The Nixon Shock - By Roger Lowenstein

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How Nixon stopped backing the dollar with gold and changed global finance, a 40-year-old decision that still echoes in Greece, Ireland, and the U.S.

"Inauguration Day was cloudy, grim," wrote Arthur Burns in his diary on Jan. 20, 1969. As he watched President-elect Richard Nixon, Burns—an immigrant from Galicia, the son of a housepainter who had risen to become the foremost expert on U.S. economic cycles and chief economist to Dwight Eisenhower—saw a man with "a look of exaltation about him." It was not a feeling Burns shared. "I would have felt better if his head were bowed and his body trembled some."

Nixon was inheriting an overheated economy—inflation was already a concern. Burns, 64, would be joining the Administration as a uniquely trusted adviser. In 1960, when then Vice-President Nixon was seeking the White House, Burns had warned him that if the Federal Reserve tightened interest rates, it could damage Nixon's chances. It had played out just so: The Fed tightened, the economy suffered a recession, and Nixon lost to John F. Kennedy. Nixon never forgot the power of the Fed, and he remembered Burns as an economist with political savvy.

So it was that a year into his term, with the economy faltering, Nixon tapped Burns to replace William McChesney Martin Jr., the Fed chief who had dashed his hopes in 1960. According to Burns biographer Wyatt Wells, Nixon issued his appointee some blunt instructions: "You see to it," Nixon said. "No recession."

Burns had more to address than a faltering economy and a famously meddlesome patron. By December 1969, inflation had topped 6 percent—its highest level since the Korean War. Inflation had disturbing international implications because, in the system known as Bretton Woods that had prevailed since the end of World War II, the U.S. was committed to backing every dollar overseas with gold. Thus, foreign countries had the right to exchange their greenbacks at the rate of $35 per ounce. The other currencies were fixed to the dollar, and the dollar—the sun in the monetary sky—was pegged to gold.

For the first years after World War II, Bretton Woods (named for the New Hampshire resort where delegates from 44 Allied nations met in 1944) worked perfectly. Japan and Europe were still rebuilding, and foreigners were eager for dollars they could spend on American cars, steel, and machinery. Even as they accumulated currency reserves, America's trading partners were content to park them in interest-bearing dollars rather than in inert metal. And since the U.S. owned over half the world's official gold reserves—574 million ounces at the end of World War II—the system seemed secure.

But from 1950 to 1969, as Germany and Japan recovered, the U.S. share of the world's economic output fell decisively, from 35 percent to 27 percent. Other nations had less need for dollars and more for deutsche marks, yen, and francs. Also, U.S. spending on Vietnam and domestic programs flooded the world with dollars. Bit by bit, America's allies began to ask for gold.