The Day the Gold Standard Died: 50 Years On

By Kerry Pechter *Wed, Aug 11, 2021*

On August 16, 1971, I was cashing an American Express travelers check in a small bank in Melun, France. The tellers were nervous. Something huge had clearly just occurred in the macroeconomy.

The “gold standard” died 50 years ago this week. I witnessed the execution, in a sense, and I’ve spent a fair amount of time since then trying to understand what happened, why, and how well it explains today’s economy.

The date was August 16, 1971. The scene was a provincial bank in France. I had pedaled north from Fontainebleau that morning, following the Seine to Paris. At the outskirts of Melun, I leaned my bike with its saddlebags against a stone wall outside the bank and walked inside.

The teller seemed flustered, even panicky. Richard Nixon had taken dollar “off gold” the day before; she wasn’t sure how many francs to exchange for my $20 travelers check. Eventually, calmer, she gave me about four francs per dollar—the usual rate. I countersigned my check, pocketed the money and left.

“Bretton Woods,” and the eponymous financial treaty that the US had just broken, didn’t mean anything to me at the time. I had just spent ten picaresque weeks in southern Europe on a budget of about $10 a day, vaguely aware of why everything was so cheap. The future—the oil crisis and the “stagflationary” 70s—was still over the horizon.

A whistle-stop in New Hampshire

Mount Washington Hotel

Bretton Woods is a section of Carroll, New Hampshire, and the home of the still elegant Mount Washington Hotel. That's where, in July 1944, to escape the swelter of Washington, DC, for the cool White Mountains, the world's finance ministers met to replace an international monetary system whose perverse incentives helped cause two world wars in 30 years.

Or, rather, the ministers came to rubber-stamp the new dollar-based regime, designed mainly by the Roosevelt administration. Given America's economic strength and the fragility of Britain's empire near the end of World War II, America was in a position to replace England as the world's economic leader and the dollar to replace the pound as the world's "reserve" currency.

The dollar became a proxy for gold and a benchmark for all other currencies. Under the Bretton Woods agreement, the US (with 55% of the world's yellow bullion) was the only country that would exchange its money for gold on demand from foreign central banks. Dollars, backed by about $25 billion in gold, would and did help finance the economic recovery of a war-whacked world.

The boom—including the Baby Boom—lasted through the mid-1960s. By then, deep-pocketed Uncle Sam eventually spread so many dollars around the world (via wars and imports) that it couldn't afford to keep releasing ounces of gold for only $35—at least, not without cutting spending on Vietnam, raising interest rates, cutting imports, clamping controls on domestic wages and prices, and throwing the US economy into recession. With his eye on re-election in 1972, Nixon threw the gold standard under the bus instead of the US economy.

The Golden Key to Global Power

"The US commitment to $35 gold was the foundation of the international financial system set in place in Bretton Woods, New Hampshire, in the summer of 1944. The central understanding of Bretton Woods was that countries other than the United States would fix the *dollar* value of their currencies, while the US maintained the *gold* value of the dollar. The system worked as long as payments between the United States and the rest of the world approximately balanced but faltered when the US balance of payments started to deteriorate in the late 1950s. Some countries, believing the deterioration a temporary phenomenon, parked their accumulating dollar balances in Treasury bills. Others took up the Treasury's standing offer to sell gold at $35 an ounce." (Garbade, *After the Accord*, p. 4)

American presidents and British prime ministers "believed reserve currencies underpinned world power," even if not always "aware that the exercise of power on a global scale was eased by the use of their national currencies as important elements of other countries' reserves; that… the reserve role of their currencies permitted an expansive foreign policy and the acquisition of corporate empires overseas without an overriding concern for the foreign exchange costs thereby incurred; [or] that reserve currency status gave them leverage over states confronting serious balance-of-payments deficits." In any case, much American opinion "had come to regard [the $35 per ounce price of gold] as no less sacrosanct than the flag, the Constitution, Thanksgiving and blueberry pie." (Gowa, *Closing the Gold Window*, pp. 132-133)

In his 1981 book, ***The Money Lenders***, Anthony Sampson summarized the financial sea-change:

"The supremacy of American bankers was already questioned by the end of the sixties, as the balance of financial power was shifting. The world's confidence in the dollar, which lay at the basis of the Bretton Woods agreement, was undermined by the Vietnam War. The long boom of the West was faltering, with too much capacity and too little employment. The pound was devalued in 1968 followed by other currencies, which in turn undermined the strength of the dollar. American manufacturers were losing out against Europe and Japan; Japanese cars were beginning to roll into America. The United States showed a [trade] deficit for the first time since 1893." US gold reserves stabilized after slipping to about $10 billion in 1968, but the antagonism between the gold standard and the expansion of US spending was set.

"The Nixon administration tried to hold up the dollar but by 1971… they 'had either lost or abandoned any semblance of control of the situation'; and they finally decided to force devaluation on the others. The western finance ministers at the Smithsonian Institution in

Washington legitimized what the market had already decided, and devalued the dollar against gold… By March 1973 Nixon gave up the attempt to fix the dollar to gold. All western currencies floated up and down freely. The Bretton Woods system had virtually collapsed (p. 118-119)."

That collapse has been well-described and explained in several non-technical books: ***Closing the Gold Window***, by Joanne Gowa; ***The Way the World Works***, by Jude Wanniski, ***The Fate of the Dollar***, by my late uncle Martin Mayer, among others. The most recent may be Kenneth D. Garbade's 2021 book, ***After the Accord***, an academic history of the Federal Reserve from 1951 to 1979. For events leading up to the Bretton Woods agreement, see Ben Steil's ***The Battle of Bretton Woods*** (2013.)

