United Gold Direct

World must abandon paper reserve currencies

Today's dollar has lost 85% of its value since 1971 and relative to gold that dollar has lost 96% of its purchasing power. The value of dollar has been decreasing over the years and the time will come when the world will need to abandon the paper reserve currencies.

By Lewis E. Lehrman
Sept. 26, 2011, 10:32 a.m. EDT
Market Watch

GREENWICH, Conn. (MarketWatch) — Federal budget deficits and balance-of-payment deficits have radically increased since World War II. Today's dollar has lost 85% of its value since 1971. Relative to gold the dollar has lost 96% of its purchasing power.

But America has experienced sustained inflation and deindustrialization because of the overvalued reserve currency role of the dollar, overvalued relative to other paper currencies, especially the Chinese yuan USDCNY +0.19%.

While China is an important trading partner of America, it may also be a mortal threat. The Chinese economy is subsidized and sustained by the pegged, undervalued, yuan-dollar exchange rate. Neither the United States nor China seem to grasp the long-term, destructive consequences of the world dollar standard. The Chinese financial system has been corrupted by tyranny, deceit, and reckless expansionism. But, like America, China is destabilized by the perverse workings of the world dollar standard.

Only monetary reform, including an end to the reserve currency system, can permanently correct the American, Chinese, and global disequilibrium. Without international monetary reform, the perverse effects of the dollar reserve currency system will continually metastasize into one financial and political crisis after another — even on the scale of the Great Recession of 2007–09. Currency wars, protectionism, and social instability will intensify.

Currently, China holds more than $3 trillion of official reserves and more than $1 trillion in U.S. government securities. These Chinese dollar reserves, earned by export surpluses, directly finance the American federal budget and balance-of-payments deficits. China has chosen to hold a significant fraction of its export surplus in the form of official dollar reserves. These dollars are promptly re-deposited in the U.S. dollar market, where they are used to finance U.S. budget and balance-of-payments deficits.

The reserve currency system of the paper dollar, whereby Chinese surplus dollars are reinvested in the United States, ignites inflation by multiplying purchasing power in China and the U.S., without associated equal production of new goods and services during the same market period. Thus, total spending, or purchasing power, exceeds the total value of goods and services at prevailing prices. When total demand exceeds total supply, the price level must rise.

The "exorbitant privilege" of the dollar is matched by the insupportable burden of America's overvalued reserve currency role, which since World War II has tended to deindustrialize the United States. The official dollar reserves held by China amount to a massive mortgage on the work and income of present and future American citizens, gradually increasing social inequality by reducing the standard of living of lower- and middle-income families, even while the banker, speculator, and governing class is enriched.

The Fed's response is to depreciate the dollar in the hope of eliminating the balance-of-payments deficit — by becoming more competitive abroad as America becomes poorer at home. The perversity of the official reserve currency system is endless.

Ultimately America, must choose between two options:

1.) The United States can wait for the eventual demise of the world dollar standard under chaotic conditions.

2.) Or, America could take the lead in reforming the official reserve currency system based on the dollar.

Such a monetary reform program would entail a careful windup, by agreement, of the world dollar standard. At the same time, America would reestablish by statute a dollar convertible to gold, i.e., a dollar defined in law as a weight unit of gold. Gold would replace the dollar as the world's reserve currency. The reform would, first and foremost, establish a tested, non-national, impartial monetary standard as the basis of a stable dollar — one which reasonable sovereign trading partners could accept. Gold would become the international settlements currency, replacing the dollar as the basis of world trade and finance. Inasmuch as monetary history shows that no unstable national currency can permanently serve as the crucial world reserve currency, it follows that neither can an unstable basket of national currencies, nor can a fiction such as the SDR.

After the failures of several generations of unhinged paper-credit currencies, pegged and floating exchange rates, America should embrace a stable monetary system tested in the laboratory of human history — the cornerstone of which the elites have rejected for a century. It is time to restore the true gold standard, shorn of the economic pathology of official reserve currencies. It is time to restore the American monetary standard anticipated by the founders in the Constitution. What the Founders learned from the paper money inflation of the Revolution, the recent past has taught us again.

America and the world need a monetary standard which, unlike the paper-credit dollar, cannot be created at zero marginal cost with which to subsidize the U.S. government and insolvent financial institutions at near zero interest rates.

For America to establish the gold standard would provide the least imperfect monetary solution to the problems of a century of financial disorder.