CPM Group

Market Commentary

No. 7 28 August 2012

Republican Party Calls For A Gold Standard

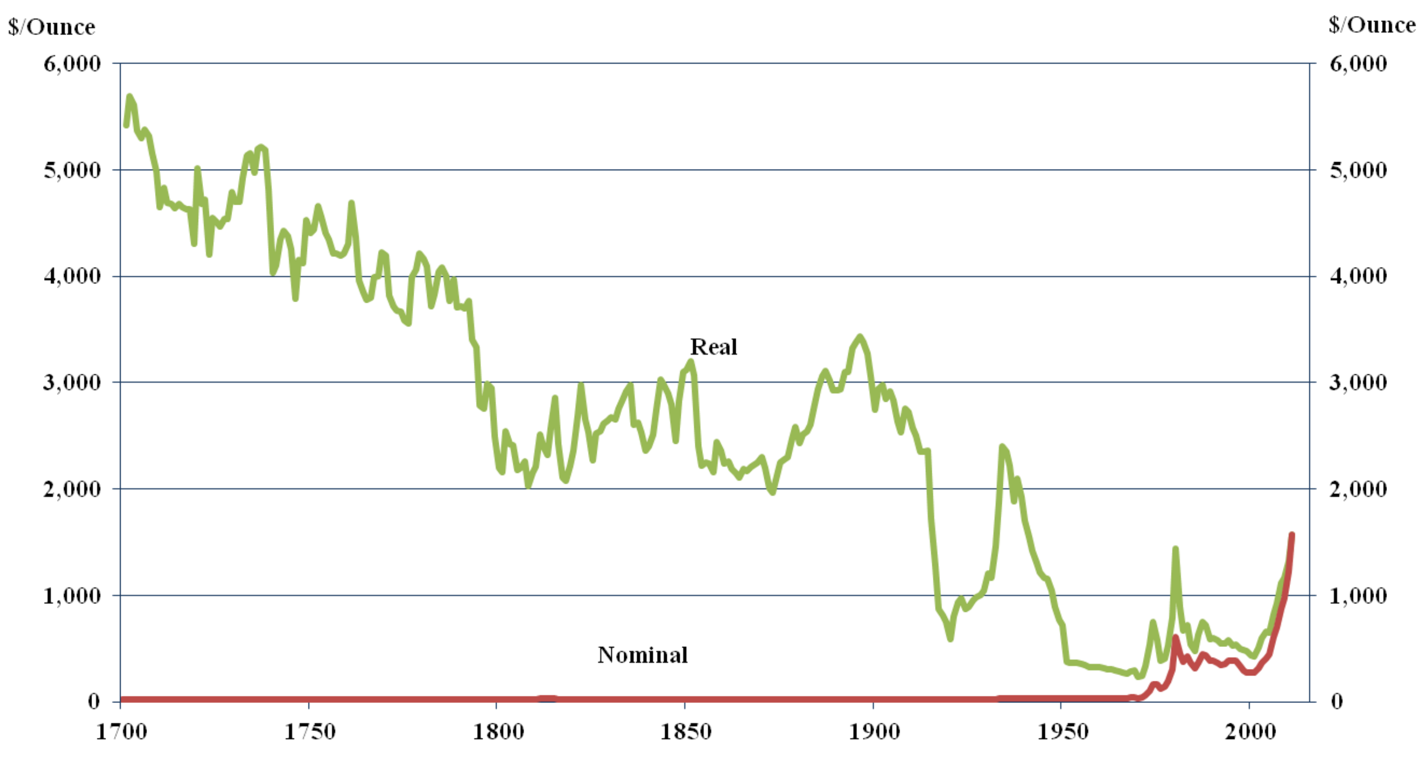
The U.S. Republican Party is holding its convention this week, nominating Mitt Romney to run for President. A Platform Committee met prior to the convention to put together the platform of proposals and policies on which the Party is to run its campaign. Early last week, around 21 August, it became public that the platform contained a 'plank' that called for a Presidential Commission that would study ways to possibly fix the value of the dollar to gold or some other asset or index of assets.

It is not clear what exactly the proposed Republican platform is calling for, since the draft platform is not available from the Republican Party's website or other party sources. Various news agencies have reported that the platform contains a plank that calls for the President, should Romney win the election, to convene a commission to study ways to stabilize the U.S. currency (presumably precluding any fiscal reform that could restore stability to U.S. government spending, deficits, and debt). There were stories that the commission would be directed to consider the potential of a return to some form of a gold standard, or another fixed currency regime that pegged the value of the dollar to something else, perhaps an index of commodities prices.

Every gold standard that has ever existed has collapsed, and none of them prevented either the long-term historical decline in the purchasing power of the dollar, the pound sterling, the French franc, or other currency pegged to the gold price, let alone the gold price itself. The chart below shows real, inflation-adjusted gold prices since 1700. During most of this time gold prices were fixed, against the pound sterling, the dollar, and other currencies. Those currencies all have suffered massive losses in purchasing power over time. This chart shows that gold also lost massive amounts of its historical