Garbade, an economist and former senior vice president at the New York Fed, writes that Arthur Burns, who in 1970 succeeded Fed chairman William McChesney Martin (the chair since 1951 and the man who **compared** the Fed to a "chaperone who has ordered the punch bowl removed just when the party was really warming up"), satisfied Nixon's demand for lower interest rates to stimulate the economy.

"The decline of rates reversed the flow of gold [to the US Treasury] and exacerbated a cascading series of problems that culminated in Nixon's decision to close the Treasury's gold window on August 15, 1971, putting an end to United States gold sales to foreign central banks at $35 an ounce. Within two years, the Bretton Woods system of fixed exchange rates was gone as well, replaced with floating rates."

Red lights, very cheap

At the time, Europe was still a bargain, especially if you were a young bicyclist or backpacker in southern Europe with no need for things that required money, like fancy dining, lodging or transportation. (Prices in the US in 1971 were roughly 10% of today's level—the minimum hourly wage was $1.60—but most of Europe was an order of magnitude cheaper.)

From left: Federal Reserve chairman Arthur Burns, Treasury Secretary John Connally and President Richard Nixon.

My biggest single expense that summer was airfare from New York ($250, round-trip). A Peugeot UO-8 10-speed bicycle cost $115. At the very lowest end of the tourist economy, you got very little but you paid nothing for it. The price of a cot, among three or four other cots, in a spare bedroom in an Italian family's apartment near the Rome train station: 800 lira or $1.

And so forth. A night at the only lodging house (with a staff of one, offering linen but no other amenities) in Arvi, on the southern coast of Crete: 20 drachma or about 60¢. In Holland, a cold green bottle of Heineken with ham-and-cheese on a dinner roll cost less than $1. In Amsterdam's stoner cafés and even its famous red-light district, 20 guilders or $6 could go a long way.

How do today's prices compare? Finding out would require a breadth and depth of research that I'm no longer prepared to do. For my purposes here, the more pressing question is, How did the end of Bretton Woods and the gold standard impact the world's economy?

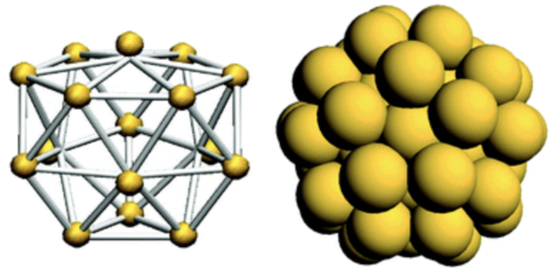
A 40-year bull market begins

In *How the World Works*, Wanniski describes how it led to a decade of **stagflation**—inflation plus low growth. By unmooring the dollar from gold while lowering interest rates and stimulating the economy for political reasons, Nixon added to the inflation that had already been underway. Then a series of hefty political and economic dominos began to fall.

Wanniski, a "**supply-side**" journalist who championed economist Arthur Laffer's famous "**curve**," noted that inflation drove American's salaries into higher tax brackets and reduced their spending power, leading to the famous "stagflation" of the 1970s. But more fatal geo-political other-shoes soon dropped.

Precipitously, the oil producers of the Middle East, to offset the falling value of dollars, raised the price of oil, which was fixed in dollars. That event was followed by the oil shortages of 1973, the "Yom Kippur War" between the Arabs and Israelis, Nixon's resignation from the presidency, and then the recession of 1974-1975, when the Dow dropped to 619 (3264, adjusted for inflation).

On an inflation-adjusted basis, the Dow fell from the present equivalent of about 8000 in 1966 to 2252 in 1982—bottoming out after two or three years during which Fed chair Paul Volcker stopped accommodating the banks' needs for reserves and allowed the fed funds rate—which today stands at only 0.25%—to climb to 20%.



Gold's atomic structure

That's when the post-Bretton Woods fever seemed to break. From that point—the climax of perhaps the greatest stock- or bond-buying opportunity in financial history—the prices of securities began climbing and, with a couple of significant but transitory interruptions, ascended to today's alpine heights. Many people remember the 1970s as a gloomy time; Warren Buffett probably doesn't. He scooped up blue-chip bargains.

But it was also the start of the era of widening economic inequality in the US (between those who own a lot of securities and those who don't), the exponential accumulation of US deficits and debt (the value of outstanding Treasury debt rose to $28 trillion in 2021 from $1.2 trillion at the end of 1982), and the appearance of large trade deficits. Once a major exporter, the US has been the world's biggest importer for more than 40 years. Once the world’s largest creditor, the US is now the world’s largest debtor.

That makes for a lot of historical dots, and there’s no limit to the number of ways you could connect them. One residual question: How has the dollar managed to remain the reserve currency even after so many trillions of them have been put in circulation worldwide?

We shouldn’t mourn the end of the gold standard. As Keynes noted, digging gold out of the earth, exchanging it for paper at a central bank, and re-burying it in Fort Knox or in a vault under the Federal Reserve Bank of New York never made sense. In any case, there isn’t nearly enough gold in the world to finance today’s global economy. And that’s not the worst aspect of it.

Countless Aztecs, Incas and Africans were enslaved or slaughtered for gold. In the 1940s, Europeans were killed for the crowns and fillings in their teeth. Toxins still bleed from old gold adits in Colorado. Cyanide-laced pools stagnate beside new gold mines all over the world. All because of gold’s intrinsic value: its perfect atomic structure, which makes it ideal for conducting electricity and for making jewelry that never loses its lustre.