

INTERNATIONAL MONETARY RELATIONS BETWEEN THE UNITED STATES,
FRANCE, AND WEST GERMANY IN THE 1970S

A Dissertation

by

MICHELLE FRASHER RAE

Submitted to the Office of Graduate Studies of
Texas A&M University
in partial fulfillment for the requirements of the degree of

DOCTOR OF PHILOSOPHY

August 2003

Major Subject: History

© 2003

MICHELLE FRASHER RAE

ALL RIGHTS RESERVED

INTERNATIONAL MONETARY RELATIONS BETWEEN THE UNITED STATES,
FRANCE, AND WEST GERMANY IN THE 1970S

A Dissertation

by

MICHELLE FRASHER RAE

Submitted to the Office of Graduate Studies of
Texas A&M University
in partial fulfillment for the requirements of the degree of

DOCTOR OF PHILOSOPHY

Approved as to style and content by:

H.W. Brands, Jr.
(Chair of Committee)

Alex Mintz
(Member)

Cynthia A. Bouton
(Member)

Lora Wildenthal
(Member)

Arvind Mahajan
(Member)

Walter Buenger
(Head of Department)

August 2003

Major Subject: History

ABSTRACT

International Monetary Relations Among the United States, France and the
Federal Republic of Germany during the 1970s. (August 2003)

Michelle L. Frasher Rae

Chair of Advisory Committee: Dr. H. W. Brands, Jr.

The United States acted unilaterally to terminate the Bretton Woods monetary system in August 1971, and international exchange rate management went from a regime of fixed to floating parities, much to the displeasure of the membership of the European Community. The Nixon, Ford, and Carter administrations adopted policies that heavily benefited US reform objectives and domestic economic goals, which frequently clashed with allied concerns, and damaged American monetary relations with France and West Germany. Yet, the inability of France and the Federal Republic of Germany to form cohesive economic and monetary policies throughout international negotiations or within the European Community (EC), allowed American desires to dictate the path and pace of European integration.

France and Germany attempted, with limited success, to influence US monetary policy through bilateral diplomacy during years of exchange rate fluctuations, dollar devaluations, oil shocks, and payments deficits. Finally, President Valery Giscard d'Estaing and Chancellor Helmut Schmidt created the European Monetary System (EMS) in 1979, reversing the trend of half-hearted attempts at European integration so prevalent the decade before. The EMS detached the EC's currencies from the dollar's control, was compatible with the reformed international monetary system, advanced a more independent European monetary identity, and formed the base for future monetary integration. As a result, the EMS, as the birthplace of the Euro, the single European currency launched in 2002, may soon rival the dollar's position as the primary reserve currency.

American monetary policies designed to improve the health of the dollar during the 1970s were a catalyst for European integration. However, as the European Union deepens its economic integration and the Euro grows in strength, it seems that U.S. policies created a regime and a currency that will challenge its dominant position in international monetary affairs.

For my family.

ACKNOWLEDGMENTS

Foremost, I would like to thank my committee members for their advice and patience during this process. Their support for such a challenging topic made all the difference. My chair H.W. Brands encouraged me to tackle such a demanding topic and believed that I had the abilities to carry it through. Cynthia Bouton, Arvind Mahajan, and Alex Mintz offered great advice on presenting and framing the subject. Lora Wildenthal agreed to join the committee late in the development of the dissertation and readily gave me helpful commentary. Finally, my gratitude goes to Arnold Krammer, who gave me encouragement throughout my academic career at Texas A&M University.

As primary documents provided much of the sources for this work, a great number of archivists and institutions on both sides of the Atlantic deserve my gratitude. Thanks to Barbara Sloan at the Library European Union, Delegation of the European Commission to the United States in Washington, DC, the Nixon Presidential Materials staff at Archives II in College Park, Maryland, and Nixon audio archivist, Ron Soldano, for helping me navigate through the tapes for future reference. The staff at the Lyndon Baines Johnson Library at Texas University in Austin, offered their expert knowledge on both the John Connally papers and monetary subject files. The archivists at the James E. Carter library went out of their way to assist me, even going so far as to declassify some documents during my visit. The Lafayette College in PA, whose library staff was gracious enough to photocopy my microfilm requests from their holdings of William E. Simon's papers.

Special thanks goes to the Gerald R. Ford Foundation, for choosing to fund my visit to the Ford Presidential archives in Ann Arbor, Michigan. The staff's kindness and professionalism made my research enjoyable and frustration free.

For my research in France, I thank countless archival staffs and both American and French academics, among them Prof. Kenneth Moure, at the University of California at Santa Barbara, for their encouragement and guidance to locate and view materials. Madame Cavillon-Troadec and the staff at the Bank of France archives for submitting

the necessary clearances I needed to view documents, Madame Anne de Castelnau at the Comité pour l'histoire économique et financière de la France, Mr. Laurent Dupuy at the Centre des Archives Economiques et Financieres, the National Archives in Paris for their assistance in navigating the rigors of both the Georges Pompidou and Valery Giscard d'Estaing papers. Special thanks goes to the archivists and their assistants at the 20th Century section at the National Archives for working around my short stay in Paris and making exceptional arrangements for me to view the French presidential papers during their difficult building renovations. An overdue thank you goes to André de Lattre, whom was generous with his time, knowledge, and assistance that were a great help to this study. Lastly, I want to acknowledge Preston Perluss, my assistant in Paris, for his language and archival skills.

In Germany, Prof. Dr. Heinrich Volkmann, Prof. für Wirtschaftsgeschichte an der FU Berlin Universität, Prof. Dr. Michael Ulrich Brückner, Prof. Dr. Michael Bolle, at the Centre of Excellence for European Integration, Freie Universität Berlin, Prof. Dr. Dieter Lindenlaub at the Deutsche Bundesbank, as well as others took the time to answer my letters about archives in the Federal Republic, which greatly enhanced my understanding of the processes and contributed to my successes. Dr. Gertrud Lenz and Dr. Christop Stamm at the Willy-Brandt-Archiv im Archiv der sozialen Demokratie der Friedrich-Ebert-Stiftung in Bonn, archivist of the Willy Brandt and Helmut Schmidt papers respectively and the entire staff at the Friedrich-Ebert-Stiftung, were wonderful in their assistance to me during my visit. All of this research would not have been possible, however, without my German assistant Dani Kranz, whose professionalism, fantastic research and translation skills, and Rhinelandian hospitality made my time in Germany enjoyable and efficient to say the least.