Real and Nominal London Gold Prices since 1700

Prices through 2011, Base Year = 2011



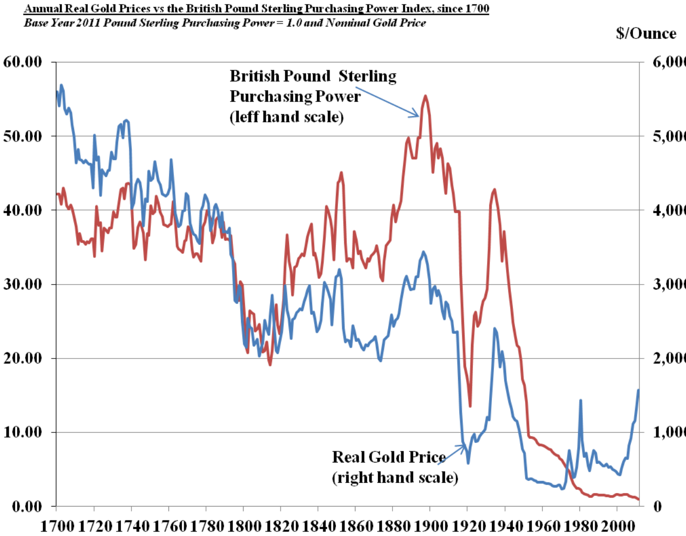
Republican Party Calls For A Gold Standard (cont.)

purchasing power, in stark contrast to the myth so wildly believed that gold's purchasing power is constant over time.

The inclusion of this plank in the platform was seized on by gold standard advocates as a sign of serious intent on the part of the Republican party to consider a return to a gold standard as a legitimate area of intellectual consideration. Most other observers saw it as a way of pandering to Tea Party members and Ron Paul supporters, even as the Republican National Committee was stripping Ron Paul's campaign of many of his delegates prior to the actual convention beginning. In case there was any real concern that the Republican party could consider a gold standard as a viable monetary policy, the party made economists available to the press who expressed the opinion that there were many better ways to achieve economic stability, and the real intent of the platform plank was to signal to the voting public that the Republican party was serious about considering the need for economic stability.

There are many reasons why the Republican leadership has no real interest in a gold standard. First and foremost is the fact that a gold standard would constrain their ability to play budgetary and monetary tricks, as they have since the late 1960s. Secondarily, they also realize that a gold standard would be devastating to the U.S. and global economy.

Additionally, the last thing that Republican-backing western gold mining interests and their congressional representatives want is for the gold price to be fixed again by government diktat. The last time that happened, gold mining all but disappeared in the United States, as gold prices were fixed at $22 and then $34 per ounce, and gold mining did not make financial sense. By the time the U.S. got off the gold standard in 1971 there was only one significant U.S. gold mining company left operating. These interests do not want the gold price set by government decree.



Not The First Time

This is not the first time that the Republican party has paid lip service to the idea of a gold standard. It did so in 1980 and 1984. Nor is it a surprise. In fact, CPM Group has been including a set of slides in its gold presentations for more than a year that started with a cover page titled "Gold Standard Rhetoric Will Be Thick in 2012."

In 1980 the Republican platform of Ronald Reagan called for a return to a gold standard. Conceived and drafted by Arthur Laffer, the father also of the "supply side" economic theory that took the Federal deficit from around $50 billion under President Jimmy Carter to more than $300 billion under Ronald Reagan, the gold standard proposal in the platform in 1980 called for the U.S. government to agree that 40% of the U.S. Treasury Notes it put into circulation would be backed by physical gold held by the U.S. Treasury. Laffer knowingly excluded U.S. Federal Reserve Notes from being backed by gold. Virtually all of the money 'printed' and put into circulation after 1971 was in the form of Federal Reserve Notes, so that Laffer's proposed gold standard would in no way impinge upon the government's ability to issue more money in the form of Federal Reserve Notes in exchange for bonds. When asked in private about this, Laffer explained that the government needed to make people think that the dollar was backed by gold, which would instill confidence in the dollar, while allowing the government to 'print money until the cows come home' if it needed or wanted to do so.

Reagan won the election and convened a Presidential Commission to study the potential use of gold in a future monetary system. In the interest of full disclosure, Herbert Coyne, then chairman of J. Aron and Company, was appointed to the Commission. Anna J. Schwartz, the Columbia University economist who had co-authored **A Monetary History of the United States** with Milton Friedman, was appointed as the economist to the com-

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mission and Mr. Coyne offered her the full use of the J. Aron Research Department in providing her data and analysis of gold. CPM Group is the outgrowth of the J. Aron Research Department.

The Gold Commission in the early 1980s concluded that there were no valid reasons to think that a return to the use of gold as the denominator of the dollar's value would assist in stabilizing the dollar's value or the international currency regime of floating rates.

Gold Standards Do Not Work

One of the recurring themes of CPM Group's gold presentations is that gold standards in fact are not a panacea for currency market volatility nor have they provided currency market stability in the past. Monetary discipline is what is needed. Indeed, any return to a gold standard could only be effected by first establishing a disciplined creation of currency, and once that was achieved, as a prerequisite of a return to a gold standard, the return to a gold standard would be redundant and unnecessary. What is needed is monetary discipline.

We often point out that while gold standard advocates like to say that no monetary system that did not have gold or silver as its basis ever has lasted, that statement is both true and meaningless. It is true that no monetary system that did not use gold or silver as its basis of value has lasted. However, it is also true that the only monetary system that has not ended, in collapse or a dying gasp, is the current one. What is true and meaningful is that no monetary system, no currency regime, has ever lasted, except the current one… and most of the monetary systems throughout history were based on gold and silver. Gold and silver do not solve the problem of inherent monetary system instability and ultimate failure. The important take-away from an honest study of international currency regimes is that they fail, and that everyone, from investors to government officials, should manage their assets based on the assumption that the current currency regime, regardless of its structure, will fail in time.