Role of gold in central banking

Abstract

The first chapter is devoted to the characteristics of central banks as institutions that have a monopoly on the issue of cash money, conduct monetary policy and regulate the banking system. The first central banks emerged in the 17th century. However, they differed from the contemporary central banks. Their primary task was to provide financial resources to the sovereign. They gradually gained more power over time and became the central banks that exist today. Contemporary central banks usually have powers such as issuing cash money, conducting monetary policy, regulation and supervision of the banking sector. Central banks compile their balance sheets, which are statements of the amount and structure of assets and liabilities. Gold is among the items that appear on central bank balance sheets.

The second chapter is important for understanding how the gold standard function. It explains concepts such as the pure standard and the modified gold standard, which covers the gold bullion standard, the gold reserve standard and the gold exchange standard.

The third chapter describes the evolution of the gold standard since the 1930s when monetary blocks, consisting of states with similiar views on the continuation of the gold standard, were formed. These included the gold bloc, uniting countries such as France, Switzerland and Czechoslovakia; the sterling bloc composed mostly from Commonwealth countries, Japan or China; the dollar bloc Tripartite including countries from Central America and the Philippines; and the Tripartite Agreement associating the USA, France and the United Kingdom.

The fourth chapter is about the Bretton Woods monetary system. In 1944, a conference was organised in the American city of Bretton Woods at which a new monetary order was set. It was influenced the most by the proposals of the American White and the British Keynes. The International Monetary Fund was established. The US dollar became the main reserve currency and a fixed exchange rate was introduced with the possibility of offsetting any imbalances that might arise. The dollar became the only currency that could be exchanged for gold at the Federal Reserve System. However, only central banks and treasuries could exchange dollars for gold at the FED. Private entities had to trade gold on the London gold market.

The Bretton Woods system experienced its first major difficulties in the late 1950s and early 1960s. The US gold reserves were shrinking due to foreign central banks exchanging dollars for gold at the FED. In the second half of the 1960s, the US inflation was raising as a result of, among other things, involvement of the USA in the Vietnam War. There was global

fear of US economy problems. In 1961, the Gold Pool was created to keep the price of gold at an agreed level. The Golden Pool collapsed in 1968. In the same year, dual gold prices were introduced: a market price (freely formed by the market) and an official price for monetary purposes. The market price was significantly higher than the official price. In 1971, US President Nixon declared the end of the concertibility of the dollar into gold. This ended the era of the gold standard.

The fifth chapter is devoted to the problems of the Bretton Woods system – particularly to the problems of liquidity, confidence and adjustment. The breakdown of the Bretton Woods system was caused by factors such as distrust in the US dollar due to the American balance of payments deficit, inflation and currency speculation; the inability to maintain the price of gold at the agreed-upon rate of $35 per ounce; and the disconnection between the fixed market price of gold and the dollar stock.

The sixth chapter presents the arguments of proponents and opponents of the return of the gold standard. The fact is that the introduction of the gold standard means a reduction in the powers of central banks. The supporters of the gold standard take it as an advantage, whereas its detractors see it as a disadvantage. The proponents of the gold standard praise its anti-inflationary character. Opponents claim that there is not enough gold in the world. Proponents respond to this argument by saying that there is not too little gold in the world, but an excess of paper money. From the reintroduction of the gold standard would benefit the most countries with rich deposits of gold and countries that currently hold large gold reserves.

For the gold standard to be implemented, society-wide consensus would be necessary. Otherwise, it is unlikely that politicians would support its reintroduction. Citizens have become accustomed to various social programmes that require constant printing of money, which is incompatible with the gold standard.

The seventh chapter describes the factors why central banks hold gold in the 21st centrury. The reasons for holding gold include diversification of their portfolios, hedging agains inflation and the gold’s characteristic as a general store of value. The low risk of gold is also appreciated. It is worth mentioning that a great deal of interest in gold comes from countries that are concerned about financial sanctions. When a central bank has gold stored in its own country, this asset is immune to sanctions. The disadvantages of holding gold for central banks are the high costs of transportation, storage and security. Also, gold does not bear interest except for the gold deposit rate. Since the global financial crisis of 2008, central banks' gold reserves have been increasing. The year 2022 was a record year for gold purchases. It is expected that central banks will continue with gold purchases.