RECREATING THE GOLD STANDARD

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GOLD STANDARD:

A monetary system in which the value of a currency is fixed to a determined quantity of gold (Gold Standard, 2017).

This system is characterized by the freedom of exchange domestically and internationally of the currency into gold.

The advantages of the gold standard:

- Governments cannot create excessive amounts of currency
- Provides a fixed patterns of exchange rates to ease international trade (Gold Standard, 2017).

The disadvantages of the gold standard:

- It may not provide sufficient quantities for the supply of money necessary for the growing needs of economies due to the restrictions of physical mined gold.
- Does not allow the avoidance of a depression or inflation by through changing the value of currency (Gold Standard, 2017).

WWI saw a step back from the gold standard with every country fully off the gold standard by 1937 due to the catastrophic economic downturn of the 1930's.

THE EURO

The euro is a unified currency of 19 countries within the European Union. These countries are referred to as the Eurozone. It's goal is to create unity within Europe using a single currency with quasi-fixed exchange rates (Varoufakis, 2016).

Euro. (2017).

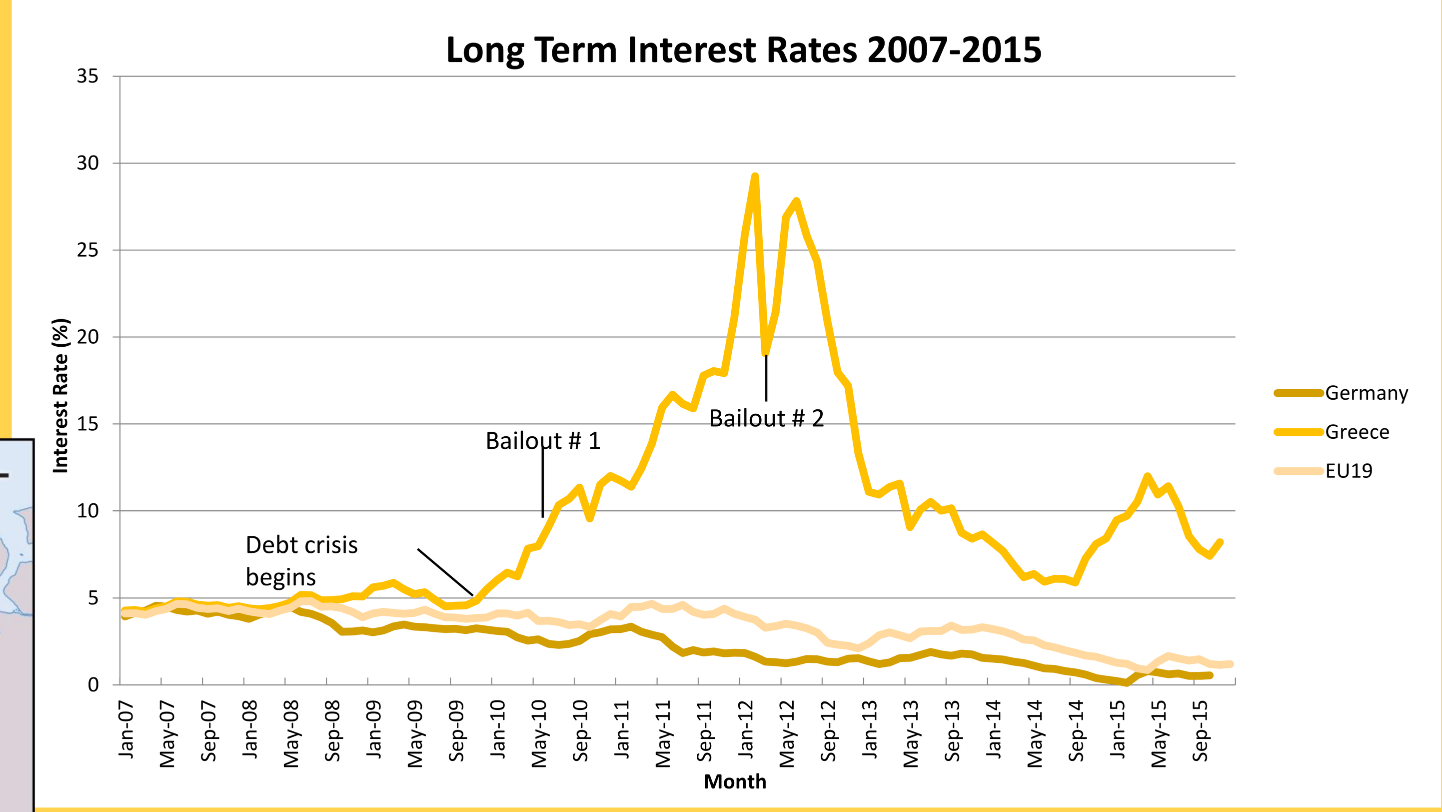
EURO ADOPTION RULES:

- Annual public debt must be ≤ 3% of GDP and sovereign debt ≤ 60% of GDP
- Maintenance of exchange rate stability without the devaluation of currency or the application of high interest rates
- Inflation rates must be kept within 1.5% of the lowest three EU inflation rates with long term inflation rates lower than 2% (Shwartz, 2013)

Euro. (2017).

GREECE'S ADOPTION OF THE EURO:

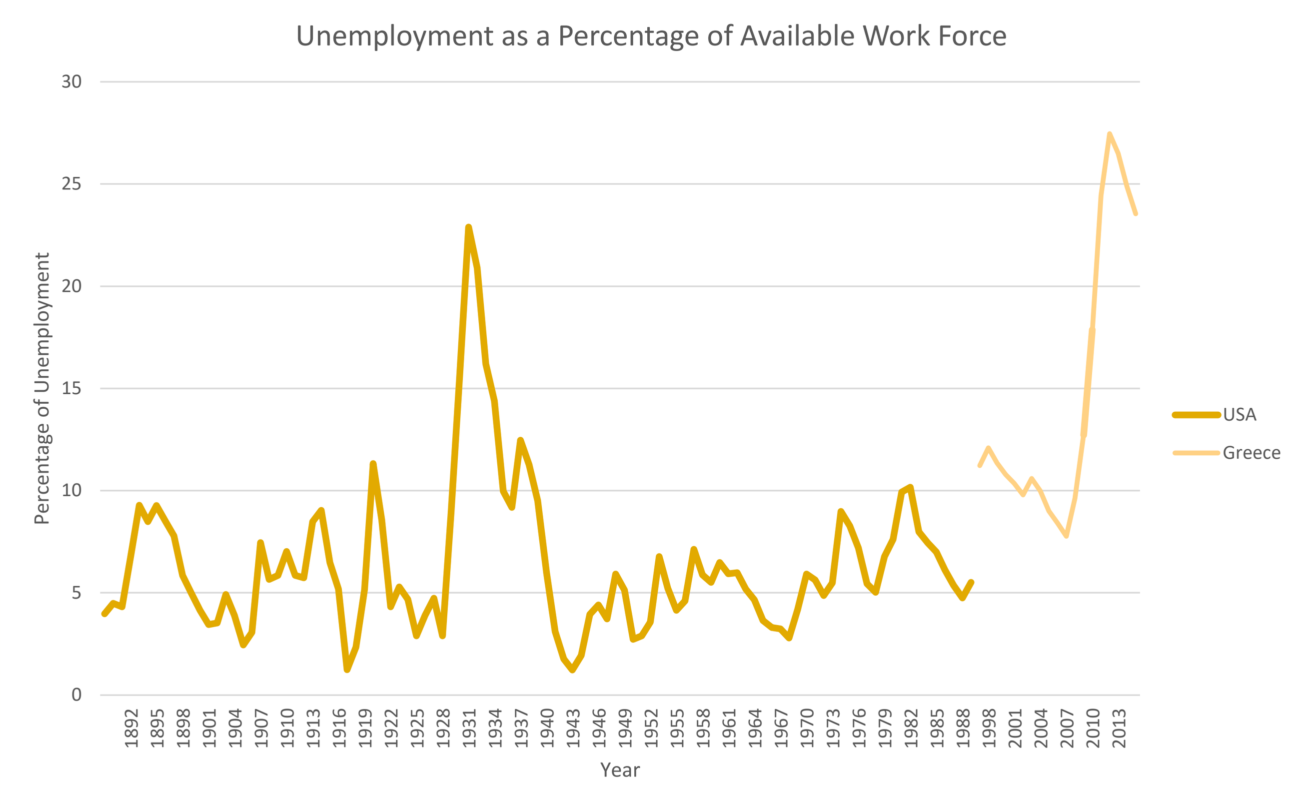
Like the classical gold standard of the 1920s, Greece and Europe are missing an adjustment mechanism to regulate imbalances in outside trade by allowing core countries to recycle their capital surpluses towards peripheral countries such as Greece, allowing them to safely run a trade deficit (Varoufakis, 2016).



