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Will the Gold Standard be an Alternative to the Dollar?

With the discussion of De-Dollarization, comes one of alternatives currency options. We know that the dollar will not be replaced in this system, even if countries begin to move away from the dollar to other currencies in an attempt to decrease their reliance on US currency. So, the other option is the Gold Standard. We know that it will be adopted when the Khilafah is reestablished, but could the USA reform its policies and re-introduce the Gold Standard in an attempt to stabilize its economy? And more importantly would they do it when the realities and implications of the Gold Standard are considered?

This is not a new discussion; the US politicians have discussed the use of the Gold Standard in their campaigns in the past. Though, interestingly in October of last year, U.S. Representative Alex Mooney (R-WV) introduced the “Gold Standard Restoration Act”.

“It calls for the repegging of the Federal Reserve note to gold in order to address the ongoing problems of inflation, runaway federal debt, and monetary system instability.

If the Bill passes, the U.S. Treasury and the Federal Reserve would have 30 months to publicly disclose all gold holdings and gold transactions, after which time the Federal Reserve note “dollar” would be pegged to a fixed weight of gold at its then-market price. The Federal Reserve notes would become fully redeemable for and exchangeable with gold at the new fixed price, with the U.S. Treasury and its gold reserves backstopping Federal Reserve Banks as guarantor.” (Source)

This bill hasn’t become law, and it has to pass through a long process for it to even get to a point where it’ll be considered by the Senate and then the President. But it’s just another example that shows that people are worried about the state of the economy, and see the Gold Standard as a way of stabilizing it.

But would the USA return to the Gold Standard, and what would it mean if they did?

Rather than looking at this from an economic point of view and discussing the value of gold etc., let’s consider it from a political point of view.

The discussion about whether or not to reinstate the Gold Standard is a political one, as the dollar was one of the USA’s major tools in embedding its power into the world when it restructured the International Order.

It’s also used by the politicians in the USA to gain domestic support. Their people are worried about inflation and politicians need to attempt to give them a solution, which is why Republican hopefuls in the past have used the Gold Standard as a point in their campaigns. This is because, while inflation is an inevitable consequence of the current fiat currency system, it’s not as prominent in the Gold Standard system.

An example of this can be found in the UK, from when they used the Gold Standard in the 19th and early 20th Century, price levels were the same in 1914, as they had been in 1816. But since abolishing the Gold Standard and moving to a fiat currency, the UK has experienced persistent inflation, with a yearly increase in the price level. (Source)

But just as the possibility of the Gold Standard can give hope to the population, it can also scare them, as politicians are also able to focus on all the problems that came with their version of the Gold Standard, and remind people that it’s “*a barbarous relic that has nothing to recommend it today.” (Source)*

And that argument can be used to justify other policy decision. Of course, the USA must make every effort to avoid moving back to the Gold Standard now, even if this means that the Federal Reserve needs to increase inflation or the government needs to use tax payer's money to bail out the banks. What's the alternative? An economic currency that collapsed? And possibly caused the Great Depression before the USA moved away from it?

But voter manipulation aside, would the USA, decide to pass the Gold Standard Restoration Bill?

If they did, it wouldn't mean much. It certainly wouldn't solve all of the problems we are experiencing, as those problems are based on issues within the current Capitalist State that go beyond the currency issue. Capitalism has an interest based economy, which is manipulated by the government and the international organizations, with world's resources that are owned and exploited by private companies. This last point basically means that whenever the people need access to resources, be it oil or food, the public sector needs to pay money to private companies. And if they don't have the money, they have to either take a loan or print more money.

But putting all of this to the side, it's unlikely that the USA will take a step towards the Gold Standard as it would diminish their hegemonic power.

They built this power over the course of the 20th Century, establishing an economic system that they had control over. They control the global currency, so they control local currencies. This allowed them to establish a Neocolonialist system where they could extend their influence (to varying degrees over others) in a more informal manner.

It's also important to remember that even when the USA presided over the 'Gold Standard', it was their own diluted version of it. During the World War, they stopped gold exports and after that they implemented the 'Gold Exchange System' in which other countries were reliant on the USA, and their monetary policy.

