



LECTURE TEN - PART FIVE



The New Dollar Standard System

- A modified exchange rate system called a partially fixed or adjustable peg system.
- Replaced the gold standard with a U.S. dollar standard.
- U.S. dollar designated the world's key currency.
- Most international trade and finance transacted in dollars.
- Fixed exchange rate parities set in both gold and dollar terms.

For Example

- The British pound was set at £12.5 per ounce of gold while the dollar was set at \$35 per ounce.
- **The Math:** $\$35 / \pounds 12.5 = \2.80 per one pound

A Partially Fixed Rate System

- The Bretton Woods agreement remained wedded to the concept of fixed exchange rates.
- **The Big Difference:** Bretton Woods provided for a cooperative mechanism in which the exchange rates were only partially fixed.
- These new “partially fixed” rates could be periodically adjusted to reflect changes in currency values.
- The Process: “**Adjusting the Peg**”

A Partially Fixed Rate System

- **Central Idea:** Provide both the stability of the gold standard's fixed rates with the adaptability of flexible exchange rates.
- Through this adaptability, relative price changes could be addressed through periodic and cooperative adjustments in exchange rates.
- It would avoid the painful deflations and recessions that had plagued the gold standard.

The Success of Bretton Woods

- For the first decade of its existence, Bretton Woods was a great success.
- Under the Marshall Plan of 1947, the U.S. lent large sums to Europe for rebuilding.
- These dollars flowed back to the U.S. for the purchase of machinery, equipment, and consumer goods.

The Collapse of Bretton Woods

- By the 1960s, a huge surplus of dollars was accumulating in foreign banks.
- Speculation led foreign governments to redeem dollars for gold.
- As gold reserves plunged, the U.S. government tried unsuccessfully to pressure these foreign governments into retaining their surplus dollars.

President Nixon's Move

- In August of 1971, the Nixon Administration abandoned the dollar standard and Bretton Woods.
- No longer would dollars be redeemable for gold.
- The dollar's value fell precipitously.