Personal thanks goes to the following persons or groups who have contributed to the retention of my sanity in many ways great and small. In no particular order, I wish to acknowledge Prof. Patricia A. Weitsman, a host of friends who copied documents for hours on end in archives, and the Department of History office staff who often went

beyond the call of duty. Finally, I owe the most to my parents, and my husband. Nothing would have been possible without you.

TABLE OF CONTENTS

	Page
ABSTRACT	iii
DEDICATION	iv
ACKNOWLEDGEMENTS	v
TABLE OF CONTENTS	ix
ABBREVIATIONS.....	xiii
CHAPTER	
I INTRODUCTION: CURRENCY AND POWER.....	1
Purpose.....	1
Organization	2
Literature Review	6
II ALL THAT IS GOOD IS NOT NECESSARILY GOLDEN: 1944-1968	10
A Short History of International Monetary Management	11
Making Bretton Woods	12
Bretton Woods in Practice.....	18
The United States Balance of Payments Problem.....	22
The Fight for Liquidity and the Decline of the System	30
The System Teeters on Collapse	44
Conclusions	52
III BRETTON'S SINKING SHIP: 1969-1970	54
Nixon's Domestic Economic Agenda.....	56
The Nixon International Agenda.....	58
The Economic Team Develops with Changes in Monetary Strategies.....	61
European Parities and the Issues of International Reform	64
European Try to Advance Common Interests	67
After The Hague.....	71
Conclusions	76

CHAPTER	Page
IV BRETTON WOODS BREAKING POINT: 1970-1971	79
The Bretton Woods Parities Waffle	80
The U.S. Plans for the Defense of the Dollar	84
The Treasury Tries to be Flexible	89
Burdens Too Heavy to Bear	91
Forging a New Economic Policy at Camp David	94
Unilateralism Revealed	100
European Reactions	102
The Community Attempts a Unified Response	105
Negotiation – Texas Style	109
Europe’s Balance of Power in International Monetary Negotiations	111
The Rome Conference	114
The Azores	119
The Smithsonian Agreement	127
Conclusions	128
V SNAKES, TUNNELS & FLOATING: JANUARY 1972-SEPTEMBER 1973	131
Pompidou’s Serpent	132
The Pound Crisis of 1972	135
From Pound Crisis to Dollar Speculation	137
Reaction to the Pound Crisis	142
United States Approaches for Reform are Finally Defined	145
Negotiating Long-Term Reform in Rome	146
The October EC Summit in Paris	148
Another Weak Link in the Smithsonian Agreement	151
Dollar Devaluation	156
The Year of Europe	163
The Realities of Floating	167
Conclusions	172
VI OIL CRISIS AND NATIONAL INTERESTS: OCTOBER 1973-DECEMBER 1976	175
Arab-Israeli Relations	175
The Economic Impact of Oil	179
A Plan on Oil	182
Ford, Schmidt, and Giscard	186
Martinique	190
Europe Postponed	195
Negotiating Rambouillet	197

CHAPTER	Page
The French Understanding	205
Rambouillet	206
Jamaica ..	208
Europe Back on Track	211
The Snake's Bite Gets Duller	213
Puerto Rico July 1976	216
Revaluations, Election Revelations, and Integration Hesitation	220
Conclusions	223
VII PHOENIX FROM THE ASHES: EUROPEAN MONETARY IDENTITY, 1976-1979	226
Change, and Yet More of the Same	227
London ..	229
The Federal Reserve Has Its Say	230
Harsh Adjectives of Monetary Diplomacy: Benign, Malign, and Aggressive Neglect	232
Intervention Through Partnership	237
Least Not Forget	237
Copenhagen	241
The Community Study	242
Membership Has Its Privileges	244
Bremen ..	245
Bonn ..	247
All in the Details	251
Dollar Dilemmas and the Last Slide of the Snake	255
The Dream and the Debate	257
Brussels ..	258
Bitter Pill of Realpolitik	260
The Atlantic Reaction	260
Conclusions	261
VIII CONCLUSIONS: AMERICAN MONETARY HEGEMONY AND THE EUROPEAN CHALLENGE	264
GLOSSARY ..	276
REFERENCES ..	283
VITA ..	296

ABBREVIATIONS

BIS	Bank for International Settlements
C-20	Committee of Twenty
CAP	Common Agricultural Policy
CDU	Christian Democratic Union
CEA	Council of Economic Advisors
CIEP	Council on International Economic Policy
ECSC	European Coal and Steel Community
EC	European Community
ECOFIN	European Community Finance Ministers
EEC	European Economic Community
EMCF	European Monetary Cooperation Fund
EMF	European Monetary Fund
EMS	European Monetary System
EMU	European Monetary Union
EPU	European Payments Union
ERM	Exchange Rate Mechanism
EU	European Union
EUA	European Unit of Account
FDP	Federal Democratic Party
FMOC	Federal Open Market Committee
G-10	Group of Ten
GATT	General Agreements on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
IEA	International Energy Agency
IMF	International Monetary Fund
JEC	Joint Economic Committee
MCA	Monetary Compensatory Amounts
MTN	Multilateral Trade Negotiations
NAFTA	North Atlantic Free Trade Agreement
NATO	North Atlantic Treaty Organization
NEP	New Economic Policy
NSC	National Security Council
OECD	Organization for European Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
SDP	Social Democratic Party
UA	Unit of Account (European)
UN	United Nations

CHAPTER I

INTRODUCTION: CURRENCY AND POWER

Purpose

Historians have written many books and articles about Bretton Woods and the formation of the European Monetary System (EMS), but have largely ignored the affect that United States monetary policy had on integration and its relations with the European Community (EC). Similarly, there is little connection in the literature of how American plans for the dollar in the international monetary system during the 1970s contributed to the development of the Euro – the single currency for the European Union (EU) – which may yet challenge the dollar as the primary reserve currency for international finance. Indeed, the Euro owes its naissance to the demise of Bretton Woods and the progress of the EMS.

