Assessing Role of Gold as World’s Reserve Currency in Terms of Uncertainty

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Abstract

Objectives: The research is aimed at extending the holistic theoretical concept of genesis and development of the global foreign exchange market. It also presents guidelines to reorganize the world monetary system, as well as a rationale for the author’s view of a place and a role of gold on the today’s world currency market (in terms of uncertainty). Methods/Analysis: Considering the methodological issues within the examined problem, the authors were supported by principles of the modern economic theory. The research was based on the system analysis; specific problems were solved with the help of the comparative, statistical and graphical analyses, using ranking and clustering methods. Results: The paper has presented an analysis for the current situation with the reserve currency, the US dollar, and given ideas of its possible reorientation towards gold as a more stable reserve asset in the global financial and currency markets. The authors have concluded that in the current conditions in the global foreign exchange market, there is no alternative to the existing reserve currency, the US dollar, but there is an opportunity to return the gold or e-gold as a reserve currency or a currency unit of account as a basic element within the global monetary system. Novelty/Improvements: There are the authors’ views on the current state of gold in the world and national monetary systems; the possibility has been proven to return the functions of the world’s money and a single international payment instrument to gold.

Keywords: Gold Exchange Standard, Gold Value Standard, Monetary Gold, World Monetary System

1. Introduction

So far, there has been an identified need in large-scale reforms to the global monetary system, which has been still running according to the latest guidelines and regulations, developed within the Jamaican currency system as early as in 1979, the matter is that such principles are no longer relevant and do not meet today’s realise in the global monetary system.

The global financial and currency market has recently faced major shocks associated with a prolonged stay of the US dollar as a reserve currency, with the dramatic volatility of euro as a single European currency, with new alignment of forces in the global currency market.

According to famous Russian researcher a global threat is the conceptual framework of the Jamaican currency system, mainly aimed at recommendations of monetarism and boundless liberalization, which have led to the weaker inter-state monetary and credit control. The global financial and economic crisis has revealed inefficiency of the IMF as an institution for such control, only applied to the developing borrowing countries, excluding the developed countries, the United States among them, as they have ceased their borrowing from the Fund¹.

As the history shows, the crisis within the world monetary system generates various initiatives to reform it. For instance, in terms of crisis in the Bretton Woods monetary system, there were hot discussions on projects to make a common reserve currency, issue a single global currency, based on gold and commodities, and increase a role of gold in the international monetary system up to a recovery of the gold standard. The certain historical continuity of the discussed proposals to reform the Jamaican currency system is standing out. This includes keeping a

