

NINETY-FOURTH INTERNATIONAL ATLANTIC ECONOMIC CONFERENCE

THE ECONOMIC CONSEQUENCES OF JOHN CONNALLY AS
SECRETARY OF THE U.S. TREASURY
FEBRUARY 1971-JUNE 1972

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INTERNATIONAL ATLANTIC ECONOMIC SOCIETY—
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FOCUS OF PRESENTATION

- HAS THE U.S. POLICY OF BENIGN NEGLECT TOWARD FOREIGN PURCHASES OF DOLLAR SECURITIES AND THE PRICE OF THE DOLLAR ADVANCED THE U.S. ABILITY TO ACHIEVE ITS EMPLOYMENT, PRICE LEVEL, AND NATIONAL SECURITY OBJECTIVES?

U.S. CHOICES AT CAMP DAVID AUGUST 1971

- U.S. OBJECTIVE—INCREASE THE U.S. TRADE SURPLUS

- MENU—

INCREASE THE U.S. DOLLAR PRICE OF GOLD TO \$100 OR \$140

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OR

- CLOSE THE GOLD WINDOW--MOVE TO FLEXIBLE EXCHANGE RATES --

IF THE MAJOR U.S. TRADING PARTNERS COULD HAVE VOTED

THEY WOULD HAVE VOTED FOR A HIGHER GOLD PRICE BECAUSE THEY
OWNED LARGE AMOUNTS OF GOLD

CLOSING THE GOLD WINDOW WAS A TAX ON THEIR WEALTH

“GOLDEN AVALANCHE” 1933-34 (AND 1971)

- PRODUCTION OF GOLD INCREASED
PRIVATE DEMAND FOR GOLD DECLINED
- MONETARY VALUE OF THE GOLD AVAILABLE FOR INCREASES IN
 - INTERNATIONAL RESERVE ASSETS SOARED
- U.S. TRADE SURPLUS INCREASED IN RESPONSE TO GOLD INFLOWS

WHAT WAS THE PREDICTABLE IMPACT OF CLOSING THE GOLD WINDOW ON

LIQUIDITY OF GOLD AS A RESERVE ASSET?

DEMAND FOR OTHER RESERVE ASSETS?

PURCHASES OF DOLLAR SECURITIES AS INTERNATIONAL RESERVES?

IF THE U.S. DOLLAR PRICE OF GOLD HAD BEEN INCREASED TO \$140

- GOLD PRODUCTION WOULD HAVE INCREASED
- THE MONETARY VALUE OF GOLD PRODUCTION WOULD HAVE SURGED
- THE PRIVATE DEMAND FOR GOLD WOULD HAVE FALLEN
- THE AMOUNT OF GOLD AVAILABLE FOR THE INCREASE IN INTERNATIONAL RESERVE ASSETS WOULD HAVE EXPANDED TENFOLD
- GOLD WOULD HAVE FLOWED TO THE UNITED STATES AND THE UNITED STATES WOULD HAVE HAD A TRADE SURPLUS

THE CASE FOR FLEXIBLE EXCHANGE RATES— POSITIVE CLAIMS

- CHANGES IN MARKET PRICES OF CURRENCIES REDUCE NEED FOR CHANGES IN REAL VALUES (EMPLOYMENT, PRICE LEVEL)
- CHANGES IN THE PRICES OF CURRENCIES WOULD BE GRADUAL
- GREATER INSULATION FROM SHOCKS IN TRADING PARTNERS
- FEWER CURRENCY CRISES
- REDUCTION IN DEMAND FOR INTERNATIONAL RESERVE ASSETS

SCORECARD ON THE POSITIVE CLAIMS

- ZERO RIEN ZILCH
- CROSS BORDER INVESTMENT FLOWS IN A FLEXIBLE CURRENCY ARRANGEMENT ARE THE SOURCE OF MONEATY INSTABILITY

WHY THE CASE FOR FLEXIBLE EXCHANGE RATES IS INTELLECTUALLY BANKRUPT?

- DIFFERENCES BETWEEN THE CHANGE IN THE INTEREST RATE DIFFERENTIAL AND THE ANTICIPATED CHANGE IN THE PRICES OF FOREIGN CURRENCIES WILL CHANGE MORE OFTEN AND BY LARGER AMOUNTS WHEN CURRENCIES ARE NOT ANCHORED TO PARITIES
- INVESTOR PURCHASES OF FOREIGN SECURITIES WOULD BE HIGHLY VARIABLE AND LEAD TO CHANGES IN THE MARKET PRICES OF CURRENCIES RELATIVE TO PPP PRICES
- THE CASE FOR FLEXIBLE EXCHANGE RATES IS INTELLECTUALLY BANKRUPT BECAUSE IT IMPLICITLY ASSUMED CROSS BORDER CAPITAL FLOWS WOULD BE CONSTANT –AND THEY WILL BE MANY TIMES LARGER WHEN CURRENCIES ARE NOT ATTACHED TO PARITIES

HOW DOES A NATIONAL ECONOMY ADJUST IF ITS CURRENCY IS FREELY FLEXIBLE AND

- 1 IF FOREIGN PURCHASES OF ITS MANUFACTURED GOODS INCREASES?
- 2 IF FOREIGN PURCHASES OF ITS SECURITIES INCREASE (THE COUNTRY'S CAPITAL ACCOUNT SURPLUS INCREASES)?
 - ASSUME FOREIGN PURCHASES OF ICELANDIC SECURITIES
 - INCREASE—ICELAND'S CAPITAL ACCOUNT SURPLUS
 - CAN INCREASE ONLY IF ITS CURRENT ACCOUNT DEFICIT
 - INCREASES BY THE COMPARABLE AMOUNT

THE COSTS TO THE UNITED STATES OF A TRADE DEFICIT THAT IS NEARLY 4% OF U.S. GDP

- INFLOW OF FOREIGN SAVINGS DISPLACED U.S. SAVINGS
- LOSS OF THREE MILLION MANUFACTURING JOBS-- MANY HIGH-PAYING

HIGH PRICE OF THE U.S. DOLLAR DEPRESSED ANTICIPATED PROFIT RATE IN THE PRODUCTION OF TRADABLE GOODS—AND U.S. RATE OF ECONOMIC GROWTH

VARIABILITY IN FOREIGN PURCHASES OF U.S. DOLLAR GOODS HAVE LED TO ECONOMIC BOOM AND BUST CYCLE

CONCLUSION--COSTS OF BENIGN NEGLECT

- INCREASE IN U.S. INTERNATIONAL INDEBTEDNESS LED TO CONSUMPTION BOOMS
- LOSS OF THREE MILLION MANUFACTURING JOBS
- SLOWER U.S. RATE OF ECONOMIC GROWTH
- CLOSING THE GOLD WINDOW WAS AN AFFRONT TO MAJOR ALLIES
- THE OVERVALUED DOLLAR LED TO IMPORT BARRIERS, WHICH WOULD HAVE BEEN LESS LIKELY TO HAVE BEEN ADOPTED IF THE DOLLAR HAD NOT BEEN OVERVALUED