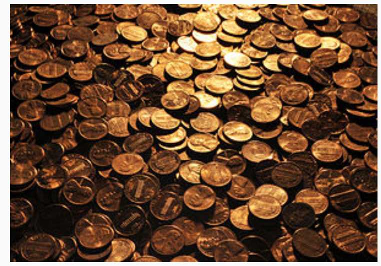
Don't You Dare Eliminate The Penny



(Photo credit: Wikipedia)

Earlier this month, Henry Aaron of the Brookings Institution lent his name to the cause of getting rid of the penny, our one-cent piece here in the United States. Aaron joins the group of "anti-pennies" (that would be a play on "penny-ante"), which includes A-listers such as former Council of Economic Advisors Chair Greg Mankiw and the nation of Canada. Last year, Canada, if you haven't noticed, stopped minting pennies.

Aaron's argument is that pennies—and nickels—cost too much to make and aren't worth the hassle. To wit: "A penny costs nearly 2 cents to make, a nickel nearly 8 cents. And since the U.S. mint has minted nearly 92 billion pennies 15 billion nickels since Y2K, the nation's $1 billion loss making these coins is not, like the coins themselves, chump change. Back in 1940, and even much after that, we got along just fine without coins that bought as little as pennies and nickels do today."

In Aaron's vision, the dime would become our new penny. Everything would be rounded to the nearest tenths place. John D. Rockefeller must be rolling in his grave. He used to give out shiny new dimes to lads and lasses for a job well done.

"I can't think of any good reason not to do so"—to get rid of the penny and the nickel, Aaron writes. Yet the reason to keep these money-pieces is actually very compelling.

Our monetary units developed over time in the original years of the country, as people met their need for "hand-to-hand" currency, which is to say money used in everyday cash transactions. The gold piece was $20, because that was the smallest you could get a stamped disk of gold worth a reasonable amount and still see it. Silver traded about $1/20^{th}$ of gold on the markets, so a similarly sized piece in silver became the dollar. Nickel was worth less than silver as much as silver was worth less than gold, so it came in for the 5-cent piece. Cooper traded at a fifth of nickel, so it got tabbed for the penny.

Note the relationship between the monetary unit and the metallic constituent of the unit. The monetary unit was worth just a little more than the underlying metal. If you boiled a gold dollar into liquid (an old French word for boiling was *bouillion*), you would get a shade less than $20 in gold, and the same thing in turn for all the other units. Bullion was cumbersome as a means of exchange, but reliably stamped common units of bullion were not. The stamp added commercial value. Hence the monetary system of the old days—the days that gave us the industrial revolution, incidentally.

The reason that everybody in the economy preferred money actually made of precious metals such as gold and silver, and their almost-precious cousins nickel and copper, is that this ensured that the issuer did not overproduce money and ruin the economy. If the issuer used a non-precious material—say, paper—as the stuff of its currency, currency could be overproduced, and everybody would lose confidence in it. Wild investment and spending binges, and then a bust, would ensue: not the stuff of industrial revolution and ever-expanding prosperity.

The close relationship between the physical content of the money-token and its value on the markets was essential. It was the best guarantee that the economy got exactly the amount of money it needed for the real purposes of saving, spending, investing, and giving.

OK, so all that was shot into the sun with the rise of legal tender laws (where issuers force you to use their currency), federal reserve systems (where the overall supply of money can be increased by tremendous magnitudes in a matter of no time at all), and the demise of paper-currency redemption in gold (which had made paper as good as gold).

What do we have to show for it? Let it always be noted that the pathetic recovery from the Great Recession, this slow-growth state of ours since 2009, is not only probably the worst extended recovery from deep depression that the nation has ever seen, but also the era of the most gargantuan episode of state-sponsored monetary creation in the history of the world.

The Federal Reserve has bought out bond-holders to the tune of $40 billion a month for the long term, stacked up “excess reserves” in the accounts of its numerous money-center member banks, lowered interest rates to the zero-bound, and blown off standard market measures of the judiciousness of its easing (as in the 400%-600% run-up in gold this millennium).

All that, again, for the worst recovery since the Great Depression, if not ever.

Thus what we have with the penny and the nickel is the last, residual restraint that the government actually faces when it manufactures money. This money, this petty change, actually costs something to make. Which would be precisely why we should insist that the United States keep making it. It can remind the country of how properly to conduct monetary policy. When market signals say you are pushing too hard, stop it. The real economy will respond by getting back to what it does best, which is roaring.