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single-currency system based on the US dollar; making a two-track system, based on the US dollar and EURO; making the multi-currency system, based on the currency most used in the world economy; introducing the system based on regional currencies; an increased use of SDRs as a single reserve currency; a return to the gold standard; establishing the multiple-product standard. We believe that some of these proposals are unpromising. Keeping the dollar standard, typical for America centrisms, conflicts with an incline towards polycentrism in today's global economy. The idea of the multiple-product standard conflicts with a purpose of the global monetary system, i.e. a choice of a specific functional form of the world money instead of goods. The proposal to restore the gold standard cancelled by all the countries in the global economic crisis of 1929-1933 and later, is unhistorical. The current crisis has driven the more intensive discussions on reforms to the global monetary system. To implement this current initiative, it makes sense to justify conceptual approaches to a development of the draft reform within the world monetary system in accordance with the principle common in fundamental economics that says that 'the principle defines the rules'. Sustainability in the world monetary system, as evidenced by a retrospective analysis of its development, depends on a degree of compliance of its structural principles to national interests. In this regard, a priority of the reproduction criterion to evaluate a status of the valid world currency system enables systematic structuring for specific areas in reforms to its structural principles. At the same time, it is essential to take into account specifics of the current reproduction process. Influenced by globalization in finance that leaves behind economic globalization, a disparity has increased between a development of the real production and the financial sector of economy. This is facilitated by the liberal conceptual framework for functioning of the global financial market and the global monetary system. Russian researcher Krasavina believes that the most acceptable option to reform the Jamaican currency system relies on a relation between its two methods. Firstly, following a line of drastic updates to its structural principles replacing outdated principles with the new ones. Secondly, adherence to the principles in their historical continuity, which can be adjusted to today's conditions in the world to meet interests of the majority of countries. The relationship of both methods, the drastic and adjective, defines the conceptual approach to reforms of the structural principles within the world monetary system. So far, the issue of role performed by monetary gold has again become relevant. This is driven by demand for gold as real reserve assets, as volatility of world currencies has increased (US dollar and EURO). The price of gold has reached a record level, from USD 1,141 per troy ounce in November 2014, to USD 1,230.6 in December 2014. Crisis shocks have set a direction for a reform to the global monetary system, associated with predicting a fate of gold. A disputable nature of this problem depends on a contradiction between a formal exclusion of gold from the Jamaican currency system and its actual use as an international reserve asset. Despite claims by many practitioners and analysts of "a descending reserve role of gold" and a total rejection of this reserve asset, central banks all over the world keep in their reserves about 30,000 tons of gold that is about 18% of the ever-mined world's gold reserves, estimated at a level of 165,000 tonnes. Central banks in the developed countries with the largest Gold and Foreign Exchange Reserves have a leading role in the process (GFER). According to the World Gold Council's data, in 2013, a demand for gold in China was 428 tons, while own production was only 314 tons. Secondary metal production from scrap gold does not cover a difference that arises. A similar trend is observed in other south-eastern countries, such as Malaysia. The Chinese government has only recently allowed its citizens to invest in gold, so they are not inclined to part with it even with an increase in its price. But actually, a gap between the national demand and supply in China is even larger, as China usually makes rare updates to the statistics for public gold purchases. So, in 2014, for the first time since 2003, the People's Bank of China informed countries that it had increased the government gold reserves in China from 454 to 1,054 tons. It is worth mentioning in addition that in China in 2008, there was a meeting of a special-purpose expert group. Its recommendation was to increase the Chinese gold reserves to 6,000 tonnes for next 3-5 years and possibly up to 10,000 tonnes in 8-10 years. However, the matter is that even the fantastic figure of 10,000 tons (it is to be recalled that the United States gold reserves is the world's largest with 8,133 tonnes) at valid gold prices will mean a share of just over 15% of China's gold and foreign exchange reserves. China possesses enough US dollar and other foreign currency assets in its reserves, but an attempt to buy gold in such quantity will reverse its price. Nevertheless, an interest in gold in China has not only been growing from the part of the government. According to the World Gold Council's data, a share of China in the
world demand for gold has increased from 5% in 2002 to 15% in 2014. On average, over the recent five years, the demand for gold in China has annually grown by 13%. In 2014, China was the only country in the world, where the demand for gold jewellery did not only show any decline, but increased by 6%. Investments in gold coins and gold bars increased in the same year by 22%. Upon that, it is worth mentioning that about 80% gold jewellery purchased by the Chinese are triple nine and regarded as an investment.

In terms of an annual demand for gold per capita (not including governmental supply build-up), China with the index of 0.33 grams in 2014, was lagging behind many countries in the world, including India, South Korea, Russia, the USA, the UK, Japan and Italy. However, this figure has doubled since 2012, despite an about 50 million-increase in population and in the gold price in US dollars by 216% for the same time.11

A rapid economic growth, yuan strengthening, an increase in a number and the higher well-being of the social group of the rich and the middle class, a traditional cultural predisposition to gold among the Chinese, the high standard of savings among the population, the government policy of the liberalization and the development on the national market of precious metals and diversification of foreign exchange reserves are the factors that will drive the higher demand for gold in China.12 Thus, the World Gold Council predicts doubling in a demand for gold in China for next ten years, and this year it has even entered into an agreement with the China's largest Industrial & Commercial Bank of China (ICBC) on cooperation to promote gold investments in China.13

In view of the abovementioned, the research and the paper itself are aimed at:

- Proving that a return of gold or the gold exchange standard into the global monetary system and the global foreign exchange market is possible;
- Proving that today the US dollar is failing to function as a reserve currency;
- Making recommendations to revise the IMF principles in terms of a status definition for a reserve currency or establishing a process of asymmetry for the reserve currency.