Additionally, because monetary and economic relations involve technical and sometimes confusing terminologies, historians have generally left these topics to the expertise of economists, who then omit the political considerations involved in making policy. Rarely have historians merged the narrative of diplomacy, decision-making, and power politics, with a practical understanding of monetary mechanics. The relationship between these disciplines can hardly be ignored, with the strength of currencies frequently determining the social and political wealth of a nation. The interdependence of politics, power, and the mechanics of policy must be implicit to any analysis of monetary relations. International and national monetary policy comprises political considerations as much as a comprehension of economic factors, and these decisions are most often made at the executive levels of government.

In order to illustrate the complexities of international monetary affairs from executive viewpoints, this study employs primary and secondary archives and resources

This dissertation follows the style and format of *Diplomatic History*.

of presidents, chancellors, and their advisory institutions. These include; in the U.S., the Council of Economic Advisors (CEA), the chairman of the Federal Reserve Bank, and the Secretary of the Treasury; and in Europe, Finance Ministers and Central Bank governors or presidents. This will explain what led the U.S. to act unilaterally to terminate its commitments to the Bretton Woods system, its subsequent efforts to reform the system to the dollar's advantage against European opposition, and how American decisions dictated the path and pace of French and German efforts to construct the European Monetary System (EMS).

Organization

The Bretton Woods agreement of 1944 established an international framework for the management of exchange rates around the globe. Designed to correct the inadequacies of the gold standard, it provided institutions for the exchange ideas and problem-solving and standardized guidelines to manage trade and commerce in a growing and interdependent world. For thirty years, it successfully aided the reconstruction and development of post-war economies until its demise in the early 1970s. Bretton Woods brought monetary policy to the center of relations between the United States, France, and the Federal Republic of Germany¹ because of the interdependence of their economies and the dominance of the dollar upon European currencies. American presidents used the dollar's power to determine the shape of international and national monetary affairs, which influenced European integration, and may have long-term consequences for the primacy of the dollar's power in international monetary affairs.

Chapters two, three and four (1944-1971), describe the functions and structure of Bretton Woods, and the deterioration of the dollar's position in the system. Bretton Woods created a standard for all member states to value their monies and easily convert them against other currencies, which made international trade and investment easier. The U.S., the wealthiest nation, immediately emerged to dominate the system in

¹ I shall refer to the Federal Republic of Germany, known then as West Germany, simply as Germany throughout the text.

currency and power. As Bretton Woods tied the U.S. dollar to gold at a set rate of \$35 an ounce, members chose to keep dollars instead of gold bars in their reserves, and pegged exchange rates to the strength of the dollar and the U.S. economy. As long as the US held enough gold in its reserves to back the amount of dollars in circulation, the system operated soundly. During the 1960s, the recovery of the European economies and the U.S. balance of payments and trade deficits deteriorated the value of the dollar, while European economies boomed, thereby appreciating their currencies, which meant that the Bretton Woods rates were undervalued. This left the burden of maintaining fixed exchange rates heavily upon an overvalued dollar. Thus, when the Europeans grew stronger both politically and economically in the 1960s and 1970s, but refused to appreciate the value of their currencies, the harmony of interest it enjoyed with the U.S. began to wane.

American presidents generally upheld the Bretton Woods agreements and maintained the dollar link to gold at the expense of the domestic economy. However, the dollar's privileged position meant that the U.S. held most of the political control over the fate of Bretton Woods, even as the U.S. economy grew weaker. Richard Nixon suspended dollar/gold convertibility in August 1971 -- for the sake of the health of the domestic economy, the strength of the dollar, and for his own power as executive. The Europeans were angered that the U.S. had made the decision without consulting its allies. The French held out for bilateral negotiations with the Americans, and won some concessions. France would continue to use this tactic in monetary affairs, making certain demands that would necessitate special treatment in international monetary policy. The U.S./French discussions cleared the way for the Smithsonian Agreement in December 1971, an accord that widened the bands within which currencies could fluctuate, and adjusted the par values of major currencies. The European Community responded to flexibility of the new rates by restricting their currencies to a narrow band known as the "snake" that traveled through the wider "tunnel" of the Smithsonian system.

Chapters five and six (1972-1975), introduce American strategies for greater exchange rate flexibility, and describe how the Europeans coped with these changes. This was a transition period for international exchange, and a time of confusion for European monetary identity. France focused on the international dimension, while working towards European integration. Germany, although interested in integration, preferred to concentrate on the reform in the international system, because unlike the French, the Federal Republic did not have such an adversarial relationship with the Americans. Germany embraced the European dimension in monetary affairs with reservations, fearing that the unstable French economic policies might wreck the Federal Republic's economic success. During these years, national interests took precedence over European concerns. The EC reacted to monetary upheavals as individual states instead of spearheading initiatives on their own continent.

The U.S. gradually moved towards floating the dollar without intervention in the markets, while France and Germany floundered to build common initiatives for European monetary union. A year after the Smithsonian rates were in place, the market forced the U.S. to float the dollar in 1973, bringing exchange rates farther from the fixed parities that the Europeans, and especially the French, had demanded. During this period, the U.S. focused on international reforms that would legalize floating as a stable exchange rate regime in the IMF charter.

