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Global Instability of Gold Prices: View from the State-corporation Hegemonic Stability Theory

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Abstract:

Purpose: *The purpose of this paper is an explanation of reasons of gold prices instability after the establishment of the free gold market in 1968-1974. Subject of the analysis, i.e. the gold has been chosen because of its big strategic importance as a reserve metal for states and business over the world. Therefore, prices of the gold are connected with the global political-economic situation.*
Design/Methodology/Approach: *The design is a new application of the theory of the state-corporation hegemonic stability, i.e. a new contemporary theory of international political economy. The research method is a describing political-economic analysis based on statistical data. Author analyses the gold prices in particular time periods and according to the state-corporation hegemonic stability theory.*
Findings: *According to presented point of view, fiat money in circulation and a lack of fixed gold exchange standard in connection with a relatively stable global political-economic situation are the most important reasons of unstable and relatively low market prices of the gold in long time periods. However, disturbances of the world system cause fast and relatively big growths of gold prices in short time periods. Therefore, the global instability of gold prices is a phenomenon of the contemporary world. A destruction of the global system or world war in the future can cause a big increase of gold prices. Moreover, in the longer run, a further growth of prices of the gold will be probably unavoidable because of inflation in spite of periods of their drops. A fiat money system without any established gold parity adds monetary advantages for the contemporary global market economy, i.e. opportunities to increase money supplies in spite of a lack of gold reserves. Therefore, according the state-corporation hegemonic stability theory, state-powers and biggest transnational corporations are not interested to change the fiat money standard into the gold money standard.*
Practical Implications: *The result can be considered for short-term and long-term investments in gold.*
Originality/Value: *Original research based on the new theory.*

Keywords: *Unstable gold prices, fiat money, the global system, the state-corporation hegemonic stability theory.*

JEL Classifications: *E31, E39.*

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1. Introduction

The purpose of this paper is an explanation of reasons of gold prices instability. Subject of the analysis, i.e. the gold have been chosen because of its big strategic importance as a reserve metal for states and business over the world. Therefore, prices of the gold are connected with the global political-economic situation. The research method is a describing political-economic analysis based on statistical data. The theoretical basis is the state-corporation hegemonic stability theory that stresses a view that the global system is maintained and stabilized by the global collective hegemony of state-powers and major transnational corporations (Staszczak, 2011; 2015). In this way, this hegemony is interested in maintaining the global fiat money system without the gold parity. They can be some reasons of hegemonic interests, e.g. opportunities to conduct more flexible monetary policy, especially during recessions or states and business needs to withdraw the majority of the gold from the human reserves. In this way gold is a strategic reserve of governments and transnational corporations. Moreover, an economic policy is not limited by gold stores directly.

There are many more profitable investments and possible speculations, e.g. stocks and shares than gold in the contemporary world. Moreover, a limited demand for the gold from state mints, within the framework of the contemporary fiat money system, forces lower real gold prices than prices in the gold money standard. Therefore, there will be verified the first hypothesis that fiat money standard and relatively stable the global political-economic situation promote comparatively low gold prices in longer time periods.

However, the gold is still a strategic metal that is required during big instabilities of the global political-economic situation. In such periods other investments and speculations, especially in stocks are very risky and dangerous activities. Therefore, the second verified hypothesis is that big disturbances of the global system promote big growths of gold prices in short time periods. The supply of gold is also dependent on a volume and size of gold mines and resources. A higher growth of fiat money than real output causes inflation. A growth of prices of many commodities in longer time periods promotes also a growth of the gold prices but not in the same scale. Therefore, the third verified hypothesis is that inflation connected with the fiat money standard cause a relatively slow increase of gold prices in long time periods.

