Mundell - "A Reconsideration of the 20th Century"

Key Theme: The Role of Monetary factors as determinants of political events

For example,

Mismanagement of Gold Standard $\Longrightarrow$ Depression
$\Downarrow$
Hitler
$\Downarrow$
WWII!

According to Mundell, the Intl. Monetary history of the 20th Century can be divided into 3 roughly equal parts:

1900 - 33 - International Gold Standard

1934 - 71 - Bretton Woods (the Dollar Standard)

1972 - 99 - Flexible Ex. Rates / Fiat Money

I. Mismanagement of the Gold Standard

1.) Why did the Gold Standard collapse during WWI?

- Inflationary finance of wartime expenditures
- Breakdown in cooperation among participants

2.) Why did attempts to restore the Gold Standard during the 1920s fail?

1.) The war had led to an increase in price levels

2.) Countries attempted to peg to Pre-War gold prices.

$\Rightarrow$ deflation

$\Rightarrow$ recession

3.) According to Mundell, what should have been done?

Peg to a higher gold price! (i.e., devalue)

II. Bretton Woods

1.) How did Bretton Woods differ from the Gold Standard?

- Each country pegged its ex. rate to the $ rather than to gold
- Dollars used as reserves, rather than gold
- Highly asymmetric. USA in a privileged position.

2.) Why did Bretton Woods collapse?

1.) Excessively expansionary U.S. monetary policy
Loss of confidence in gold convertibility.

2.) Disagreements over the (common) international inflation rate

3.) Declining U.S. power (?)

3.) According to Mundell, what can be learned from the collapse of Bretton Woods?

1.) Fixed ex. rate systems require agreement over monetary policy + inflation.

2.) They work better among friends than among enemies/rivals. (They require cooperation and compromises).

III. Flexible Exchange Rates / Managed Floating

1.) According to Mundell, why did inflation erupt during 1970s?

1.) Inexperience with fiat/unbacked monetary systems.

2.) Eventually Central Bankers learned how to sustain low inflation.

2.) According to Mundell, how does the current "system" compare to the Gold Standard of the first third of the century?

Unfavorably! Still too much ex. rate volatility.