Data sourced from OECD. (2017b).

Before 2009, markets perceived Greek debt as a safe investment due to an expectation that they would be bailed out. Thus, Greece was allowed to accumulate large external imbalances that the adjustment mechanism normally would regulate, culminating in the debt crisis of 2009 (Dellas & Tavlas, 2013). Greek interest rates rocketed as credit risk suddenly increased.

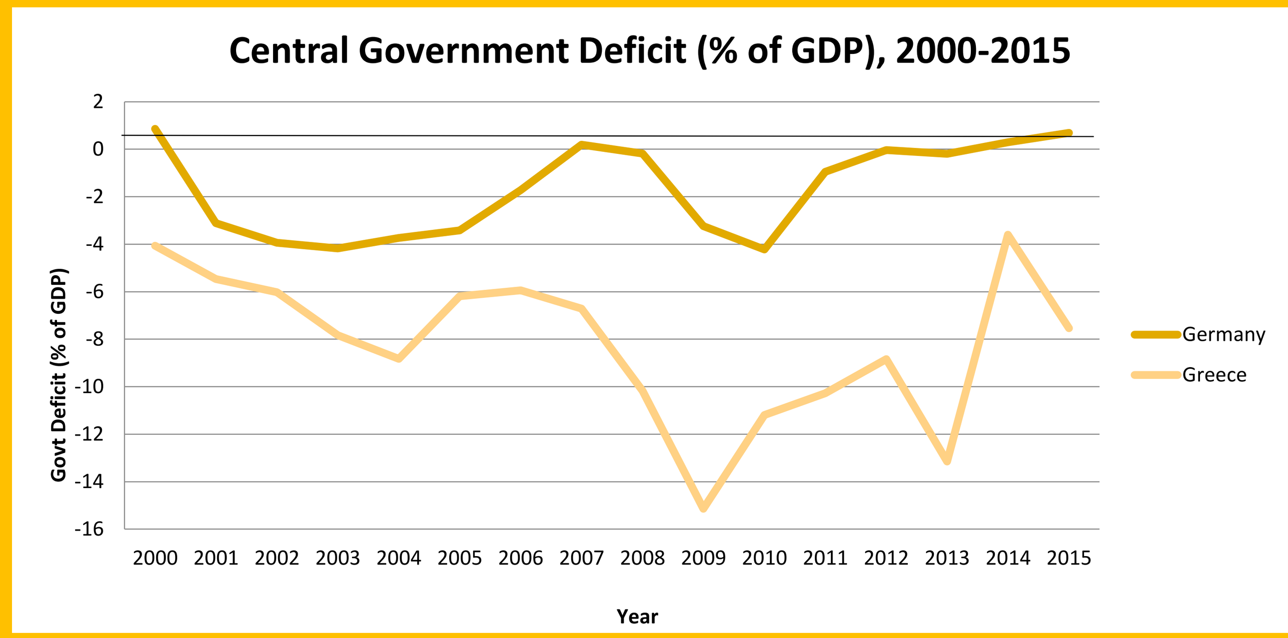
Under the euro, Greece is unable to devalue their currency to get out of debt without exiting the Eurozone and causing massive economic downturn (Varoufakis, 2016).



Data sourced from OECD. (2017a); Historical Statistics of the United States. (2017).

ECONOMIC CRISIS IN GREECE:

Before 2008, there was no need for the political surplus recycling mechanism, but once America couldn't meet Europe's demand for exports, the doom loop began between insolvent banks and insolvent European nations such as Greece. When America's 2008 financial crisis reached Europe in 2009 and when need for the mechanism was at its highest to reduce the growing trade imbalances, it was impossible to implement any mechanism under the euro regime (Varoufakis, 2016). The crisis is reflective of the depression of the 1930's as seen in the graph above.



Data sourced from OECD. (2017c).

Why maintain fixed exchange rates? In the gold standard regime, currency devaluation was forced by fears of inflation. Similar evidence exists in why countries such as Greece are keeping the euro: a return to the 'old' currency would be hostile and inflation is likely to sharply increase (Morys, 2014).
In the debt crisis, Greece was left with two options: borrow at restrictive rates or lower GDP at impossible rates (Wilsher, 2014).

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