What a Return to the Gold Standard Means for Your Money

Investors and workers should prepare for a bumpier ride.

As election season moves into full swing, gold is becoming a hot topic among GOP candidates.

In the most recent debate, Senator and presidential hopeful Ted Cruz said the Federal Reserve should focus on “sound money and monetary stability, ideally tied to gold.”

Cruz is not alone. Overstock.com executive and Republican candidate for Utah Governor Jonathan Johnson told the United Precious Metals Association, a group that supports legislation making bullion the state’s legal tender, that his company keeps a cache of more than $10 million in gold and silver in preparation for a forthcoming financial crisis.

Meanwhile, GOP presidential candidate and Senator Rand Paul — who supports creating a commission to study whether the dollar needs to be linked to a hard asset like gold — has introduced a bill aimed at “auditing” the Federal Reserve.
This is not the first time GOP candidates have tried to hitch their wagons to gold.

Four years ago, the Republican Party platform called for the establishment of a committee “to investigate possible ways to set a fixed value for the dollar.”

That was after at least three candidates in that campaign — Herman Cain, Newt Gingrich, and Rand Paul’s father Ron Paul — openly called for the U.S. to return to the gold standard.

Some folks steadfastly believe that the Fed — after seven years of low interest rates and an unparalleled bond buying program — has made the world financial system fundamentally unstable. And they view gold, or the gold standard, as the cure.

The question is why? And what exactly would a return to the gold standard — a policy that was in place until 1971, when Republican President Richard Nixon dismantled it — mean for your money?

**Why Gold**

The seemingly inescapable love affair with bullion may seem a tad strange. It’s a commodity that doesn’t produce earnings or dividends.

But the yellow metal has always held a special psychological value.
During the terribleness in the 1930s, “Victorian and Edwardian virtues of thrift, reliability, stability and cosmopolitanism were invoked ritually as attributes of a the monetary system. Gold was moral, principled and civilized; managed money was the opposite,” writes economists Barry Eichengreen and Peter Temin point out in their paper *The Gold Standard and the Great Depression*.

One reason might be that gold holds its value over long stretches of time – think millennia, rather than decades. “In 562 B.C., during the reign of the Babylonian King Nebuchadnezzar, an ounce of gold bought 350 loaves of bread. At today’s gold price, that’s $3.14 per loaf – roughly what I pay at Whole Foods,” Duke University finance professor Campbell Harvey, co-author of the recent paper “Golden Constant,” told MONEY.

Of course that’s the really long-term.

Gold prices for mortal investors is much less predictable. “Gold’s volatility is about the same as the S&P 500,” says Harvey. Indeed, in just the past five years, gold has fallen from a peak of $1,855 an ounce down to as low as $1,087, which represents a 40% drop in value. "It is not clear that people would accept being paid in S&P 500 shares and having their bank accounts in S&P 500 shares, because they would consider that too risky," Harvey says.

The Standard

For all intents and purposes, the gold standard refers to a monetary system where the value of a currency (like the dollar) is tied to the price of a specific amount of gold. The amount of money supply, then, is determined by how much of this yellow stuff you can dig out of the ground.

The problem is that countries need to hold onto ever increasing amounts of gold in order to keep up with demand. “Note that if all the gold in the world was melted down, it would fit in a 67 foot cube,” says Harvey.

The most important question is, what would happen to your finances should such the nation ever return to the well, or mine?

Your Money

“That’s easy,” says financial theorist William Bernstein, and author of The Investor’s Manifesto. "Your portfolio would become a lot more unstable, along with the rest of your financial life.

Limiting the amount of money the government can print when times get really bad and people aren’t spending can result in higher unemployment. My spending is your income, so when people have less means to consume, other people lose their jobs. And down the nasty spiral we go.

There was double digit unemployment throughout the 30’s, in fact more than a quarter of workers didn’t have a job in 1933. During the early stages of the depression, some 9,000 banks failed resulting in the loss of $140 billion in 1933.
As the global economy began to tumble seven years ago, the Federal Reserve was able to effectively print money to help prop up the economy. The unemployment rate maxed out around 10% in the spring of 2010.

If there was another crisis, and the Fed didn’t have the tools it did in 2008, investors might be even more scared than they were.

Which raises the question, why bother?

“I would simply ask Mr. Cruz and other proponents, what precisely do you hope to achieve by returning to the gold standard?” asks chief economist of BMO Financial Group Douglas Porter. The Fed is charged with keeping inflation stable and maximizing unemployment. Inflation “has been quite low for the past few decades,” notes Porter. Moreover, the unemployment rate is now hovering at about 5%.

Moreover, returning to the gold standard might limit the amount of gold people are actually able to hold, says Harvey.

FDR actually banned individuals, corporations, and organizations from holding gold because folks were hoarding the stuff. (To be fair, Harvey does say that it would be easier for people to defeat this type of regulation than in the ’30s.)

Calling for a currency backed by something that seems august like gold sounds like a serious, prudent policy. But with a strong dollar against other major currencies, low inflation and recent employment gains, the case for bullion feels hollow.