The oil crisis of 1973 and 1974 made the U.S.-EC monetary relationship more difficult. The Community hoped that the snake mechanism would serve as the first step to European Monetary Union, but the 'snake' failed to provide stability to the European money markets in the face of the Middle Eastern crisis. Higher oil prices wreaked havoc on national economies, produced rampant inflation, and trade and payments deficits. The snake could not cope with the differences in European economies that were exacerbated by the oil shocks, and soon only the strongest currencies, notably Germany's deutschmark, remained members of the snake. The experience stalled integration efforts for much of the decade, as the European nations could not agree how

or if they should coordinate economic policies for the sake of Europe. They chose to concentrate on their own individual economic recoveries.

On the international level, the French blocked American efforts to form an international agency of oil consumers, fearing that its interests in the Middle East would be harmed. However, the chaos of the oil shocks was not the only dissonance between the Atlantic allies. In the last years of the Nixon administration, officials tried to “reestablish” ties with the Europeans through the “Year of Europe”, where American administrators attempted to create formal ties between the U.S. and the EC. France, which looked upon the Community as its own domain, rejected any such formalities with the U.S. that might usurp France’s special treatment in international or European affairs.

International relations improved in 1974, but only because of changes in leadership. Gerald Ford became U.S. president and cultivated friendships with the new German chancellor Helmut Schmidt and French president Valéry Giscard d’Estaing. Schmidt and Giscard had already built a close trust from their days as finance ministers in their respective countries, and immediately instituted regular bilateral summits to discuss European and international issues when they ascended to leadership. The spirit of consultation carried over to Atlantic and international relations, when they both supported shifting the making of international monetary policy from the IMF, to a smaller core group of the most powerful industrialized nations. The era of the economic super-summit moved international monetary reform to the fast track, and enabled the U.S. and its allies to negotiate reforms at the executive level, which brought monetary policy to the fore of high politics.

Chapter seven (1976-1979), analyses the legalization of floating in the IMF, the U.S. approach to manage exchange rates through the domestic economy without market intervention, how this drove the Europeans to confront the inadequacies of European integration, and finally the U.S. reactions to the EMS. The Ford administration secured the legalization of floating for the dollar through a series of bilateral meetings with Giscard, and economic super-conferences in France and Jamaica. However, the U.S.’s

refusal to support the dollar in the markets and limit fluctuations put pressure on European banks that forced the EC to intervene to maintain their currencies within the snake. The Carter administration further established this policy of “malign neglect” and evoked the ire of Germany, which was often the target of the speculative frenzies provoked by the falling dollar. Carter, like most leaders at this time, was coping with a recession, but he chose to use the domestic economy as a means to support the dollar. As floating was legal, the U.S. used the economic summits not for reform, but to urge its European allies to institute economic policies to combat their own recessions, believing that the domestic economy, not intervention, was the best way to support stable parities. Carter’s pressure on the Federal Republic to reflate and sacrifice a payments surplus damaged the U.S./German relationship, and pushed Schmidt closer to the French to cooperate in European monetary affairs.

Giscard and Schmidt forged ahead with European Monetary Union, understanding that the combined strength of the EC nations would be the only successful challenge to U.S. dominance. Motivated by dollar fluctuations, oil shocks, and the uncontrollable currency movements within and outside of the snake, they created a new purely European monetary scheme that was compatible with the international system, but promoted European economic coordination and integration. The U.S. welcomed the European system publicly with casual interest, but privately issued warnings about the Community’s compatibility with international exchange mechanisms and U.S. policy towards managing the dollar. Still, the U.S. was confident that its hegemony in monetary affairs was solid, and looked upon the EMS as a complimentary addition to monetary stability that would enhance Europe’s role in the world and make it a more equal partner to the U.S. in the Atlantic alliance.

Literature Review

Academics and government officials have written many books and articles about the EMS, but few have ventured to write an analysis of its birth from both the American and European sides. Prior to this dissertation, there was no comprehensive study of U.S./European monetary relations, save a brief and generalized analysis by J. Robert

Schaetzel, *The Unhinged Alliance: America and The European Community*. (New York: Council on Foreign Relations, 1975), which is now outdated, and did not cite any archival materials. Lastly, only a minority of texts on this subject have analyzed these relationships with understandable explanations of the mechanics of monetary and economic policy for those outside of the economics and finance professions. Authors have overlooked the “political economy” between the U.S., France, and Germany that illustrated the connection between political power and monetary policy, or how politicians were successful at controlling the fluctuations of the market, or how at other times they were at the mercy of those markets.

All of the texts written on the development of the EMS focused on European -- mainly German and French -- initiatives or to conflicts within the European Community. Few narratives consistently incorporated both the American and European histories. Sima Liberman's, *The Long Road to A European Monetary Union*. (Lanhan, MD: U. Press of America, 1992), combined historical narrative with a clear presentation of how the international monetary system operates. The work emphasized the cooperation between the European states, but commented little about the U.S. role, except for the American involvement in international economic summits or the impact of dollar fluctuations on the world economy. Lieberman used only secondary sources and periodicals. Peter Ludlow, *The Making of the European Monetary System*. (London: Butterworth Scientific, 1982), provided the most detailed account of the political maneuvering between Germany and France, and their interactions within the European Community. This work continues to be an invaluable source, and is cited in nearly every publication on the subject. Ludlow credited Great Britain with the initial push to the EMS, and believed that Helmut Schmidt made it operable. This report was written entirely from public sources, and supplemented by interview material. Haig Simonian, *The Privileged Partnership: Franco-German Relations in the European Community 1969-1984*. (Oxford: Clarendon Press, 1985), presented political, defense, and economic integration issues within the EC, and favored the foreign policy and international side. The author covered domestic politics as it applied to the Community, but there was little

mention of the United States' role in integration. Simonian used secondary and periodical literature and interview material. Rainer Hellmann, *Gold, the Dollar, and the European Currency Systems : The Seven Year Monetary War*. (New York : Praeger, 1979), was originally published in Germany in 1976 as *Gold, Dollar, und Schlange*. His analysis was biased to the European side, a fact which he readily acknowledged. Because this was published in the thick of the EMS debate, he gives more detail to divergent contemporary views, rather than simply stating the outcome of the negotiations. Hellmann cited secondary sources in French and German.

