Nixon's Colossal Monetary Error: The Verdict 40 Years Later

Forbes *By Charles Kadlec | Forbes – Mon, Aug 15, 2011*

Related Content

- 

  Nixon's Colossal Monetary Error: The Verdict 40 Years Later

Today, Aug. 15, 2011, is the 40th anniversary of President Richard Nixon's colossal error: severing the final link between the dollar and gold. No other single action by Nixon has had a more profound and deleterious effect on the American people. In the end, breaking the solemn promise that a dollar was worth 1/35th of an ounce of gold doomed his Presidency, and marked the beginning of the worst 40 years in American economic history.

The announcement itself was dramatic, contained in a Sunday evening address to the nation from the Oval Office. The promises made were profound and reflected the received wisdom of that day and today: unshackling the U.S. government from the requirement of maintaining the dollar's value in terms of gold would empower able men and women at the Federal Reserve to use monetary policy to increase the general prosperity of the American people.

Domestically, we were promised that the manipulation of quantity and value of a paper dollar would avoid costly recessions, provide high employment, and produce strong economic growth. Internationally, we were promised that the devaluation of the dollar would reduce our trade deficit and improve the international competitiveness of American workers and businesses. And, because trade was only one-tenth of the U.S. economy, all of this could be done while maintaining price stability.

Each and every one of these promises has been broken.

Since Nixon killed the gold standard, the unemployment rate has averaged over 6% and we have suffered the three worst recessions since the end of World War II. The unemployment rate averaged 8.5% in 1975, almost 10% in 1982, and has been above 8.8% for more than two years, with little evidence of any improvement ahead.

This performance is horrendous compared to the post World War II gold standard era, which lasted from 1947 to 1970. During those 21 years of economic ups and downs, unemployment averaged less than 5% and *never* rose above 7%.

Growth, too, has slowed. Since able men and women were given the power to manipulate the quantity and value of the dollar, real economic growth has averaged 2.9% a year – more than a full percentage point slower than the 4% growth rate during the post World War II gold standard era.

A 1% difference may not seem like much, but in reality it is the difference between prosperity and austerity. A growth rate of 3% creates just enough jobs for all new workers. A growth rate of 4% yields higher employment and a decline in the unemployment rate.

In addition, when compounded over 40 years, 1% slower growth under the paper dollar system has had a mind-boggling impact on all things that depend on the overall size of the U.S. economy. At 3% growth, the U.S. economy is about $8 trillion smaller than it would have been had we continued to experience the average growth rate prior to Nixon severing the link between dollar and gold. That implies that median family income today would be about $70,000, or nearly 50% higher than it is today.

It would also mean that the tax base – for the federal, state and local governments – would be approximately 50% bigger as well, generating a bounty of tax revenues that would make the current and projected fiscal challenges manageable without severe spending cuts or growth killing tax increases on working Americans.

And, what about the promise that devaluing the dollar would magically improve our competitive position? During the past 40 years, the dollar has fallen in value by more than 70% against the euro/German mark and the Japanese yen. The U.S. had a modest net export surplus in 1971 before Nixon started the dollar on its downward path. Today, we have a $405 billion trade deficit.

Finally, the dollar has done anything but keep its value. Today, the dollar is worth less than two dimes in buying power compared to the pre-Nixon dollar. And, with little reason to believe that the dollar will maintain even this paltry value, the average American family is left with no meaningful way to save for their children's education or their own retirement. We experience all of this in the form of financial insecurity and well-grounded anxiety about the future.

By contrast, a gold standard is extraordinarily good at maintaining the buying power of the dollar. From 1948 to 1967, inflation averaged less than 2% per year. Interest rates were low and stable, with the yield on AAA corporate bonds averaging less than 4%, providing a reasonable cost of funds to borrowers, and a fair return to savers.

Moreover, if Nixon and his successors had maintained the promise that a dollar was worth 1/35th of an ounce of gold, a barrel of oil today would sell for less than $2.50.

That's right, the whole notion of an energy crisis and the ever more intrusive government regulations dictating energy usage are based on the grand illusion that the price of oil has gone up more than 30 fold, when in fact, it is the dollar whose value has fallen relative to gold, oil, and all other goods and services over the past 40 years.

And finally, since Nixon killed the gold standard, the world has suffered from 12 financial crises, beginning with the oil shock of 1973 and culminating in the financial crisis of 2008-09 and now the debt crisis in Europe, and the growing deficit crisis in the U.S. Conversely, between 1947 and 1967, there was only one currency crisis, involving the British pound, and no major bank failures or Wall Street and corporate bailouts in the U.S.

The evidence is in. The great experiment of a paper dollar managed by able men and women has failed and failed miserably to keep any of its promises.

We have paid dearly for Nixon's colossal error. But this abhorrent deviation from a sound dollar can be corrected. The country -- and the world -- awaits the political leader who truly understands making the dollar as good as gold is vital to the prosperity, security and liberty of the American people, and who can therefore lead the country and the world forward to a 21st century gold standard.