ASK AN ECONOMIST

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

A. 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.

Submit your question in a letter to the editor. Do so online at www.stlouisfed.org/re/letter or mail it to Subhayu Bandyopadhyay, editor, *The Regional Economist*, Federal Reserve Bank of St. Louis, Box 442, St. Louis, MO 63166.

LETTER TO THE EDITOR

This is in response to the "Ask an Economist" column in the July issue of *The Regional Economist*. The question was: Is the large and persistent U.S. trade deficit a concern? The question was answered by St. Louis Fed economist YiLi Chien.

Dear Editor:

Apparently, YiLi Chien's greater interest and concern are for banking rather than wage-earning households. USA's global trade deficit has a leveraged effect upon our GDP. Trade deficits are detrimental to the GDP and the median wage. The net effect of a nation's global trade products is reflected within the nation's total GDP, but prices of individual products are dependent upon the products' producers' costs. Producers often receive reduced cost production support from nonprofit entities. Governments often facilitate infrastructure and police security for producers at reduced-costs. Similarly, universities often provide research for individual producers or their entire industries at reduced costs. (The sum of net costs to both the producers of goods and the nonprofit entities is fully reflected within the producing nations' GDPs.) The total value, rather than the understated value of USA's trade deficit, fully benefited the exporting nations rather than the USA. All economic differences between domestic and imported goods occur prior to the goods reaching a domestic producer's shipping platform or a USA port of entry. New Zealand lambs were nurtured, butchered, packed and shipped from New Zealand. USA's purchasers helped pay New Zealand's taxes, their roads, their schools, their veterinarian colleges' research and development programs and many other of their enterprises' overhead expenses. We contributed to their knowledge and experience because they (not us) were employed to perform all of those tasks. Today, we don't produce goods; tomorrow, we'll be unable to produce goods? Refer to: www.USA-Trade-Deficit.Blogspot.com and http://en.wikipedia.org/wiki/Import_Certificates

Bernard Belitsky, retiree in Fort Lee, N.J.

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