Historians have ignored the political economy of America's post-war policies. The limited studies that served as surveys on the topic included, David P. Calleo, *The Imperious Economy*. (Cambridge, Mass.: Harvard University Press, 1982), and Diane B. Kunz, *Butter and Guns: America's Cold War Economic Diplomacy*. (New York : Free Press, 1997), which focused on trade and economics and monetary politics was a secondary theme. They also covered U.S. economic relations with the entire world, and not just the European continent.

Only a few authors have examined presidential economic and monetary policies in any detail. Two historians wrote about Richard Nixon's policies in any detail, but concentrated on the domestic impacts of the Nixon era, with foreign relations as an afterthought. Joanne Gowa, *Closing the Gold Window: Domestic Politics and the End of the Bretton Woods System*. (Ithaca: Cornell, 1983), gave a short history of the policy making process during the August 1971 decision. Gowa was interested in applying domestic bargaining theories to the decision and this book favored a political science methodology. Gowa presented a detailed account of the Camp David meeting from the perspective of William Safire, Nixon's speechwriter, who gave Gowa access to his papers in the early 1980s, prior to opening of the Nixon Presidential Papers project at the National Archives. The author stated that domestic concerns overrode international interests in the Nixon administration and believed that the United States was responsible for Bretton Woods's demise. Allan J. Matusow, *Nixon's Economy: Booms, Busts, Dollars and Votes*. (Lawrence, KS: University Press of Kansas, 1998), was the only

author who wrote directly about Nixon's economic policies, but kept the analysis to the domestic side, and concentrated on Nixon's relationship with Congress and trade. He devoted an entire chapter to the Camp David meeting using some of the Nixon archives.

Virtually nothing has been written about Presidents Ford's and Carter's monetary policies, and much of the information in this text was provided by archival research at their presidential libraries. President Carter was particularly weak in economic and monetary policy and the records of the Council of Economic Advisors at his presidential library were not yet available for research. Anthony S Campagna, *Economic Policy in the Carter Administration*. (Westport, Conn.: Greenwood Press, 1995), and Gary M. Fink, and Graham, Hugh Davis. eds. *The Carter Presidency: Policy Choices in the post-New Deal Era*. (Lawrence: University Press of Kansas, 1998), compiled short collections on Carter's policies, mostly concentrated on the domestic side. .

Finally, there are countless publications written by economists that explained the technical side of the international monetary system and the EMS. These were referred to in the footnotes of the study for those who would like to examine the mechanics of monetary affairs.

CHAPTER II

ALL THAT IS GOOD IS NOT NECESSARILY GOLDEN: 1944-1968

When the representatives of forty-four nations met at Bretton Woods, New Hampshire in 1944, they faced the task of creating a formal system of international monetary management. They wanted to establish a means where all member nations could easily convert each other's currencies and secure the flow of goods and investments with dependable communication among central banks. In short, currency values had to be easily determined and there had to be enough money to supply growing economies. Prior to the conference, nations depended on an unreliable method of currency conversion tied to the world gold supply to manage their exchange rates.

The delegates at Bretton Woods successfully produced a regime for international currency management that reflected each state's economic wealth and allowed for the free flow of goods and investment. Regardless of these achievements though, the system did not function as the delegates planned. The rapid growth of national economies and their constant need for capital soon expanded beyond Bretton Woods's resources. The adaptation of the United States dollar as the primary reserve unit for the majority of central banks, put strains on the U.S. economy and constrained U.S. presidents' policy choices. As years passed, and U.S. presidents faced the decline of the U.S. economy, they consistently weighed their international commitments against the health of the national economy. The U.S. tried to keep its commitment to gold/dollar convertibility and maintain its defense and economic interests while attempting to fix the inadequacies of the system through reform.

Inevitably, the reform negotiations soon put the U.S. in conflict with its European allies. Europe sought to assert its role in the future of monetary administration, which matched its economic power and potential, while looking to the monetary integration of Europe. Despite a series of reforms, sparked by significant exchange rate adjustments, gold crises, rampant market speculation, deficits and surpluses, Bretton Woods continued to deteriorate. These factors, and the struggle between international and

national priorities among the members determined the course and the very existence of the Bretton Woods regime. However, by the end of the 1960s, many academics and officials questioned the wisdom of reform over the creation of an entirely new system.

A Short History of International Monetary Management

The Gold Standard

Currency exchange operated on a gold standard, which was comprised of informal agreements among nations on a “fixed” price for gold.² It operated through two systems of convertibility – the value of national currencies to gold, and the available supply of gold in the world. At the national level, the values of currencies were set through law or custom. Ian M. Drummond explains the British logic, “the gold content of the pound sterling derived from the silver content of the shilling, the market price of gold in terms of silver in 1717, and the Carolingian definition of a unit of account wherein a pound contained twenty shillings.”³ Bankers and politicians gave no consideration to the condition of economies when determining these values.⁴ Therefore, the value of national currencies was mostly due to happenstance.

The currency/gold exchange rates established international exchange rates, also called “mint pars,” “gold pars” or “par values”. Again, Drummond explains, “Because the pound’s gold content was just over 486 per cent of the dollar’s, the par value of the pound had to be just over \$4.86.” The main forms of exchange were trade, and merchants’ transport of coin or gold bullion from one country to another. Ships carried

² For more on the operation of the gold standard see Arthur I. Bloomfield, *Monetary Policy Under the International Gold Standard, 1880-1914*. (New York, 1959); Gustav Cassel, *The Downfall of the Gold Standard*. (London, 1936); Benjamin J. Cohen, *Organizing the World’s Money*. (New York, 1977), 75-89; Barry Eichengreen, ed., *The Gold Standard in Theory and History*. (New York, 1985); Paul Einzig, *A History of Foreign Exchange*. (London, 1962); P.H. Emden, *Money Powers in Europe in the Nineteenth and Twentieth Centuries*. (London, 1937); Giulio M. Gallarotti, *The Anatomy of an International Monetary Regime: The Classical Gold Standard, 1880-1914*. (New York, 1995); Edwin Kemmerer, *Gold and the Gold Standard*. (New York, 1944). An excellent book on France and the gold standard is Kenneth Mouré, *The Gold Standard Illusion: France, the Bank of France, and the International Gold Standard, 1914-1939*. (New York, 2002). On Europe and the gold standard see Luca Einaudi, *Money and Politics: European Monetary Unification and the International Gold Standard*. (New York, 2001).

