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The Gold Standard and Price Inflation

Each issue of The Regional Economist, published by the Federal Reserve Bank of St. Louis, features the section "Ask an Economist," in which one of the bank's economists answers a question. The answer below was provided by Vice President and Economist [David Andolfatto](#).

Why doesn't the U.S. return to the gold standard so that the Fed can't "create money out of thin air"?

The phrase "create money out of thin air" refers to the Fed's ability to create money at virtually zero resource cost. It is frequently asserted that such an ability necessarily leads to "too much" price inflation. Under a gold standard, the temptation to overinflate is allegedly absent, that is, gold cannot be "created out of thin air."

It would follow that a return to a gold standard would be the only way to guarantee price-level stability.

Unfortunately, a gold standard is not a guarantee of price stability. It is simply a promise made "out of thin air" to keep the supply of money anchored to the supply of gold. To consider how tenuous such a promise can be, consider the following example. On April 5, 1933, President Franklin D. Roosevelt ordered all gold coins and certificates of denominations in excess of \$100 turned in for other money by May 1 at a set price of \$20.67 per ounce. Two months later, a joint resolution of Congress abrogated the gold clauses in many public and private obligations that required the debtor to repay the creditor in gold dollars of the same weight and fineness as those borrowed. In 1934, the government price of gold was increased to \$35 per ounce, effectively increasing the dollar value of gold on the Federal Reserve's balance sheet by almost 70 percent. This action allowed the Federal Reserve to increase the money supply by a corresponding amount and, subsequently, led to significant price inflation.

This historical example demonstrates that the gold standard is no guarantee of price stability. Moreover, the fact that price inflation in the U.S. has remained low and stable over the past 30 years demonstrates that the gold standard is not necessary for price stability. Price stability evidently depends less on whether money is "created out of thin air" and more on the credibility of the monetary authority to manage the economy's money supply in a responsible manner.

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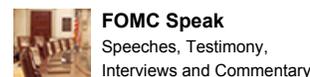
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