Atl Econ J (2021) 49:117–126
https://doi.org/10.1007/s11293-021-09720-7

Auric Goldfinger, Henry Morgenthau, and Camp David: August 1971

Robert Z. Aliber[1]

Accepted: 21 July 2021 / Published online: 27 August 2021
© International Atlantic Economic Society 2021

Abstract There were two dramatic changes in United States (U.S.) government policy toward the monetary role of gold in the last 100 years. The first was in 1933-34. Private holdings of gold were nationalized in March 1933. Then, the U.S. Treasury adopted a new parity for the U.S. dollar of $35.00 an ounce at the end of January 1934. Gold production surged, the private demand for gold fell sharply and the U.S. experienced large increases in the foreign demand for U.S. dollar securities. There was a massive flow of gold to the U.S. The second change in U.S. gold policy followed a meeting at Camp David in August 1971 when the U.S. Treasury closed its gold window because of the perception that there might be a run on its gold holdings as they declined toward $10 billion. Some U.S. officials sought to diminish the monetary role of gold, which was accomplished by, in effect, setting the U.S. monetary price at zero. The anticipation of some U.S. officials at the Camp David meeting was that the persistent U.S. payments problem would disappear once foreign currencies no longer had parities in terms of the U.S. dollar. The prices of these foreign currencies would increase and the U.S. trade surplus would become larger. Instead, many foreign central banks became even larger buyers of U.S. dollar securities, which led to a higher price of the U.S. dollar and a U.S. trade deficit. The U.S. international investment position morphed from the world's largest creditor country to the world's largest debtor.

Keywords Gold policy · Gold market · Gold window · Investment · Trade deficit · Revaluation

JEL F33 · G01 · G15 · G33

✉ Robert Z. Aliber
robert.aliber@gmail.com

1 University of Chicago, Chicago, IL, USA

Introduction

The change in the U.S. Treasury's gold market arrangements in the 1930s may have affected the plot of the book version of Ian Fleming's thriller, Goldfinger, which involved a Bonnie-and-Clyde type planned holdup of Fort Knox, Kentucky. Goldfinger sought to enlist several Mafia-type gangs from Detroit, Chicago, Las Vegas, and other cities to assist in loading the gold shipments to both airports and seaports, and then transporting them to foreign financial centers (Fleming, 2012). The producers of the film version concluded that theaters would run out of popcorn before the movement of the 150 million ounces of gold (nearly 4,000 tons) to foreign centers was completed. The plot of the film version was that the price of gold would soar if there was a sharp reduction in supply, which would result from eradication of the U.S. stock of gold at Fort Knox. First, Ms. Galore and her colleagues in the Flying Circus would saturate the area around Fort Knox with Delta-9 nerve gas. Then, Goldfinger would place a nuclear device inside Fort Knox that would remain radioactive for the next 56,000 years. Anyone in the building for more than a few seconds would die from radiation poisoning.

Goldfinger did not anticipate that two weeks after Fort Knox became radioactive, the U.S. Treasury would auction the structures and contents as surplus government property. Goldman Sachs would present the highest bid, and then would develop an initial public offering (IPO) with 150 million shares, about one share for each ounce of gold bullion in Fort Knox. Investors could buy either physical gold or certificates that were a claim on the Fort Knox gold.

The U.S. government can manage two variables regarding the monetary role of gold. One is the price at which the U.S. Treasury buys and sells gold. The gold price is too high if there is a massive flow of gold to the U.S. The price is too low if the flow of gold from the U.S. is too large. The second is the identity of the customers or clients with whom the U.S. Treasury will buy and sell gold, particularly whether individual Americans can buy and own gold.

The First Act of the First U.S. Congress in 1787 established the gold content of the U.S. dollar, which was based on the gold content of the British pound. The gold parity for the British pound was four pounds six shillings and six pence. The U.S. dollar price of one ounce of gold was $20.67. The U.S. dollar price of the British pound would have been $4.796 if the gold content of U.S. coins had been identical to the gold content of British coins. The gold content of British coins was slightly higher than the gold content of U.S. coins, which led to the U.S. dollar price of $4.86 for one British pound.