2. Methodology

In a process of research, the authors used publication's issued by IMF and IBRD, reporting information published by leading rating agencies. The research was also based on the system-oriented analysis; specific problems were solved with the help of the comparative, statistical and graphical analyses with ranking and clustering methods.

The theoretical and methodological basis included papers researchers that show patterns in functioning and the development of the global foreign exchange market, monetary-and-credit and foreign exchange aspects in the national economic policy.

Changes to the current state in the global monetary and financial system and development trends on the global foreign exchange market, considered in the research, were discussed in layman's terms in papers by Russian economists and practitioners in this field.

The range of issues raised in this paper, was repeatedly described and explored by famous Russian researchers, but these authors support the existing reserve currency, the US dollar, and do not offer an alternative for it, in comparison to the authors of this paper, who do this with gold or the gold exchange standard.

3. Results and Discussion

It is well-known that in the 1980-90-ies, there was formal demonetization of gold with elimination of its formal cash functions in the international monetary system set by the agreement. There was an immediate issue appeared about a role of gold. A cancelled formal price of gold completely makes its free price legal. The real purchasing or payment power of gold reserves has been increasing. There is an opportunity for central banks to sell or purchase gold at a high market price. It turns out that the reserve function of gold has not been reducing, but even increasing as it is clear that it is impossible to regulate the function of gold with any international agreement. The IMF Articles of Agreement is silent on the issue: nothing is said about a role of gold as a means of international reserves, there is no mention as well of a cancellation of the role. We believe that the IMF should review its positions on the role of gold in the world currency market and give it a new status as an emergency reserve resource.

A demand for gold has increased by 30% over the past ten years. Today, the global demand is over the rate from the early 1990-ies, when the price of gold reached record values, USD 1,850 per troy ounce. This is shown in Table 1. According to various estimates, a gap between levels of demand and gold production from mining is from 500 to 1,700 tons annually.
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Herewith, in 1995-2000, the price of gold fell from USD 388 to 273 per ounce troy, while in 2001-2015, it increased again to the level of USD 300-1450 per ounce troy, as shown in Figure 1.

Each party traditionally opposing others in a dispute of gold was able to interpret and interpreted its new status as implementation of its principles and objectives. The US ‘demonetisers’ argued that there was an implemented idea of the monetary system, separated from the spontaneous gold factor and subject to flexible international control. At the same time, the French ‘metallists’ focused on legalizing the high market price of gold and an increase in its real reserve and payment potential.

Like the reform itself, further developments in the field of gold are ambiguous. On the one hand, gold has been no longer a basis for the international currency system. It acts as a commodity with a price, changeable in the market, like prices for other products. On the other hand, a potential and real economic role of gold has increased owing to repeated increases in the gold price, while in its function of international reserves it has demonstrated its advantages against inflationary national currencies and the international credit money. This dichotomy is important for the gold’s future. In our view, a dual role of gold in the current environment might have both a negative and a positive impact on price policies of countries that are active participants to the stock exchange and the world’s gold exchange, as sharp fluctuations of gold prices in 2011-2013 influenced an overall balance of the world foreign exchange market.

The economists adhering to opposing views on economic functions and the future of gold may in quite a different way interpret all the facts mentioned above. Those, who believe that gold demonetization is a main development trend, argue that sales of gold at significantly fluctuating market prices indicate a conversion of gold into a commodity, a decrease in its monetary functions. Those who deny demonetization, by contrast, see an evidence of gold’s monetary functions saved and increased in an expansion of transactions with gold and an increase of its price in paper currency. These differences at least indicate that a problem of gold’s economic role has remained pressing and complex yet.

On the other hand, it should be said that an increase in the gold price in USD in a med-term and long-term aspects is almost inevitable, while an increase in its purchasing power is quite possible.