³ Ian M. Drummond, *The Gold Standard and the International Monetary System 1900-1939*. (London, 1987), 10.

⁴ Although paper currencies were widely used, the circulation of gold coin was widespread, and in some cases, citizens could use other metals like silver and copper to settle debts.

gold if it was more profitable than buying foreign currency. As there was no government regulation of foreign monies -- no exchange control -- buying and selling currencies depended on the ability to move gold across borders and converting paper currency into gold. Thus, foreign exchange was most often done in terms of trade, leaving supply and demand to control exchange rates.⁵ The standard forbade nations to make any adjustments in their currency values over one per cent of the set price for gold, but the rates rarely exceeded these constraints. As rapid industrialism expanded national economies in the 18th and 19th centuries, the need for investments, an increase in global trade, and consumer purchasing power, exposed the inadequacies of the standard. Gold discoveries could not keep pace with growing economies.

The gold standard limped through the industrial age until the First World War effectively brought the system to an end. The war cut off the flow of gold from state to state, ended gold/paper convertibility, and moved the gold coinage in circulation back into national treasuries. The restriction of the gold supply, economic policies that fed inflationary trends, and massive European borrowing from the United States, destroyed the future of regulating international currencies exclusively through the gold supply.⁶ After the war, the global community tried to return to the gold standard, but confronted with the economic and financial devastation of the Second World War, the Allies convened Bretton Woods to try to fix the inadequacies of the traditional gold standard, and, establish a *coordinated* and *cooperative* system that could maintain currency stability between the industrialized economies that would emerge after the war.

Making Bretton Woods

The Dawn of the European-American Monetary Relationship

There were plenty of opinions on how the new arrangement should operate. The main players in the conference were the British and the Americans. The two parties shared a common vision, but held divergent views on obtaining their goals. Great Britain, led by premier British economist John Maynard Keynes, had concerns that

⁵ Drummond, *The Gold Standard*, 11.

⁶ *Ibid*, 29-30.

reflected its own position in international finance. Even if it emerged from the war victorious, its economy would be in shambles. The nation faced debt, with little gold in reserve, and a decimated industrial base. Its competitive edge in foreign markets would be lost, with recovery slow and painful. Therefore, the Keynes Plan stressed the need for a monetary arrangement with institutions that promoted global economic expansion and would help the recovery of war-damaged economies.⁷ Keynes, like British politicians and other economists of the day, insisted on national control of exchange rates so that governments could implement expansionary and full employment policies after the war. An adjustable exchange rate system would serve to maintain employment levels. Policy makers could control interest rates and the money supply to manage domestic growth, with the aid of an international organization that provided credit to its members. Keynes wanted an international bank to provide credits up to 75 per cent of each nation's average annual value of foreign trade between 1936 and 1939. The credits, called *bancors*, would have gold values that varied depending on the world gold supply. Every member's currency would have an equivalent bancor rate that could be adjusted only by the International Clearing Union.⁸

In contrast to the British position, the United States was primarily concerned with inflation in the postwar era because it was the leading creditor of war debts. The U.S. Treasury, with Henry Morgenthau at the helm, wanted to take the center of international finance from London to Wall Street and the United States Treasury. Included in this vision was the creation of solid institutions that would work with and for governments rather than for the sole interest of private enterprise.⁹ To the American representatives, currency fluctuations, unpredictable capital gains and losses, and the bank failures that were commonplace in the interwar period proved that a laissez-faire attitude towards monetary policy produced chaos in international finance, and had been a factor in the outbreak of World War II. The U.S.'s "White Plan," penned by Henry Dexter White, a

⁷ Brian Johnson, *The Politics of Money*. (New York, 1970), 111.

⁸ Sima Lieberman, *The Long Road to a European Monetary Union*. (Lanham, MD., 1992), 19-20.

⁹ Richard N. Gardner, *Sterling-Dollar Diplomacy*. Rev.ed. (New York, 1969), 76; and Johnson, *The Politics of Money*, 109.

noted economist and Treasury official, put global trade above private investment. Economic welfare depended on the government maintaining and regulating monetary policy. The Treasury took much of its inspiration from Keynes. In particular, the Americans liked Keynes' concept of *managed demand*, or government spending and interest rate variation to stimulate the economy. Morgenthau had found an ally in Keynes, but because of the difference in U.S. and British interests, this general agreement only went so far. The White Plan emphasized strictly moderated loan and bank practices that were much less liberal than the British plan. American delegates flatly rejected Keynes' bancor system too. They saw it as maintaining a British advantage in world finance where it no longer held such status, since the U.S. quota would be far less than Britain's because the Empire's trade was higher than America's in the late 1930s. The U.S. altered the Clearing House to provide for a managed and selective central fund to distribute credit and a new international currency based on gold they called the *unitas*.¹⁰

Although the U.S. and Great Britain dominated the conference, there was another alternative. The exiled Free French leader in London, General Charles de Gaulle, and a group of influential Frenchmen suggested that the new system require countries to fix their currencies vis-à-vis the currencies of other members. They wanted a system that was both neutral – one not dominated by a single currency – and based on gold. Rates