The U.S. left the gold standard at the onset of the Civil War and returned in 1879. There were no constraints on gold transactions by individual Americans. At the onset of the First World War, the Bank of England closed its gold window and the price of the British pound declined. The U.S. became the market maker in world gold transactions, ready to buy and sell gold at its parity, adjusted for minting costs.

In March 1933, the incoming Roosevelt Administration nationalized American private holdings of gold. Individuals were required to sell gold to the government

to forestall a run on the banks. Once the U.S. dollar could no longer be used to buy gold, the price of the U.S. dollar became flexible in terms of the currencies of the major U.S. trading partners. Then the U.S. Reconstruction Finance Corporation began to buy gold, silver, wheat, and other commodities in an effort to increase the U.S. commodity price level. Henry Morgenthau, an advisor to Franklin Roosevelt in Albany and Washington, became Secretary of the U.S. Treasury on January 1, 1934, and was influential in the decision to increase the U.S. dollar price of gold. On January 31, 1934, a new U.S. dollar parity of $35.00 an ounce was established for transactions between the U.S. Treasury and foreign official institutions. American citizens were still prohibited from owning gold.

The second dramatic change occurred in August 1971 when the U.S. Treasury formally closed its gold window. At the same time, the U.S. government adopted a 10 percent surcharge on dutiable imports and introduced temporary wage and price controls to dampen the spike in the U.S. consumer price level that would come from the increase in the U.S. dollar price of imports and exports. The U.S. authorities sought to affect a realignment of the prices of currencies that would lead to an increase in the U.S. trade surplus. Instead, the U.S. soon developed a massive and persistent trade deficit and the U.S. international investment position morphed from the world's largest creditor country into the world's largest debtor (Aliber, 2020).

This paper provides a synoptic history of changes in U.S. gold policy in the early 1930s followed by a review of the change in U.S. gold policy in August 1971 and subsequent change in the U.S. international investment position. Three questions are addressed. What would have happened in 1933 if the U.S. Treasury had closed its gold window? What would have happened in August 1971 if Henry Morgenthau had been Secretary of the Treasury and had convinced President Nixon that the most effective U.S. policy would be a replay of the increase in the U.S. dollar price of gold like the one in 1934? Would the U.S. dollar price of gold have increased to $70 or $100 an ounce?

Synoptic View of Changes in U.S. Gold Policy in 1933-1934

The key idea of *The Golden Constant* (Jastram & Leyland, 2009) that is embedded in the title of the book is that the real price of gold in 1900 was not vastly different from the real price 200 years earlier. In the long run, the purchasing power of an ounce of gold did not change drastically, although there were modest changes (usually no larger than two percent) in purchasing power from one year to the next. The period was one of rapid economic growth, especially in the last half of the nineteenth century. (About 15 years ago, I had a consulting arrangement with the World Gold Council to extend Jastram's story to include the twentieth century. The U.S. price level in 2000 was 20 times higher than in 1900. The real price of gold in 2000 was not vastly different from its price in 1900).

During the First World War, Great Britain and most of the other countries that were then at war stopped pegging their currencies to gold. The prices of their currencies declined. The U.S. banks continued to buy and sell gold. The U.S. had become the market marker in gold for the global economy. In terms of each foreign

currency, the price of gold was the product of the U.S. dollar price of gold and the price of the U.S. dollar in terms of each foreign currency. If annual gold production was larger than private and official demand, that gold would flow to the U.S.

Most countries in Europe experienced large increases in their price levels during and immediately after the First World War. Great Britain and many other countries initially wanted to return to the gold standard at prewar parities, despite the surge in price levels during and after the war. There was concern that a gold shortage would result. Moreover, the Austro-Hungarian, Ottoman, and German Empires had been broken up, which led to an increase in the number of independent central banks willing to hold international reserve assets. A massive decline in national price levels was needed if the demand for gold was to be satisfied at the prewar prices of gold in terms of national currencies. The prospect of a gold shortage led to the concept of the gold exchange standard, wherein countries would hold their international reserves in the form of securities denominated in the British pound, the U.S. dollar, or some other foreign currency.

