SCHWARTZ Report

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The Emperor's New Clothes

A little noted but momentous anniversary passed on August 15, 2021. It was the 50th anniversary of the US Treasury's closing of the gold window; the day that the United States of America departed from the gold standard.* Henceforth, the US Government would no longer exchange dollars for gold. As Jeffrey Garten, dean emeritus of the Yale University School of Management wrote in the Wall Street Journal's Review section in July: President Nixon's announcement "suspended the most fundamental rules of the international monetary system, affecting the prices of all products, commodities and services in world commerce. No policy choice since World War II has done more to shape global exchange with repercussions still visible in today's economic and geopolitical rivalries."

The Nixon Administration's decision overturned an arrangement reached in 1944 between the United States and its wartime allies at Bretton Woods, New Hampshire. At that conference, the US Treasury agreed that it would exchange dollars for gold at the rate of $35.00 per ounce. Given that relationship, every other country's currency could be pegged to the dollar at a fixed rate. The conference attendees hoped this would stabilize international commerce and forestall the kinds of monetary instabilities, tariff wars, etc. which followed World War I. It worked because holders of dollars knew that in the event of an economic crisis, they held an asset that could be converted to gold, as good as it gets.

Mr. Garten notes that the US commitment was made easier by the fact that Uncle Sam owned most of the world's existing gold supply at the end of the war in 1945. Even ten years later, US gold reserves exceeded dollars held by foreign governments by 160%. Successive American presidents stressed their commitment to the arrangement. For example, President Kennedy told Congress in 1963: "This nation will maintain the dollar as good as gold..." and that it would remain "the foundation stone of the free world's trade and payments system." These assurances provided the foundation for the recovery of the Japanese and Western European economies and the consumer revolution in the United States of the 1950' and 1960's. It also allowed few, if any, global banking crises from 1945 to 1971. The following era of fiat money has produced many, most recently the Great Recession of 2007-08.

The dollar remains the world's reserve currency today with all the benefits and pitfalls that flow from that status. In the years of Nixon's presidency, it became overvalued versus other currencies making American goods more expensive abroad and foreign goods cheaper to import, thus causing balance of payment concerns. Gold bugs today pine for a new or renewed gold standard and you will see frequent calls for a return in the financial press. Balance of payments issues aside, there were other valid reasons for the change not the least of which, as Mr. Garten points out, was that by 1971, US gold reserves equaled just 25% of dollars held abroad. The government clearly feared an international run on its reserves. He says, in effect, the emperor had no clothes. So, a new suit was being fashioned starting with the August, 1971 decision. The way was opened for a new convention in which exchange rates were not fixed to each other nor backed by gold. The era of fiat money would see them float up and down dependent upon market forces and the strength of each nation's economy. It also meant that money could be made on money and not by investing in productivity and technology which allows an economy to move forward.

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Some Fed watchers contend that the Federal Reserve is engineering another housing boom and thereby misallocating capital to uses that don't boost overall productivity and production. While it continues its purchase of mortgage backed securities at the rate of $40 billion per month, some opine that the housing market no longer needs nor can benefit from the help. The Fed must "taper" out of that buying practice sooner rather than later.

As we have seen over the last 18 months the number of fiat dollars, not tied to any store of value, is infinitely expandable when you possess the world's dominant currency and the political winds are blowing in that direction. When combined with what economist Alan Blinder euphemistically calls "transitory supply effects" an inflationary spiral may be in the offing the likes of which we have not witnessed since the 1970's. Desmond Lachman of the American Enterprise Institute contends that the drawdown of savings built up during the pandemic combined with these unprecedented peace time budgetary stimuli makes it likely that even if Mr. Blinder's "transitory" supply problems are solved there will still be too many dollars chasing too few goods. This is the classic recipe for a longer term and more persistent inflationary event. Milton Friedman's famous dictum was: "Inflation is always everywhere a monetary phenomenon."

*Domestic gold use for monetary purposes had already been denied to American citizens by Franklin Roosevelt in 1933.

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27 Quick and Easy Fix Ups to Sell Your Home Fast and for Top Dollar

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Through these 27 tips you will discover how to protect and capitalize on your most important investment, reduce stress, be in control of your situation, and make the best profit possible. In this report you'll discover how to avoid financial disappointment or worse, a financial disaster when selling your home. Using a common-sense approach, you will get the straight facts about what can make or break the sale of your home.

You owe it to yourself to learn how these important tips will give you the competitive edge to get your home sold fast and for the most amount of money.

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