2. Changes of Gold Prices in 1970s within the Framework of the Fiat Money Standard – Data Characteristic and Interpretation

A big growth of the annual average gold prices was observed in 1968-2012 from 39.31 U.S. dollars ($) per troy ounce (oz.) to 1668.78 $ per oz. However, this growth of the gold prices was not any stable and monotonous process. There were increases and drops dependent on the global political-economic situation (Historical, 2014;

Statista, 2018; Public Law 93-373, August 14, 1974, Stat. 2665). The first oil shock in 1973-1974 created the economic recession in 1974-1975 of the ideological West and the big growth of average gold prices to 154.00 $ per oz. in 1974 and to 160.86 $ per oz. in 1975 (Economic, 2014, Historical, 2014). Such a situation proves the second hypothesis. In the second part of the economic recession in 1975 the average gold price was only little higher than in 1974, in spite of the big U.S. annual inflation rate amounting 9.20%, (Economic, 2014, Historical, 2014, Inflation, 2014).

During the economic expansion in 1976-1979 (changes in the U.S. real GDP achieved 3.2% -5.5% annually) the average gold prices dropped only in 1976 and amounted to 124.74 $ per oz. and rose to 306.00 $ per oz. in 1979 (Economic, 2014, Historical, 2014). It was connected with a big growth of inflation rates from 5.75% to 11.22% (Inflation, 2014). Such a situation confirms the third hypothesis. The second oil shock in 1979-1980 and the big growth of the oil prices (Ikenberry, 1988) caused the next global recession in 1980 and in 1982 (changes in the U.S. real GDP achieved -0.2% and -1.9%), except the small economic recovery in 1981 (change in the U.S. real GDP achieved 2.6%), (Economic, 2014). The next event was the second cold war between the Soviet bloc and the ideological West in 1980s caused by Soviet invasion in Afghanistan in 1979 and war state in Poland in 1981 (Smith, 1992). In result, the average gold price increased rapidly and amounted 615.00 $ per oz. during the first part of the economic recession in 1980.

This high price was not pierced until 2007 (Historical, 2014). Such a situation was possible because of the speculation basing on the panic caused by the political crisis, economic recession and extreme high U.S. annual inflation rate amounting to 13,58% in 1980 connected with a loss of the people's faith in the fiat money. This situation confirms the second hypothesis. Moreover, Ronald Reagan hinted about his proposal to return to the gold standard during the presidential election campaign in 1980 (Floyd, 2012; Inflation, 2014).

Prospects of reestablishment of the gold standard could promote speculations influencing on the extreme growth of the gold prices. A possible success of such a proposal could cause a higher gold prices than in 1980. Such a situation proves that the gold price was too high within the framework of the only symbolic fiat money standard. Speculators who foresaw or were informed about unreality of reestablish the gold standard obtained enormous profits. People tried to escape from the fiat money to the gold in the beginning of disturbances of the global political-economic situation. However, during the next part of economic recession, many people had problems with low incomes compares to their spending and they were forced to sale their gold savings even with a loss because of the low prices.

3. Changes of Gold Prices in 1980s

A proposal to return to the gold standard was considered by the U.S. President Ronald Reagan who appointed a Gold Commission in 1981 in the aim to secure the economy from too much dollars into the circulation. However, a return to the gold standard was not accepted. Opponents of this solution argued that because of an inherent instability of market economy, the monetary authorities should have the opportunity to deliver enough money into the circulation in accordance with a changing situation. Moreover, a demand for gold would be higher and the world gold supply rose slowly at about 2% per year and it was not enough according to the growth of other production. Summarizing, a return to the gold standard was a difficult task. Firstly, the gold money makes impossible a controlled inflation that is characteristic for all contemporary economies over the world. Secondly, there are relatively low gold stores over the world and therefore, a return of circulated gold coins and connected with this fact a big growth of demand from many state mints must cause a big growth of gold prices (McConnell, 1987). Thirdly, there is no agreement of the strongest state-powers and transnational corporations for such a solution according to the state-corporation hegemonic stability theory (see Staszczak, 2011).

The next event influencing on big disturbances in the gold market in the beginning of 1980s was a change of monetary policy of the U.S.A. and other countries of the ideological West. Keynesian theory promoted a big growth of fiat money in the circulation and caused a big growth of inflation rates in 1970s. Therefore, it was changed for monetarist theory of Milton Friedman (1953) which stressed a limited growth of money volume to the economy. Therefore, lower inflation rates promoted a higher symbolic value of fiat money. During the small economic recovery in 1981 and the second part of the economic recession in 1982 the average annual gold prices dropped rapidly to 460.00 $ per oz. and to 376.00 $ per oz. It was a reaction against extreme high prices of the gold in 1980 (Historical, 2014).