A few countries severed the links between their currencies and gold in the late 1920s, which triggered a contagion effect and led to runs on national currencies, beginning with several currencies of the indebted countries in Latin America. The largest Austrian bank, Credit Anstalt, failed on May 11, 1931. This led to runs on the German and British banks that previously lended to the Austrian banks, and to runs on both the German mark and British pound because some investors thought that both currencies would leave their gold parities. The British government severed the link between the pound and gold on September 21, 1931. Subsequent speculative pressure was deflected to the U.S. dollar and some individuals sold their bank deposits to buy gold. Franklin Roosevelt was inaugurated as president on March 4, 1933. The Roosevelt Administration declared a one-week bank holiday and private holdings of gold were nationalized. American citizens were required to sell their gold to the U.S. government, which eliminated any likelihood that they would ask the banks to redeem deposits in gold. The Reconstruction Finance Corporation (RFC) was instructed to buy cotton, wheat, gold, silver and other commodities in an effort to increase the U.S. price level and reverse the decline that began in the late 1920s (Jones & Angly, 1951). The RFC bought gold at progressively higher prices. The objective was to increase the U.S. dollar price of gold to $40 or $42. The idea of more or less doubling the U.S. dollar price of gold came from Henry Morgenthau, who believed that an increase in the U.S. dollar price of gold would reverse the decline in the U.S. price level and move the U.S. economy out of the depression. The British government objected to the decline in the price of the U.S. dollar relative to the British pound. On January 31, 1934, the U.S. Treasury then ceased gold purchases when the U.S. dollar price of gold was about $35 (Blum, 1959).

The U.S. then experienced a massive inflow of gold (Graham & Whittlesey, 1939) as a result of the surge in global production and a sharp decline in private demand because gold became much more expensive relative to silver and other precious metals. Moreover, investors moved funds from France and neighboring countries that had left their gold prices unchanged. In addition, there was capital flight from Europe because of the concern about an impending war.

The increase in the U.S. dollar price of gold was undertaken to bolster the U.S. domestic economy at a time when the unemployment rate was above 20 percent. The value of business inventories would increase. There was modest concern about the international economic consequences of an increase in the U.S. dollar price of gold, although the decline in the price of the U.S. dollar would weaken the competitive position of firms in France and the other countries that retained parities for their currencies in terms of gold. Those countries with significant holdings of gold would benefit from the increase in the U.S. dollar price of gold since they would have revaluation gains on their holdings of gold. These gains would be even larger if they increased the price of the U.S. dollar in terms of their currencies. The countries that also produced gold would be better off. The value of the then-current level of production would increase in proportion to the increase in the market price of gold, and gold production would be stimulated.

Synoptic View of the 1971 Change in U.S. Gold Policy

The U.S. Treasury's gold holdings declined from a peak of $24.5 billion at the end of the third quarter of 1949 to slightly more than $10 billion at the end of the second quarter as a result of a persistent U.S. payments deficit, which reflected that the U.S. net purchases of foreign securities (the U.S. capital account deficit) were larger than the U.S. trade surplus. One inference from the persistent decline in U.S. gold holdings was that gold had become underpriced because national price levels had increased relative to the monetary price, more or less like the years during and after the First World War. The second inference was that the prices of currencies of U.S. trading partners were too low. If such prices had been higher, the U.S. would have had a larger trade surplus, a smaller capital account deficit, and a smaller payments deficit or even a payments surplus. In 1971, U.S. gold holdings totaled 8,134 tons, more than the combined holdings of Germany, France, and Italy. The U.S. net international creditor position was larger than the combined net positions of all other creditors as a group.

The persistent U.S. payments deficit led to the Triffin dilemma. If the U.S. was successful in efforts to reduce its payments deficit, other countries might not be able to achieve their targets for an increase in their holdings of international reserve assets. If these countries were successful in realizing their targets for increasing their holdings of international reserves, the U.S. payments deficit would persist. The Triffin dilemma was a variant of the question that led to the gold exchange standard, which was that a shortage of gold would exist because the world price level had increased substantially since during the First World War (Gilbert, 1980).

By the beginning of summer 1971, the currencies of most large U.S. trading partners, except France and Japan, were no longer attached to parities. The need to forestall a run on the U.S. Treasury's gold led to the Camp David meeting in mid-August 1971. There were two sets of decisions. One set dealt with the monetary role of gold. The second set dealt with the price of the U.S. dollar in terms of the currencies of the U.S. trading partners.