Due to gold turning into an object of intense speculation, especially on markets of the futures, it has become common in the Western countries to forecast the gold price. As far as in the same time, the price depends on multiple factors that can make changes to intensity and

| Indicators         | Volume of operations | In % of total |
|--------------------|----------------------|---------------|
|                    | 90-ies | Early 2000-ies | 2010-2015 | 1990-ies | Early 2000-ies | 2010-2015 |
| Demand             |        |                |          |          |                |           |
| Fabrication        | 14.2   | 16.3           | 32.9     | 81.3     | 77.5           | 86.0       |
| Investment         | 2.9    | 3.7            | 3.1      | 16.5     | 17.6           | 8.3        |
| Government         | 0.4    | 1.0            | 2.2      | 2.2      | 4.9            | 5.7        |
| Total              | 17.5   | 21.0           | 38.2     | 100.0    | 100.0          | 100.0      |
| Supply             |        |                |          |          |                |           |
| Primary metal      | 12.9   | 15.0           | 23.3     | 60.6     | 64.4           | 61.0       |
| Secondary metal    | 4.6    | 6.0            | 14.9     | 39.4     | 35.6           | 39.0       |
| Total              | 17.5   | 21.0           | 38.2     | 100.0    | 100.0          | 100.0      |

![Figure 1. Gold prices in 2000-2015 (Average price, USD/Ounce)](image-url)
even a direction of their influence, many forecasts seem to be wrong. \(^{(20)}\)

The world money is a function that gold has retained for the longest period. This is quite a natural thing as a replacement of gold with paper credit money in the field, where there is no valid nation jurisdiction, is especially complicated and in today's circumstances hardly possible to its full degree.

Under current conditions, there are signs of an increasing international role of gold. However, we think that this role is different in its quality than in times of the classical gold standard, even within the framework of the Bretton Woods system. We believe that gold cannot be the basis of the monetary system, if the ratio between gold and paper currencies has not been fixed for relatively longer terms, if it is not a measure of currency values. This is what the present situation looks like. However, a role of gold in the world market has not been exhausted. Whatever conflicting interpretations the facts admitted about gold's involvement in international economic contacts, the monetary element in them has been kept and is able to increase. \(^{(18)}\)

Thus, so far, many countries in the world have been confused as they have been replenishing their foreign exchange reserves with the US currency, they cannot find their own place in a particular currency group. There has been neither specific guidance issued by the IMF, nor other international organizations, which should develop and submit reasonable solutions to monetary and financial situations, as it was done at the last Jamaica Conference, since which forty years have almost passed. Our recommendations come to this that it is necessary to hold another international conference on currency and finance to consider all the pressing challenges related to the current condition of the reserve currency and the increased role of gold in the world currency market.

In 2015, there was a slight rise in price of gold up to USD 1,274 per troy ounce compared to USD 1,269.88, forecasted for an end of 2014. In the end of 2014, an actual rate was USD 1,204.

A forecast for the gold price for the coming 2016 is considered from the available exchange dynamics. The lowering forecast says that the precious metal quotations will reach levels of USD 1,050 to 1,080 per ounce troy. \(^{(21)}\)

It should be also mentioned that the investment demand for gold as a real reserve asset has been still over a half of the aggregate demand in the global market, although it has decreased in its physical volume. A high proportion of gold in gold and foreign exchange reserves of the USA, Germany, France and Italy is also standing out.

The researchers and the politicians have recently demonstrated their incline towards the restored monetary functions of gold in one or another form. According to the supporters of a consolidated role of gold in currency systems at national and global levels, gold is able to protect the international community from negative phenomena in the financial sector, as today's paper assets have little or no intrinsic value, their market price depends on an influence of a wide range of factors that can cause both an unprecedented growth, and the full security for such assets. \(^{(5)}\)

Besides, the main disadvantage of the USD like any other paper currency thereon is that it is actually an IOU issued by the US Treasury. It serves as a tool of almost gratuitous reallocation of capital and other resources from other countries in favour of the USA. Gold as a 'non-national asset' with its own value does not have such a disadvantage, and has been still considered by many experts a kind of an alternative to the existing system of monetary, financial and credit institutions, established on paper debt securities.

