

THE COLLAPSE OF THE GOLD EXCHANGE STANDARD*

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I can think of few places in the world where the subject of my remarks would appear to have less relevance. The "Big Sky" country reminds one of the vast Continental dimensions of the United States and how closed the United States economy really is compared to other countries, except for Russia and China. At Billings airport there is a prominently displayed quotation by Herbert Hoover which says that the metal resources of Montana exceed those of all the known resources in the Soviet Union. If that were true (and I very much doubt it!) Montana itself would have to be a very open economy in order to profit from them. One can easily imagine the problems this state would have if the financial apparatus in the United States broke down. But the position of Montana vis-a-vis the U.S. is not very different from the position of many nations in the world confronted with the threat of international financial breakdown. So, on second thought, Montana is not such an impossible place to speak about international monetary disorder.

I. THE EXCHANGE MARKET COLLAPSE

The financial problems with which the world economy is confronted have their roots in obsolete intellectual attitudes. When change outpaces understanding we become the victims rather than the master of governing historical forces and get inveigled into wrong interpretation and prognosis. It is to improve such interpretations that this paper is devoted.

Only a couple of years ago the world monetary system looked very different from the way it appears today. This is because of the devaluation of sterling and the breakdown of the gold exchange standard in the form we used to know it. But the real problems of the system have not changed as much as they appear. Had you asked central bankers in 1966 to specify the major problems facing the world monetary system they would probably have said: Restoring the strength of the pound and the dollar, which means ensuring the ability of Britain to maintain her exchange rate and of the U.S. to continue convertibility of the dollar into gold at \$35 an ounce. And had you asked, how should Britain and the United States go about this, they would have answered: By correcting their balances of payments through less inflationary politics or whatever other means were available. But they would say something similar today, although it would be tempered by greater caution and less dogma.

Only a year ago events had altered attitudes. The U.S. had braked the inflationary boom of 1963-66 by dear money; this occurred between June and November, 1966. Soon after, interest rates fell and the Federal Reserve was faced with the threat of recession. The U.S. authorities reversed policies and expanded, a move which coincided both with the needs of the U.S. economy and with the recessions in Germany and France. The U.S. monetary ease was bad for her balance of payments, but good for the U.S. and the world economy. Criticism of U.S. inflationary policy was much more muted in 1967, and the time became ripe for reform.

On March 17, 1967 Secretary Fowler issued at Pebble Beach, California, what was widely interpreted as an ultimatum to the Group of Ten to create a substitute for the dollar in the form of a new international reserve or else face the prospect of a reconsideration of the U.S. commitment to her current gold policy. The London agreements reached at the end of August, 1967, owed much to the hard intellectual work of the Group of Ten, but their timing was hastened by pressure from the U.S. Treasury. The outcome was an agreement to propose at the IMF Governor's Conference later in September, a new international asset called "Special Drawing Rights." The barbaric name for them was due to the need to compromise between the French officials who considered them as a credit instrument and the U.S. who considered them money.

*Opening address before the Annual Meetings of the American Farm Economics Association at Montana State University in Bozeman, Montana, on August 18, 1968.