The primary decision at Camp David was to close the U.S. Treasury's gold window. One of the second-order decisions was a 10 percent surcharge on dutiable imports designed to induce France and Japan to allow the prices of their currencies to increase. The second was price and wage ceilings to limit the increase in the U.S. inflation rate that would follow increases in the prices of U.S. imports and exports. Most participants at Camp David anticipated that the U.S. international payments problem would disappear once foreign currencies were floating in terms of the U.S. dollar (Shultz & Dam, 1977).

By 1985, the U.S. had become the world's largest debtor country even though the U.S. Treasury had not borrowed in a foreign currency, and very few Americans had borrowed in a foreign currency to finance payments in the U.S. The U.S. became an international debtor because foreign central banks took the initiative to buy off-the-shelf U.S. dollar securities. These purchases soared in the first half of the 1980s which led to an increase in the price of the U.S. dollar by 50 percent. The U.S. industrial heartland was hollowed out. Several of these countries followed beggar-thy-neighbor policies. Their currencies were significantly underpriced. The rules of the International Monetary Fund (IMF) adopted at Bretton Woods to forestall beggar-thy-neighbor policies had been jettisoned with the commitments to adjustable parities.

Much of the intellectual effort in the U.S. Treasury in the late 1960s and early 1970s was directed at securing an increase in the U.S. trade surplus through an increase in the prices of major U.S. trading partners' currencies. Relatively little attention was given to the view that the changes in the U.S. trade balance were driven by excess savings in the major U.S. trading partners, which led to increases in the U.S. capital account deficit as foreign central banks purchased U.S. dollar securities. A large variety of measures were adopted to reduce the U.S. payments deficit, but none were effective. Silber (2012) reported on a series of conversations with John Wills, then the senior civil servant in the U.S. Treasury concerned with international monetary affairs, who had the habit of responding to every initiative with the comment, "It won't work". Volcker wrote that he once asked Willis, "What will work?" Willis responded, "Nothing". The likelihood that Willis asked whether the foreign central banks' demand for international reserve assets could have been satisfied by an increase in the U.S. dollar price of gold to $70 or $100 an ounce seems small.

The senior U.S. government official at Camp David was John Connally, who had become Secretary of the Treasury in February 1971. He did not have any prior views about the U.S. dollar price of gold or about whether currencies should have parities. Arthur Burns, then the chair of the Board of Governors of the Federal Reserve, was the second most senior official at Camp David. He wanted to preserve the monetary role of gold and the Bretton Woods arrangement of adjustable parities. Three of the participants (George Shultz, head of the Office of Management and Budget, Paul McCracken, then Chair of the Council of Economic Advisors, and Herbert Stein, a member of the Council who would eventually become the Chair), were aficionados of free markets and in favor of moving to flexible exchange rates. Volcker, then the Undersecretary of the Treasury for International Monetary Affairs, wanted to preserve the Bretton Woods arrangement of adjustable parities.

One of the objectives of the participants at Camp David was to secure changes in payments arrangements that would enable the U.S. to secure a larger trade surplus because the prices of the currencies of the U.S. trading partners would increase. That the U.S. international investment position would have morphed from the world's largest creditor to the world's largest debtor would have been a surprise to the participants at Camp David. They wanted changes in the payments arrangements that would lead to a larger U.S. trade surplus. Instead, the U.S. trade deficit surged because the sharp increase in foreign purchases of U.S. dollar securities led to a higher price for the U.S. dollar. The increase in foreign purchases of U.S. dollar securities was the predictable result of closing the U.S. Treasury's gold window, which reduced the liquidity of the gold owned by U.S. trading partners. The increase in the foreign demand for U.S. dollar securities was a predictable response. It was as if Goldfinger had caused the gold holdings of the U.S. trading partners to become radioactive and useless in financing the payments deficits. The U.S. authorities at Camp David did not understand the importance of gold in the central bank holdings of international reserve assets. They failed to appreciate that many foreign central banks would seek to underprice their currencies once they were no longer constrained from doing so by the IMF rules on currency intervention.