Reaganomics (the economic politics of Ronald Reagan in 1981-1989) stimulated the big economic expansion since 1983-1990. The changes in the U.S. real GDP were extreme high and achieved 4.6% in 1983, 7.3% in 1984 and 4.2% in 1985 in the situation of relatively low U.S. annual inflation rates amounting 3.22-4.30%. Then average prices of the gold rose to 424.00 $ per oz. in 1983 and fell to 361 $ per oz. in 1984 and to 317.00 $ per oz. in 1985. Lower economic growth in 1986-1987 when changes in the U.S. real GDP achieved 3.5% promoted an increase of the gold average prices amounting to 368.00 and 447.00 $ per oz. respectively.

However, during a higher economic growth in 1988 and 1989 when changes in the U.S. real GDP achieved 4.2% and 3.7% the average gold prices decreased to 437.00 and to 381.00 $ per oz. Inflation rates were relatively low and amounting to 1.91-4.83% in 1986-1989 (Economic, 2014, Historical, 2014, Inflation, 2014). The above analysis shows that during the economic expansion the gold prices maintain on a relatively low and stable level in spite of political crisis, i.e. the second cold war. The prices of the gold usually rose during a smaller economic growth and dropped during a bigger economic growth. It means that the gold is more expensive when investors have no many possibilities for other investments and the gold is cheaper when investors have more other opportunities for alternative investments. This situation confirms the first hypothesis.

4. Changes of Gold Prices in the 1990s

The slower economic growth in 1990 and the small recession in 1991 (changes in the U.S. real GDP achieved -0.1% and inflation rate achieved 4.25%) did not cause any bigger changes of the prices of the gold (Economic, 2014; Historical, 2014; Inflation, 2014). It was connected with a fact that the recession had a gentle character and that the U.S. and other Western investors obtained many opportunities for more attractive investments in the former Soviet bloc countries. A destruction of the Soviet bloc and communism in Europe in 1989-1991 caused the second détente period between ideological West and Russia.

There were also no big changes in the gold prices during the economic expansion in 1992-2000 (changes in the U.S. real GDP achieved 2.7%-4.8% annually and the U.S. inflation rates were relatively low amounting to 1.55-3.38%). The average gold prices maintain on a relative low and stable level from 343.82 to 384.00 $ per oz. until 1996 and dropped drastically in 1997-2000 from 331.02 to 279.11 $ per oz. The economic stagnancy in 2001 (changes in the U.S. real GDP achieved 1.0% and inflation rate amounted to 2.83%) promoted the next depreciation of the gold to the extreme low average price amounting to 271.04 $ per oz. (Economic, 2014; Historical, 2014; Inflation, 2014). Such a situation could be connected with the both U.S. and Western more attractive investments in the former Soviet bloc countries and speculations.

Moreover, the economic recession in Asia in the late 1990s, (that affected the U.S. and European economies in a smaller scale) caused a drop of the global demand for the gold and opportunities of other more attractive investments for the U.S. and European capital in Asia. Capital transfers to the former communist countries caused a slower economic growth of the ideological West. Moreover, economic reforms in the former Soviet bloc caused a big unemployment. Therefore, many people over the world had financial problems and sold their gold savings. Speculators could maintain a demand on the gold in a relative low level in the aim to extreme reduce its prices. A relatively stable global political-economic situation, and peace in the most important parts of the World and excellent relations between ideological West and Russia promoted a drop of gold prices too. This situation proves the first hypothesis. According to Author’s opinion, the above described period was characterized by undervalued prices of the gold. In this way, the gold was one of less profitable investments and savings.

5. Changes of Gold Prices in the Beginning of XXI Century

An increase of the international tension since September 11, 2001 and the wars in Iraq and Afghanistan promoted a slow economic growth in 2002-2007. Changes in the U.S. real GDP achieved 1.8% in 2002 and had a growing tendency until 2004 when achieved 3.8% but these changes were smaller later and achieved again 1.8% in 2007. The U.S. annual inflation rates were relatively low and achieved 1.59-3.39%. International system altered during this period because of the growing economic and political importance of China, Russia, India, Brazil and other countries (Staszczak, 2011).