They had a political reason to change from a Gold Based Currency system to a Fiat Based System.

Today, all currencies are 'fiat' i.e. government issued money, that is not backed by a commodity or a physical asset. It's backed by the government, and the currency's value relies on a number of factors including the legitimacy of the government and the trust that the world has in it. As it is not backed by a physical asset, countries, most importantly the USA, can print money to suit their needs, and this is what makes it so advantageous to them today.

It's true that this means that there is high inflation, and that the risk of hyperinflation is significantly increased under a system with an unrestrained supply of money. But the US dollar is kept in control as the world has confidence in the ability of the US government to pay back its debts. But if this confidence disappears, they could risk of hyperinflation similar to what Zimbabwe experienced in 2008, when their inflation rate rose to over 200 million percent.

The ability to ensure that there is a continuous flow of cash is also important due to their reliance on trade. This is because countries with reserve currency face no constraints on their imports. So, the United States has been running external deficits with no interruption for many decades. They are all paid for with printed dollars, which is the cause for inflation.

But despite the rampant inflation (and the havoc that it wrecks over the people), the ability to print relatively restricted money is a factor which is very appealing in a system that experiences continuous recession and promotes materialism. And it enables the USA to maintain its hegemony in the world (through wars and loans).

There is a way of regulating currency, even with a fiat currency. It can be done with a fixed exchange rate, i.e. when a country fixes the price of the domestic currency unit against one or more foreign currencies. But once again this reduces the flexibility of their monetary currency by placing limits on the central banks' freedom to make adjustments to the interest rates to boost the economy. So the international system prefers a 'floating currency' over a 'fixed currency' though most currencies are on a scale, somewhere in the middle of both.

In a floating exchange system, governments and central banks have a great degree of independence. But with fixed exchange rates, the Central banks of different nations have to act in tandem. This is because the monetary policy that they set could influence or be influenced by the economic conditions of member nations.

In a fixed exchange rate, interest rates need to be similar to the (missing word) to maintain the exchange rate. If it doesn't happen, the country with the low interest rate will push its money supply to the country with the higher interest rate until the interest rates become equal again. The move makes the currency with a low interest rate more attractive, which increases the supply of money to the country. But this can lead to higher inflation.

So, economists argue that when the movement of money between countries is smooth, it is best to either adopt a floating rate or set a rate domestically, but not both. And that (among other reasons) is why they avoid a system which is entirely fixed.

The economy is heavily dependent on currency manipulation. In this system, a country may let its exchange depreciate to any extent required to clear the foreign exchanges market, which the Gold Standard wouldn't allow.

And while it's argued that a floating exchange rate gives currencies more independence, the discussion has shown it's not quite so simple as being an issue of independence – especially when countries across the world receive and repay their debt in dollars (for which they need to have dollars in their foreign reserves).

"Around 70 per cent of countries have the US dollar as their anchor or reference currency. In this context, US dollar reserves are essential to managing the exchange rate. Countries linking their exchange rate to the US dollar include all of Latin America, China, most of the rest of Asia, Africa and the former Soviet Union. This linkage is often motivated by foreign policy and security ties to the United States." (Source)

So, the US uses this system to maintain its power.

In this system, the USA's legitimacy (which is derived from a multitude of avenues, including their centrality to the international system), allows them to maintain the dollar's power.

The artificial value of the dollar is much more than it would be in a Gold Based System, and due to its demand, especially in times of crisis, the USA maintains its position as a global hegemon.

"The structural increase in the demand to hold US dollar safe assets is augmented by cyclical demand during times of economic stress, not least in the United States. Although the financial crisis of 2008 was centred on the US economy, the US dollar exchange rate rose during the crisis on safe-haven flows because US dollar assets remained a relatively safer bet." (Source)

The US Dollar is still the dominant currency in most economic transactions- including global debt issuance, invoicing and payments, foreign currency reserves, managed exchange rate regimes, and foreign currency turnover and settlements.