Conclusion

What would have happened if the U.S. Treasury had closed the gold window in 1933? What would have happened if the U.S. Treasury had set a new U.S. dollar price of gold of $100 an ounce in 1971? Goldfinger believed that an increase in the U.S. dollar price of gold would have led to a proportionate increase in his net worth. He would have applauded the increase in the U.S. dollar price of gold in 1934 and been confused by the logic that led the country with the largest holdings of monetary gold to reduce the price to zero in 1971. There had been periodic concerns that the supply of international reserve assets was too small, yet closing the U.S. Treasury's gold window sharply impaired the liquidity of a major international reserve asset.

The U.S. Treasury manages the world price of gold. The U.S. dollar price of gold could have been increased to $70, $100, or even $200 an ounce in 1971, or it could have been reduced to $20 or even $10 an ounce. If the price had been set below $50 or $60, the U.S. Treasury soon would have run out of gold. For gold to remain an important international reserve asset, the U.S. Treasury would have had to increase the price by enough to lead to a second golden avalanche to forestall gold purchases that would deplete U.S. Treasury holdings. The U.S. Treasury could have kept its buying price and selling price close to a new and higher U.S. dollar price of gold, or the buying price could have been five or ten percent below the selling price. Foreign official institutions would have had to adjust to the U.S. gold market policies.

Every change in the U.S. gold policy in the 1970s (either an increase in the U.S. dollar price of gold or reduced access to the U.S. Treasury's gold window) incurred reputational costs. For the previous 20 years, various U.S. government officials said that the U.S. dollar price of gold would remain unchanged until the end of time (Gowa, 1983). President Kennedy was said to believe that the only decisions more

costly than changing the U.S. dollar price of gold were those involving the use of atomic weapons. One component of these reputational costs was the standing of the U.S. government in foreign capitals. If the governments of the trading partners had been asked whether they preferred a U.S. dollar price of gold of $100 an ounce or a U.S. dollar price of zero, the universal result would have been in favor of the higher price and a continued monetary role for gold. The other component was the political standing of the U.S. president in the next election. Such costs may have been higher for a Democratic president taking the initiative to increase the gold price than for a Republican president because of the touted association between Democrats and inflation. President Nixon almost certainly could have sold the American public on the advantages of a higher U.S. dollar price of gold.

Every change in U.S. gold policy also affects the ability of the U.S. to achieve its economic objectives, which include the subset of price and employment level objectives. The U.S. government likely would not want its choice of monetary and fiscal policies to be constrained by a commitment to a parity for the U.S. dollar in terms of gold. A second objective would be to minimize the shocks to the U.S. economic objectives from adjustments to shocks in other countries that would lead to changes in the price of the U.S. dollar or changes in the U.S. trade balance.

If on January 31, 1934 the U.S. government had increased the U.S. dollar price of gold to $50 an ounce, the revaluation profits of the U.S. Treasury, foreign central banks, and individuals would have been higher, which would have led to somewhat larger spikes in spending. Runs on the French franc and other countries that still retained their gold parities would have been larger. The governments in France and other gold bloc countries might have increased the price of gold in terms of their currencies at earlier dates. It seems unlikely that there would have been substantial changes in competitiveness in the long run, in intervals longer than two or three years. The private demand for gold would have been smaller, because the price of gold would have increased by a larger amount relative to the prices of silver and other precious metals. The revaluation profits of the gold mining companies would have been larger. Gold production would have been larger. The U.S. would have experienced a larger inflow of gold, which would have led to a more rapid increase in U.S. employment and perhaps in the U.S. goods price level.

Assume that in 1933 the U.S. government had closed the U.S. Treasury's gold window at about the same time that private holdings of gold in the U.S. had been nationalized. There would have been a negative wealth effect since the price of gold would have declined. The U.S. dollar price of gold would have declined and the foreign central banks that owned gold would have incurred losses. Countries would have scrambled to increase their trade surpluses. The Great Depression would have been more severe.

