

4.4 International Considerations

Bordo and Eichengreen. The authors posit that international considerations had an important influence on Federal Reserve policy making in the early 1960s and that adherence to the Bretton Woods peg of the price of gold at \$35 per ounce served as an anchor for a low inflation policy. After 1965 international considerations became less important to FOMC deliberations. This reflects in part aggressive policy actions by the US Treasury and the Administration to protect the balance of payments and stem gold losses in the early 1960s—policies such as the Interest Equalization tax of 1963, Roosa bonds and the Gold Pool. On the understanding that the Treasury would deal with international considerations the Fed placed more emphasis after 1965 on domestic considerations, especially maintaining high employment. Proponents of tight money to stem inflation and protect the balance of payments such as Alfred Hayes, President of the New York Fed were increasingly overruled by those who placed greater weight on high employment than low inflation.

A narrative analysis of FOMC meetings from 1959 to 1971 showed considerable attention being placed to protecting the dollar in the Eisenhower and Kennedy years. On several occasions policy was tightened for external balance reasons. After 1965 external considerations received less and less attention and then only during episodes of financial crisis—1967 after sterling was devalued, 1968 after the collapse of the gold Pool and 1971 during the final crisis of the dollar. The narrative evidence is backed up by estimation of a Taylor rule from 1959 to 1971 which shows that policy rates erred on the side of tightness before 1965 and on the side of ease thereafter. Several measures of inflation persistence and of inflationary expectations also display a significant break after 1965.

Allan Meltzer in his comments emphasized the changing environment in the U.S. Treasury and the Council of Economic Advisers over the period. In the Kennedy years Douglas Dillon and Robert Roosa formulated the defense of the dollar strategy. They were succeeded by the New Economics advocates who downplayed external balance considerations in favor of rapid domestic economic growth and full employment.