And it "accounts for 63 per cent of outstanding debt securities globally. US capital markets provide a home to much of the world's saving, ranging from China's foreign exchange reserves to the retirement savings of Australians. US dollar-denominated debt issuance allows both domestic and foreign companies to tap America's deep and liquid *capital markets. The US dollar capital raised can be more easily spent than funds raised in other currencies." (Source)*

All of this gives them a power within the current system, which they wouldn't enjoy in a gold based system as it relies on their ability to ensure that there is a continuous flow of dollars across the world.

To go back would be to their disadvantage.

To switch back to the Gold Based system- even a diluted form – would call for major reform. If they saw the advantage in this, it's something they wouldn't hesitate to do. But moving to a Gold Standard would require other countries to do the same, which comes with its own set of complications.

And to move to a system where the dollar is backed by gold would mean limiting their ability to manipulate the economy. It would also put them at a disadvantage because the USA would need to have enough gold that they feel confident in retaining their hegemonic position in the world order- which they don't. It's one of the major reasons why they moved away from the 'Gold Exchange Standard' in the first place.

"At the time of the Bretton Woods Agreement, the United States held about three-quarters of the world's official gold reserves. But after that the U.S. share of world output decreased and so did the need for dollars, making converting those dollars to gold more desirable. The deteriorating U.S. balance of payments, combined with military spending and foreign aid, resulted in a large supply of dollars around the world. Meanwhile, the gold supply had increased only marginally. Eventually, there were more foreign-held dollars than the United States had gold. The country was vulnerable to a run on gold and there was a loss of confidence in the U.S. government's ability to meet its obligations, thereby threatening both the dollar's position as reserve currency." (Source)

And now, while *"the U.S. mines have a lot of gold, we're not the biggest producer…The bigger suppliers of gold would have more control over our monetary policy." (Source)*

This is made even worse by the fact that the USA owes large chunks of money to other countries like China and Japan (who bought US national debt). If the USA returns to the Gold Standard, i.e. backs their currency to gold, then these countries could ask for the debt that's owed to them to be paid in gold.

It's true that the other powerful countries have an interest in maintaining the current system, as they derive their power from it. (And that means maintaining the Dollar's hegemony) but that power, and that interest is tied to the dollar as a fiat currency – as having fiat currencies have advantages for them too. For example, China has also found ways to manipulate the economy to their advantage in trade.

Their power depends on a lack of intrinsic value, so they abolished the Gold Standard

The demise of the Gold Standard dates back to the early 1900's. The USA, with the agreement of other countries, took steps to move away from a Gold Standard to a fiat currency, augmenting their power and influence in the Capitalist System.

Countries began to move away from the Gold Standard as they began to run out of gold reserves and wanted to print large amounts of paper currency to support their war efforts. But the shift from a Gold Based Currency to a Fiat Currency didn't happen straight away.

One of the major reasons for the economic instability was that, especially after the World Wars began, none of the countries followed the tenants of the Gold Standard, as shown through the policy decisions that they made at the time, limiting the use of gold in their economic dealings. So, they moved from a Gold Standard to a Gold Exchange Standard, which also forced countries (most importantly the USA) to make choices between its international and domestic objectives. And in 1933, with the devaluation of the dollar, the United States established the principle that domestic policy objectives had primacy over the dictates of the gold standard.

The initial proposal for the Gold 'Exchange' Standard was put forth at the 1922 Genoa Conference. It was designed to downplaying the role of gold and limiting its demand, and called for the creation of central banks in countries that did not have one, and established reserve currencies as a foreign exchange in lieu of gold. This system failed, in 1931, in the midst of the Great Depression, with the UK exiting the system and other countries following their lead.

Then after the Second World War, the commercial nations made another attempt to reform the international payment system, along the principles of the Genoa Conference. The 1944 exchange system became known as the Bretton Woods system of fixed exchange rates. The objective was foster international cooperation; promoting exchange rates stability, removing exchange controls and barriers to trade and capital, and preventing beggar-thy-neighbor policies.