Assume instead that the decision at Camp David in August 1971 had been a replay of 1934, and that the U.S. dollar price of gold had been increased to $100. The subsequent events would have been similar to those in 1934. There would have been large revaluation gains by the governments that owned significant amounts of gold. The U.S. government would have had the largest gain. No government would have incurred a loss, although many would have complained that they had not shared in the gains. The private demand for gold would have declined sharply. The volume

of gold production would have increased. The market value of new gold production might have been $5-$6 billion. Countries in Europe would have wanted to increase their holdings of international reserve assets because they would have wanted large trade surpluses to be able to acquire newly produced gold. The U.S. payments deficit would have been smaller.

If the U.S. government had increased the U.S. dollar price of gold to $100 in August 1971, the governments of most of the U.S. trading partners would have increased the price of gold in terms of their currencies, some by the same amount, some by a somewhat smaller amount. A few governments might have increased the price of their currencies in terms of the U.S. dollar by a larger amount. The revaluation gains on their holdings of gold would have offset the revaluation losses on the holdings of U.S. dollar securities.

The sharp increase in the U.S. dollar value of gold production coupled with the decline in the private demand for gold could have meant that the U.S. and every other country could have had a trade surplus at the same time. This seemingly implausible result reflects that the sum of the trade surpluses exceeds the sum of the trade deficits by an amount equal to the increase in monetary or central bank holdings of gold. The mercantilist countries that wanted large trade surpluses and reserve gains could have satisfied their needs without forcing the U.S. to have a payments deficit. The Triffin dilemma would have evaporated.

The participants at Camp David apparently did not consider the impact of setting the effective U.S. dollar price of gold to zero on the foreign demand for U.S. dollar securities, which increased modestly in the 1970s and then surged in the early 1980s. Closing the U.S. Treasury's gold window reduced the liquidity of the gold holdings of foreign central banks. The U.S. government had destroyed some of the wealth of its trading partners. The predictable response was that they would seek to rebuild their international wealth. The gold buying price destroyed a massive amount of wealth. The increase in the U.S. dollar price of gold by 75 percent was larger than the increase in the U.S. price level from 1915 to 1935. The U.S. benefited from the increase in the U.S. trade surplus at a time when there was excess domestic productive capacity. They failed to appreciate that the U.S. objective in developing the Articles of Agreement of the IMF (International Monetary Fund, 2020) and its rules for managing changes in the prices of currencies was to prevent free-riding by countries that wanted larger trade surpluses, and that these larger surpluses would lead to a U.S. trade deficit, a sharp decline in the profit rate for those U.S. firms that produce tradable goods, the loss of millions of jobs in U.S. manufacturing, and a larger U.S. fiscal deficit.

References

Aliber, R. Z. (2020). Why did the United States Evolve from the Largest International Creditor in 1980 to the Largest International Debtor in 1990? *Atlantic Economic Journal, 48*(4), 405–411.

Blum, J. M. (1959). *From the Morgenthau Diaries*. Houghton-Mifflin.

Fleming, I. (2012). *Goldfinger*, a Thomas and Mercer edition, Las Vegas.

Gilbert, M. (1980). *Quest for World Monetary Order: The Gold Dollar System and its Aftermath*. New York: John Wiley and Sons.
Gowa, J. (1983). *Closing the Gold Window, Domestic Politics and the End of Bretton Woods*. Ithaca: Cornell University Press.
Graham, F. D., & Whittlesey, C. R. (1939). *Golden Avalanche*. Princeton: Princeton University Press.
International Monetary Fund. (2020). Articles of Agreement of the International Monetary Fund. Available at: https://www.imf.org/external/pubs/ft/aa/
Jastram, R., & Leyland, J. (2009). *The Golden Constant*, *The English and American Experience 1560–2007*. Cheltenham: Edward Elgar.
Jones, J. H., & Angly, E. (1951). *Fifty Billion Dollars: My Thirteen Years with the RFC (1932–1945)*. New York: The Macmillan Company.
Shultz, G. P., & Dam, K. W. (1997). *Economic Policy Beyond the Headlines*. Chicago: University of Chicago Press.
Silber, W. L. (2012). *Volcker: The Triumph of Persistence*. New York: Bloomsbury Press.

Publisher's Note Springer Nature remains neutral with regard to jurisdictional claims in published maps and institutional affiliations.