Such a situation and inflation promoted am increasing tendency in the average gold prices which rose from 309.73 $ per oz. in 2002 to 409.72 $ per oz. in 2004 and to 695.39 $ per oz. in 2007, (Economic, 2014; Historical, 2014; Inflation, 2014). Thus, after 27 years, the nominal annual average gold price surpassed the average price from 1980. This big growth of the gold prices could be connected with their long time enormous undervaluation.

However, real gold prices in 2004-2007 were lower than in 1980 because of inflation. It could be explained by the fact that investments in houses, flats, stocks etc. were more profitable than investments in gold. Moreover, the U.S. dollar was one of the worst currencies over the world in 1999-2008. It was connected with the U.S. dollar depreciation versus all major currencies in this period (Staszczak, 2015). Such s situation, connected with a slow growth of undervalued gold prices, confirms the third hypothesis.

The global situation was changed by the recession in 2008-2009 which was characterized by changes in the real GDP achieving -0.3% and -2.8% in the U.S.A. and 0.4% and -4.3% in EU. The annual inflation rates achieved 3.85% and -0.34% in the U.S.A. and 3.3% and 0.3% in the euro area. The unemployment rates achieved 5.8% and 9.3% in the U.S.A. and 7.0% and 9.0% in EU. This recession was replaced by a short and small recovery in 2010 was characterized by changes in the real GDP achieving 2.5% in the U.S.A. and 2.1% in EU. The annual inflation rates achieved 1.64% in the U.S.A. and 1.6% in the euro area. The unemployment rates achieved 9.6% in the U.S.A. and 9.6% in EU (10.1% in euro area).

The recession returned to the U.S.A. in 2011 and to EU in 2012. Changes in the U.S. real GDP achieved 1.6% during the whole year 2011 but in the first quarter the changes achieved -1.3% so it was a drop of the real GDP, i.e. a continuation of the economic recession. The U.S. inflation rate achieved 3.16% in 2011. Changes in the EU real GDP achieved -0.4% in 2012. The annual average prices of the gold increased during this recession and post-recession period 2008-2012 from 871.96 $ per oz. to 1668.98 $ per oz. Moreover, the annual average gold price rose in each particular year of this period and amounted to 972.35 $ per oz. in 2009, 1224.53 $ per oz. in 2010 and 1571.52 $ per oz. in 2011. The nominal price of the gold in 2012 was the highest in the history (Economic, 2014; 2017; Eurostat, 2014; 2018; Historical, 2014; Statista, 2018).

Such an extraordinary situation of a stable and longtime growth of gold prices during the recession and post-recession period of 2008-2012 was possible because of a big decrease of prices of overvalued real estates and stocks after 2008. Gold prices were still relatively low in spite of their big growth after 2001. It was connected with more profitable investment in Central and Eastern Europe after 1989 and 1991 (i.e. after a destruction of communist system and market reforms) and with a speculation bubble (i.e. bad credits that promoted overvalued prices of stocks and real estates) until 2008. The speculation bubble was a major reason of the recession and it caused a big risk of other investments, especially in stocks and usually safe houses and flats.

Therefore, the gold seemed to be a safe reserve. Additionally, the U.S. dollar was still a relatively weak currency in 2008-2011, i.e. the U.S. dollar exchange rates depreciated versus most major currencies, except euro and British pound. It was a continuation of the U.S. dollar depreciation from 1999 (Staszczak, 2015). Moreover, the third oil shock in 2008 was an additional reason of the global recession and it caused a big growth of oil and fuels prices (Staszczak, 2017) that are usually correlated with gold prices.

A speculative influence on gold prices in 2012 had a proposal Republican candidate for the U.S. president Newt Gingrich to get back to hard (gold) money. It was a similar utterance to the proposal of Ronald Reagan in 1980 (Floyd, 2012) but its influence on the gold prices in long time period was lower because of a little probability of its realization. Such an extraordinary situation in 2008-2012 confirmed the second hypothesis but not precisely because of the long time period of increasing gold prices. The second hypothesis concerns disturbances of the global political-economic situation in short time periods.