¹⁰ Johnson, *The Politics of Money*, 110; and Lieberman, *The Long Road to a European Monetary Union*, 19-20. A detailed description of the conference negotiations can be found in Johnson, *The Politics of Money*; and W. M. Scammel, *International Monetary Policy: Bretton Woods and After*. (New York, 1975), and Alfred E. Eckes, Jr. *A Search for Solvency: Bretton Woods and the International Monetary System, 1941-1971*. (Austin, TX., 1975); For the contemporary summary see John Maynard Keynes, *Proposals for an International Clearing Union*. (London, 1943); Harry Dexter White, *A Preliminary Draft of a Proposal for a United and Associated Nations Stabilization Fund*. (Washington, 1943); Harry Dexter White, "The Monetary Fund." *Foreign Affairs* 23 (January 1945): 195-210; and John H. Williams, "Currency Stabilization: The Keynes and White Plans." *Foreign Affairs* 21 (July 1943): 645-658. For more on Harry Dexter White see David Rees, *Harry Dexter White: A Study in Paradox*. (New York, 1973); and Nathan White, *Harry Dexter White: Loyal American*. (Waban, MA., 1956). There is a mass of literature on Keynes's life and his work. Peter A. Hall, *The Political Power of Economic Ideas: Keynesianism Across Nations*. (New Jersey, 1989); his official biographer was Roy F. Harrod, *The Life of John Maynard Keynes*. (New York, 1951); John Maynard Keynes and D. E. Moggridge, *Activities 1941-1946: Shaping the Post-War World: Bretton Woods and Reparations*. (New York, 1980); and Moggridge, ed. *The Collected Writings of John Maynard Keynes*. 26 vols. (New York, 1980); and Robert Jacob and Alexander Skidelsky, *John Maynard Keynes: A Biography*. 2 vols. (New York, 2000).

would be maintained through central bank intervention in currency markets, where each member held a portion of the others' money to supply enough liquidity for the international economy. In order to protect strong currency nations from weaker economies, each member would put up a certain amount of gold, foreign bills or raw materials, to back its money and participate in the system. A central Monetary Stabilization Office would hold this collateral and serve as a forum for discussion on future matters of finance. Although currencies would be listed in terms of dollars, members eventually would define them by a fixed weight of gold. Thus, no currency or nation dominated the system, and gold would still have a central function in international finance. It was essentially a gold standard that was manageable by central banks.¹¹

The French understood that the global demand for liquidity would soon overrun the gold supply. Therefore, they suggested creating an additional currency unit that held equal value to gold to provide liquidity, and preserve the strategy's neutrality. Making one member's currency responsible for the unit was undesirable since that same currency was also convertible into gold. That state then could not support a national deficit without taxing its reserves, and other countries that held this currency in reserve might exchange them in favor of gold, fearing devaluation if the deficit continued. Additionally, the reserve unit nation would have the power to constrict international liquidity by tightening its money supply. French authorities tried to impose some discipline to national economic policies and their debts or surpluses by tying currency reserves in equal proportions to gold and insuring compliance through multinational surveillance. This would discourage countries with surpluses from gaining too many of the unit alternatives. It secured a healthy currency and gold distribution among the members, which assured an ample money supply without depending on a single nation's currency.¹²

¹¹ Michael Bordo, Dominique Simard, and Eugene White, *France and the Bretton Woods International Monetary System: 1960 to 1968*, (Cambridge, MA., 1994), 3.

¹² Ibid, 4-5.

The French suggestions did not have a weighty influence on the final plans for the system, and the conference produced a system that had more in common with the White and Keynes Plans. Bretton Woods founded a fixed exchange rate system under the guidance of a multinational organization called the International Monetary Fund (IMF).¹³ Each IMF member set the value of its currency in terms of gold or the gold equivalent of dollars, and was to maintain its exchange rate within one per cent of the par value. The United States held the majority of the world's stock of monetary gold in 1944, and it guaranteed the price of gold at \$35 an ounce. Most countries chose to use the dollar -- buying and selling it in appropriate amounts -- to control exchange rate fluctuations. The practice made the dollar the premier reserve currency. Each country fixed the value of its currency to gold therefore fixed its exchange rate to the dollar. The exchange rate, or *par value*, was a measure of a country's economic strength relative to other members. This meant that goods in any member country would be priced equally in both gold and dollars. The stronger a country's economy, the closer its currency came to that one to one exchange rate. Any change over ten per cent had to have IMF approval.¹⁴ To support floundering economies and maintain the arrangement, each nation contributed a certain quota to the General Account of the Fund, 25 per cent of this quota was to be submitted in gold and the rest in the member's own currency. In case of emergencies, the IMF would loan funds to national banks so they could control the amount of their currency in the system thorough buying and selling monies. This would keep their exchange rates from dropping below or rising above the one per cent limit.

¹³ The International Bank for Reconstruction was originally established in Basle, Switzerland, for dealing with German war reparations after World War I. It was incorporated into the Bretton Woods structures and serves as an international bank that acts as an agent for various international organizations. It is a clearing house for interbank transactions using European currency and assists central bankers in investing monetary assets by acting as a trustee to the IMF in loaning funds to developing countries. Definitions from John Clark, *International Dictionary of Banking and Finance*, (Chicago, 1999); and Thomas Fitch, *Barron's Dictionary of Banking Terms*. (New York, 1990). For a comprehensive account of the IMF during the 1960s and 1970s see *The International Monetary Fund*. Edited by J. Keith Horsefield. 3 vols. (Washington, D.C., 1969); Margaret Garritsen de Vries, *International Monetary Fund 1966-1971*. 2 vols. (Washington, D.C., 1976), and *International Monetary Fund 1972-1978*. 3 vols. (Washington, 1980).

¹⁴ Leonard Gomes, *International Economic Problems*. (London, 1978), 102. See also Diane Kunz, *Butter and Guns: America's Cold War Economic Diplomacy*. (New York, 1997), 97.

