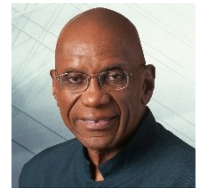

Economic Letter February 2022

The Origin of Caribbean Currency Problems

I have just finished reading *Three Days at Camp David*, an enthralling true story of a weekend retreat convened by US President Nixon in August 1971 at a resort in the Catoctin Mountain Park in Maryland. The President summoned all his top economic advisers, including the Chairman of the Federal Reserve, Arthur Burns, the Secretary of the Treasury, John Connally, and Paul Volcker, who succeeded Burns at the Fed, to make a decision on the price of gold.

Up until that time, the price of gold was fixed at 35 US dollars an ounce. To maintain the price the Federal Reserve undertook to sell gold from its stocks at that price to any central bank that requested to purchase. However, the value of outstanding dollar balances worldwide was four times as large as the US gold stocks, at the 35 dollar price. The retreat was summoned to make an informed decision on what should be done.

The outcome of the retreat was a decision to suspend all sales of gold by the US Federal Reserve, until a new higher price could be agreed on. As it turned out, no new price was ever agreed on; instead, world currency markets transitioned from an era in which all currency values were fixed to the US dollar, which was anchored to the gold price, to the current floating exchange rate system.

That has created a problem ever since for small countries which manage their own currencies. Prior to 1971 there was no pervasive fear that Caribbean currencies would be devalued, causing high inflation and eroding the value of savings. Regional currencies had fixed values, mostly in sterling, which in turn had an unchanging value in terms of the US dollar. There was no need to seek refuge in US dollars, as is now the preference of anyone who has access to the US currency.

Several things about the retreat struck me. The discussions at the retreat were informed by careful studies of the issues and possible consequences, by Volcker and Peter Peterson, another of the participants. These studies had been prepared and circulated in advance, and had benefitted from the views of many informed discussants.

Secondly, the final decision was arrived at by consensus after intense, informed and comprehensive discussions. And thirdly, the announcement of that decision was very carefully crafted to be as detailed as necessary, delivered in plain English, short and to the point. The announcement by the President was supported by a series of media events and meetings by top officials, providing additional colour, but fully consistent with the main message, thanks to the full discussions in which everyone was involved.

There were also two aspects of the process which were unfortunate: the focus and the decision were on the immediate problem of the dollar overhang. Looking back, we can see that insufficient consideration was given to what might eventuate if no new price for gold could be negotiated. More consequential was the failure to include the Managing Director of the International Monetary Fund, Pierre-Paul Schweitzer, in arriving at a decision on the fate on the world's currencies for generations to come.

This and previous Economic Letters may be found on my website ***DeLisleWorrell.com****.*