead, four years later, inflation remains unusually sluggish. Some economists and Fed officials argue the economy would benefit from a little more. But the language of the Fed's critics remains heated.

"Instead of adjusting monetary policy according to whims and getting it wrong over and over again and causing booms and busts, what the Fed should be doing is, No. 1, keeping our money tied to a stable level of gold," Mr. Cruz

said last month during a Republican presidential debate.

Senator Rand Paul, Republican of Kentucky, agreed that the Fed “destroys the value of the currency” by allowing too much inflation. Ben Carson and Mike Huckabee, former Arkansas governor, both agreed that the value of the dollar should be tied to something.

“If it’s not going to be gold, make it the commodity basket,” Mr. Huckabee said.

Economists generally regard a gold standard as a crude and outdated method of inflation control. There is nothing inherently stable about the value of gold. It fluctuates, like the value of everything else, as more is extracted from the ground and as demand waxes and wanes.

The bigger problem, however, is that economic conditions are unstable. And during recessions, printing money can help revive economic activity. Nations began to rebound from the Great Depression when they began to abandon gold. Most developed nations now ask central banks to strike a balance between stabilizing broad measures of price inflation and encouraging economic growth, and then leave it to the technocrats to decide how much money to print.

“The real world is a complex place,” Adam Posen, president of the Peterson Institute for International Economics, wrote in a recent defense of the need for human judgment in making monetary policy. “Driverless cars would veer from side to side and cause crashes if their guidance algorithm was limited to just maintaining the distance from the car in front of them, instead of assimilating more information as they went. The U.S. economy cannot be safely run on autopilot either.”

Barry Eichengreen, an economic historian at the University of California, Berkeley, said life under the gold standard, during its heyday around the turn of the last century, more closely resembled modern central banking than is

commonly recognized. The Bank of England held extra gold so it could print extra money if necessary, for example, and nations frequently suspended their standards during periods of extreme duress.

But Mr. Eichengreen emphasized that these leniencies proved insufficient, and that policy makers had made "steady and significant progress" in the intervening decades toward improving the management of monetary policy.

"There is a long history in the United States, going back to Andrew Jackson, of deep skepticism of the power of anonymous financial technocrats," Mr. Eichengreen said. "This wish to substitute simple rules partly reflects a strain of political ideology that thinks government intervention only causes problems and never solves them. And partly it reflects a lack of careful understanding of how these earlier regimes work."

In fact, the gold standard did not even work during periods of calm. What is often described as an era of stable prices was more like a roller-coaster ride that ended back where it began, after bursts of inflation and deflation.

Mr. Bordo has calculated that economic volatility in the United States was significantly greater during the gold standard years, and the nation's unemployment rate, on average, was almost a full percentage point higher.

"When people look back and say the gold standard was wonderful, they forget about the short-run swings," he said.

Even economists who want to remove human judgment from monetary policy tend to look down on the gold standard. Milton Friedman, a conservative economic icon, suggested that monetary policy should not be determined by people or by gold, but instead by a computer program.

The last few years have served as a reminder that steering straight ahead is not necessarily the best policy during a storm. After the financial crisis, the Fed has embraced responsibility not just for inflation but also for economic

and financial stability, and other central banks have followed its path.

And congressional Republicans, while levying many of the same criticisms against the Fed as the party's presidential candidates, have proved unwilling to impose a rigid rule.

The House of Representatives last month passed legislation requiring the Fed to choose its own rule for setting interest-rate levels — a Fed standard — and explain any deviations. The legislation includes a suggested rule, known as the Taylor Rule, which tries to formalize a balance between economic growth and inflation, effectively allowing some amount of extra money printing during recessions.

A similar Senate bill would not require the Fed to pick a rule, but instead to compare its conduct of monetary policy with several reference rules in regular reports to Congress.

"We will not fully realize robust economic growth until the Fed changes the conduct of its monetary policy," Representative Bill Huizenga, the Michigan Republican who wrote the House bill, said during the final debate on the House floor. He then emphasized that the legislation would leave the Fed free to "develop what it believes is the best course of action on monetary policy."

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