Perspective C

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Economic turmoil

A crisis in currencies

■ World could be seeing a breakdown of the floating-rate monetary system

By Ashby Foote
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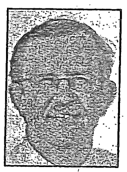
Illustration/Gannett

Maybe the gold bugs have it right.

No sooner was the D.C. melodramatic debt-ceiling deal done than the European markets fell apart — with Italy looking like a much bigger and scarier version of Greece. Only then did America grasp that while Congress fiddled Rome was burning.

Strike three for the markets was the Friday evening downgrade of U.S. treasuries from AAA to AA+ by Standard & Poor's — the same firm that a few years back was happily slapping AAA on CDOs (collateralized debt obligations) of sub-prime mortgages they new little about.



Foote

These are rugged times for international investors and U.S. citizens alike. Jobs are scarce, rates on T-bills are zilch and the S&P 500, the benchmark for U.S. stocks, is below where it was a decade ago.

About the only ones left smiling are the gold bugs — gold has been the brightest and steadiest star in the investment firmament — up over 500 percent during this most difficult of decades.

That gold, history's oldest form of money, would cruise through 10 years of economic storm, turmoil and sometimes panic, strongly suggests that trouble with the world's paper currencies may be at the root of much of our pain and angst.

In short, the world may be experiencing a slow but unrelenting breakdown in the floating rate monetary system it has been operating under since 1971.

Some background: Forty years ago on Aug. 15, 1971, President Richard M. Nixon closed the gold "window," effectively bringing to an end the Bretton Woods monetary system put in place in 1944. As World War II was coming to an end, Western leaders met in Bretton Woods, N.H., and created a new international monetary system.

A primary objective of the new system was to preempt the turmoil of hyper-inflation that was a big factor in Hitler's rise to power in the 1930s.

With that goal in mind, fixed rates were set for major currencies versus the dollar and the United States, as the leading world power and owner of the largest gold reserves, took on the responsibility of exchanging gold for dollars with foreign governments and their central banks.

Nixon's momentous action marked the first time in 1,500 years that international currencies would not have some link to gold. Years later, Republican icon and serious economic student Jack Kemp would quip that President Nixon should have been impeached, not for Watergate but rather for closing the gold "window."

Nixon would have been well served to follow the advice of the first and most important U.S. Treasury secretary, Alexander Hamilton, who was a strong believer in hard money backed by gold and silver.

In a 1790 report, Hamilton warned Congress about the hazards of paper money,

"The stamping of paper is an operation so much easier than the laying of taxes, that a government, in the practice of paper emissions, would rarely fail, in any such emergency, to indulge itself too far in the employment of that resource, to avoid, as much as possible, one less auspicious to present popularity. If it should not even be carried so far as to be rendered an absolute bubble, it would at least be likely to be extended to a degree which would occasion an inflated and artificial state of things, incompatible with the regular and prosperous course of the political economy."

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Hamilton understood the simple and elegant discipline that gold and silver brought to the important role of money.

Unleashed from the discipline of gold, the decade of the '70s witnessed economic turmoil of ever-higher inflation, unemployment and interest rates, dismal stock market performance and stagflation.

As a sign of how tough conditions were, a misery index was created to

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measure just how discouraged folks were — all while gold rocketed from $42 to over $500 per ounce.

The parallels between the '70s and the most recent decade are disconcerting.

In some ways, the two decades are sad bookends to what has now been a 40-year experiment in floating rate currencies.

It is no coincidence that most of America's stock market gains and job creation over the past 40 years occurred during the '80s and '90s when gold traded in a narrow range between $350 and $500.

Even in olde English and across two centuries, Hamilton's words are profound and prophetic.

Greece and Italy are prime examples of "indulgent" governments that created "an inflated and artificial state of things" and they appear headed for some form of default.

This will be a critical test for the Euro Zone and its central bank.

What the world economy needs today is a sound and stable dollar. The international monetary system is not functioning properly and badly needs an overhaul. Only then might our economy reach its potential for growth and job creation.

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