The agreement tied currencies to the US Dollar, which was linked to gold. The U.S. dollars were convertible to gold at a fixed exchange rate of $35 an ounce, and the US had the responsibility of keeping the dollar price of gold fixed and had to adjust the supply of dollars to maintain confidence in future gold convertibility.

The agreement also established the International Monetary Fund (IMF) to regulate the system; acting as a lender of last resort and preventing deflationary adjustments. A country had to maintain a rate of exchange that was fixed with relation to the US dollar, and rely temporarily on borrowing from the IMF to make a transition to equilibrium. Each country had to define its currency in relation to the US dollar and peg it at par with a spread of ±1 percent reminiscent of the gold points of the classical gold system; each country was allowed to devalue up to 10 percent if necessitated by a fundamental disequilibrium. And an adjustment beyond 10 percent had to be approved by the IMF.

When the USA decided to peg the dollar to the Gold Standard, it was to their benefit. They held an overwhelming majority of world central bank monetary gold reserves. But when the Nixon administration came into office in 1969, they realized that the world economy had grown very, very big. Everybody wanted dollars, so the Federal Reserve was printing lots of dollars. As a result, there were four times as many dollars in circulation as there was gold in reserves. The rate of $35 for an ounce of gold was good in 1944, but it hadn't changed, so by 1971, the dollar was really overvalued. That meant imports were very cheap, and exports were very expensive. And as a result, they experienced their first trade deficit since the 19th century and were also experiencing employment problems. (Source)

When they dropped the Gold Standard in 1971, "the levels of US securities held by foreign central banks were becoming unsustainable for the United States with a currency fixed to the value of gold." And countries like Britain were demanding their dollar holdings be paid in gold.

But despite the fact that the USA finances were in a precarious state, the rest of the world didn't have a reason to move away from the dollar (especially as the structure of the international system was in place by this time). They were the only viable option for international exchanges and the USA possessed the necessary political control over financial institutions that would facilitate the capital flows required by a global reserve currency.

If the Gold Based System was left in the past, will it work in the Khilafah?

There is no reason that the Gold Standard wouldn't work under the Khilafah. As we've discussed, the problems with the gold/ silver backed currency lie in the system, and how the countries chose to manipulate the Gold Standard to their benefit.

We need to understand that in Islam we are not allowed to have fiat currency. Our currency has to be 100% backed by gold and silver, as we will have a dual metallic standard. So, unlike the currency that's operating in the world today, the Bait ul-Mal (State Treasury) won't be allowed to print any money unless it has the corresponding amounts of gold and silver in its reserves.

We will also have the same domestic and international currency. So, people inside and outside the Khilafah deal in the same units unlike the situation today. By making sure that both the domestic and foreign currency is the same for all the transactions in the Khilafah, we will lend stability to our dual metallic currency.

And by using the gold and silver system, we will increase the quantity of currency in circulation for transactions. This is because there are two precious metals in circulation as opposed to one. This would remove the fear of monopolising the metal currency available in the market, which, in turn will contribute to price stability. It's possible to have price stability when using single-metal currency, but there will be greater stability when we use the bimetallic standard.

The availability of gold and silver will not be a problem as the Muslim lands have gold; it's just being stolen by private companies and Capitalist governments. But as Muslims, we understand that gold and silver, that is available on Muslim lands, is a property of the Ummah which is managed by the state. The state will handle the extraction of gold and silver, not just the legal currency that is based on it. This is because the underground metals are categorized as public property. So, we will also develop our manufacturing capabilities and so on to ensure that we are in complete control of our currency. The fact that gold and silver are public property makes it impossible for private companies to take ownership of gold, or hoard it to drive up the price and use it for their own profit.

The Bait ul Maal will then manage the economy, implementing and working according to the laws of Islam. As an example, if the price for certain commodities increases in a state's province, then the state must return it to its equilibrium state by transporting the commodity from other provinces and restoring its supply in the markets. It is considered as caring after the affairs of the Ummah, and they are forbidden to fix the prices.

Thus, the currency will be used for the betterment of the citizens within the Khilafah's lands, not to line the pockets of corrupt entities and ensure the continued colonialization over the rest of the world.

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