At the same time, it is now possible to say that gold is not only a theoretical alternative to the existing system of monetary, financial and credit institutions, but also an action-oriented one.

The matter is that the developers of global computer financial systems have already reached an agreement that the world markets need a computer currency, independent from national economies. They have already started developing global electronic systems, able to settle accounts using digital gold in that part. \(^{(22)}\) We fully support the abovementioned option concerning a usage of digital gold and offer to use it as an alternative that will be a substitution for the reserve currency and the gold exchange standard. This fact should be discussed too at the next international conference.

We believe that in time of reforms to the global monetary system, in the Articles of Agreement of the IMF, it makes sense to confirm a status of gold as an international reserve asset, as well as principles that regulate transactions with gold made by central banks in accordance with the valid Washington Agreement on Gold.

So far, the global economy has entered a zone of risks, associated with a sharp change to major macroeconomic indicators. \(^{(23)}\) At a record pace, prices have been rising for
raw materials, mineral resources, household debts, the deficit in balance of payments of the USA, the world's largest economy, while the profit-making capacity of government bonds, by contrast, has been decreasing.

The today's situation is exacerbated with the fact that in terms of the globalized world economy, there is an imbalance between financial indicators of leading economic centres in the world. Thus, an unprecedented deficit in the US balance of payments comes up to 5.7% of GDP or more than 1.5% of global GDP. Such a situation is dangerous because of possible troubles for the country, which issues the main world currency that is the reserve currency, and the situation may lead to an irregular fall of the USD, which, in turn, will cause the chaos in all the financial markets.

In terms of the remaining strains in the world's financial markets, the paper assets, including stocks and the USD, have been getting cheaper.

To avoid losses, the investors buy commodities like gold, oil and metals. Their prices have reached record levels, and there have been recent changes to them almost on a day-to-day basis. However, this is also true for quotations of separate currencies, while for the others it assumes abysmal records. There have been recorded the latest round of commodity price rises and the dollar's fall on world's stock exchanges.

The country, the currency of which has an international status, that is, is in significant quantities concentrated in hands of the foreigners, receives a share premium in the form of a difference between a nominal value of banknotes and actual costs of their production. Thus, according to estimates made by the Deutsche Bank, about 50-60% US dollars circulating in cash are concentrated outside the country of their origin, while in general the USA revenues from an international demand for dollars come up to 0.1% of the country’s GDP.

However, so far a share of the USD in the global forex/gold holdings has fallen from a level of 80% in the mid-1970-ies to 65%. Herewith, we should also add the ‘twin deficits’ process, specific for the US economy, i.e., if we add the deficit in the balance of payments to the USA federal deficit, we will get so-called ‘twin deficits’.

In the last 3-4 years, against the background of a fall, the issue of the USD status as a world reserve currency has become relevant again. The government should have a powerful, flexible and diversified economy, deep financial markets, a large national market and be a leader in the field of innovative technologies for its national currency to become the world's reserve one. We believe that the US dollar has outlived as a reserve currency, that it has been losing its leading positions in the world financial and currency markets.

If at the end of the 1990-ies, they said about a possible substitution of the USD as an international reserve currency with EURO, now after recessions in specific states within the euro zone, this subject can be closed.

4. Conclusion

The paper has presented the authors’ view of a status of gold in the world and national monetary systems and given reasons for a possible return to the functions of gold as the world money and a common international means of payment in the global and national markets of currency. Based on the stated authors’ view of an asymmetry process for the reserve currency in the world monetary system, there has been proved a possibility of a refusal from the reserve currency in making international payment transactions. The research has also identified changes to a development of the global financial market and the global monetary system in terms of the globalized world economy.

The authors of this paper hope that researchers, practitioners in international affairs and college professors will use for their academic and executive summaries the findings and proposals to reform the world's monetary system and a balance of powers in the world arena, related to a role and an influence of gold and the reserve currency on other states, and the global financial market in general.

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