The newest economic recovery characterized a slow growth in the real GDP achieving 1.7-2.5% in the U.S.A. and 0.3-2.3% in EU in 2013-2016. However, changes in real GDP achieved -0.2% in euro zone in 2013. The U.S. unemployment rate dropped from 7.4% in 2013 to 5.3% in 2015 and the EU unemployment rates and decreased from 10.9 % in 2013 to 7.7% in 2017. However, the unemployment rate was very high in Spain and achieved 24.5% and in Greece and achieved 26.5% in 2014. Therefore, the recession did not finish in all countries in 2013-2014. The annual average gold prices dropped from 1411.23 $ per oz. in 2013 to 1160.06 $ per oz. in 2015 and increased to 1257.12 $ per oz. in 2017 and to 1268.49 $ per oz. in 2018 (Economic, 2017; Eurostat, 2016; 2018; Statista, 2018; 2019).

Relatively low gold prices in 2013-2017 in comparison to high prices in 2011-2012 were connected with a relatively stable period in spite of a beginning of the third cold war between ideological West and Russia concerning the Ukrainian crisis in 2014. A long recession in many countries caused a per oz. in 2018 situation that people needed money for a purchase of necessary commodities and services and for paying taxes and debts etc. People usually are not able to live without food and any flat or house but they can live without the gold stores and jewelry.

Therefore, they began to sell their gold reserves and jewelry. Moreover, the earlier big growth of the gold prices connected with a difficult financial situation of many people promoted a fast growth of the gold mining. It was so called gold rush often connected with economic recession or information about new gold resources. Then people try to exploit new and old gold mines. In result, an increasing growth of the global supply of the gold from people savings and mines meets a limited demand from a small group of usually rich people that causes a drop or limit a growth of gold prices. Therefore, this period confirms the first hypothesis.

However, information about the slowed economic growth promoted the big growth of the oil prices since 1270.05 $ (minimum of 2019) to 1542.60 $ (maximum of 2019), (Macrotrends, 2019). A situation in 2019 confirms the second hypothesis.

6. Conclusions and Perspectives for Gold Prices

The most important reasons of the contemporary instability of gold prices and their relatively low levels are a low demand of state mints and a lack of big danger of the real world war and many possibilities of other investments. Nowadays, mintage of gold bars and coins is limited for investors (so called gold bullion coins) and for collectors (so called gold collector coins which except gold value include pictures of important persons, events, etc.). A fiat money, i.e. notes and electronic money promote a limitation of mints demand for the gold and its relatively low prices. The third cold war between ideological West and Russia started in 2014 and local wars in Iraq, Syria, Libya, Afghanistan and Ukraine stimulated a growth of the governments armaments spending and promoted a bigger economic growth in 2017.

Such a situation will create many opportunities of more attractive investments and will limit a growth of the gold prices. Therefore, there are usually relatively low and unstable gold prices. Moreover, various assets and foreign exchanges are often more convertible for fiat money than gold. Commissions to change foreign exchange and assets (e.g. shares and stocks) are less than to sale or buy the gold.

However, a growth of money in circulation and inflation rates cause a relatively slow growth of gold prices in the long run. In spite of this fact, the gold prices are undervalued because of a lack of gold coins in circulation or the fixed gold exchange standard. A return of the gold money standard would be a method to a big growth of these metal prices because of an enormous growth of state mints' demand but there is a little probability of this scenario in the near future. Such a solution requires a new agreement between state-powers and transnational corporations in this matter according to the state-corporation hegemonic stability theory. However, the contemporary fiat money system gives opportunities to increase money supplies to the economy in spite of a lack of gold reserves. Therefore, there are no important discussion and interest in this matter.

The other way for a big increase of the gold price could be a political danger of the global war and a long and enormous economic recession which could cause a lack of human faith in notes and assets. Such a negative scenario for the world cannot be an excluded event in the long time period because of the unstable world system and contradictory interests within the framework of the collective state-corporation hegemony.

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