Financial planning combined national and international money management. The balance of payments¹⁵ among member countries, interventions by the IMF, or changes in exchange parities were only utilized to correct *fundamental disequilibrium*, although the charter did not define what this meant. Thus, Bretton Woods relied on an honor system that carried few mechanisms to enforce compliance. The IMF could not effectively punish defectors, and nations could not use the Fund to correct short or medium term payments problems. Fundamental disequilibrium translated into a lack of action until impending crisis. Left to their own devices, with little to fear from the IMF, countries carrying deficits cut their debts by currency devaluation, or raised interest rates to attract investment, instead of restricting growth. Here, international financial health and national policies were at odds. A country with a balance of payments deficit should have reduced domestic demand and decreased imports, but these actions risked higher unemployment. Surplus countries needed to stimulate domestic demand to increase national demand for imports, which in turn raised prices, and inflation. Such a policy also curtailed the country's exports and reduced international competitiveness.¹⁶

While most nations were satisfied that the Bretton Woods system offered the best odds for the vigor of postwar society, the French proposal did offer a hint of future problems. First, the relationship between money and gold was direct, which meant that currencies were immediately fixed in their parities and the gold supply. Second, by attaching the gold price to the dollar, one currency had been given an advantage. There was no illusion of neutrality among nations. Bretton Woods implied that a nation that

¹⁵ Balance of payments is defined as the "Account of all recorded financial exchanges made between the residents of a country and those of another country. The balance of payments is divided into current and capital accounts. The current account takes stock of all *invisible* [trade of services rather than tangible goods] and *visible* [trade of goods rather than services] trade (the balance of trade is part of the balance of payments current account), and the capital account includes all movements of capital [international investments, private or public, which include intergovernmental loans] in or out of the country. Defined in John Clark, *International Dictionary of Banking and Finance*. It is also important to note that the nations in this study did not calculate their payments in the same manner. The United States and Germany calculates its balance of payments with short-term [less than a year] and long-term [exceeding fifteen years or an indefinite period of time] capital movements, although Germany includes inward and outward movements of capital. See Eric Chalmers, *Monetary Policy in the Sixties*. (London, 1968), 124.

¹⁶ Lieberman, *The Long Road to a European Monetary Union*, 84-85.

held the central currency and carried a deficit could threaten the health of international finance came to seem prophetic in later years. Lastly, French delegates objected to the IMF's practice of lending funds to correct currency imbalances that were due to national payments deficits.¹⁷ This last provision undercut national sovereignty and at the same time could encourage irresponsible domestic economic policies. The use of the IMF also placed decisions in the hands of an international organization rather than relying on multilateral relationships. Still, the IMF had virtually no authority to punish those who violated the charter, aside from barring a member from access to its resources. These questions would loom over the Bretton Woods system in the years to come, and the French problems with it would follow and serve as the base of French monetary policy strategies for many years to come – most of which centered around their criticisms against the dollar/gold relationship in the system.

Bretton Woods in Practice

European Recovery and the First Steps to Integration

Bretton Woods went into effect in 1958 in order to give the European economies time to recover and for currency values to establish themselves with the aid of national banks and the IMF.¹⁸ Initially, there was a shortage of dollars in the global market and an excess of gold in U.S. vaults. The U.S. began to supply goods and services to Europe, pour massive amounts of aid in the form of the Marshall Plan,¹⁹ and provide for the continent's defense. All of these efforts flooded the global markets with dollars, providing more than enough liquidity. The military and economic exodus fueled an

¹⁷ Bordo, Simard, and White, *France and the Bretton Woods International Monetary System*, 6.

¹⁸ See Robert Triffin, *Europe and the Money Muddle: From Bilateralism to Near-Convertibility, 1947-1956*. (New Haven, CT., 1967). For detailed descriptions of the European Payments Union and its functions see Barry J. Eichengreen, *Reconstructing Europe's Trade and Payments: The European Payments Union*. (Ann Arbor, 1993); Douglas J. Forsyth, *Restoring International Payments: Germany and France Confront Bretton Woods and the European Payments Union*. Working Paper 111. (Madrid, Spain, 1997.); and Jacob Kaplan and Günther Schleminger, *The European Payments Union: Financial Diplomacy in the 1950s*. (New York, 1989).

¹⁹ Out of the volumes written on the Marshall Plan see John Gimbel, *The Origins of the Marshall Plan*. (Stanford, 1976); Michael J. Hogan, *The Marshall Plan: America, Britain, and the Reconstruction of Western Europe, 1947-1952*. (New York, 1987); Charles P. Kindleberger, *Marshall Plan Days*. (Boston, 1987).

economic boom in the States, while the future partners of European union managed their transitions to stable democracies and economies.

In the first years after the war, France turned to coordinated planning to revive its economy. Initially, efforts focused on utilizing Marshall Plan money to rebuild and modernize production and increase employment. It emphasized labor-management coordination and agriculture and soon surpassed growth targets. Growth stimulated inflation, which made French products too expensive at home or abroad, and the value of the franc deteriorated. The constant presence of inflation in France was a burden on those who depended on pensions and government pay, even though the National Assembly raised wages. The conditions made many French believe that if their country was going to continue to rebuild that inflation was a necessary evil.²⁰ A balance of payments deficit grew, despite the deluge of U.S. spending on NATO headquarters in Paris.

Cutting the budget was politically unpopular, and so officials relied on devaluations in 1948 and 1949 to reduce export prices and make French goods competitive. The government also raised the price of imported goods to decrease domestic demand. This did not win the favor of the international community as it put the burden of the domestic economy on France's trading partners. France further irked its allies by instituting a dual exchange rate system to cope with its economic problems and the dollar shortage. There was an official rate for most transactions and one for tourism that was calculated by a "free exchange market." American and Canadian dollars, along with the Portuguese escudo and Swiss franc were allowed to exceed the

²⁰ For a comprehensive account of French economic and monetary policies from 1897-1973 see Jean-Pierre Patat and Michel Lutfalla, *A Monetary History of France in the Twentieth Century*. Patrick Martindale and David Cobham, trans. (New York, 1990). Sima Lieberman, *The Growth of European Mixed Economies*. (New York, 1977), 8-16. Bordo, Simard, and White, *France and the Bretton Woods International Monetary System*, 8. See also Jean-Marcel Jeanneney, *Forces et faiblesses de l'économie française, 1945-1956*. (Paris, 1956); Martin Wolfe, *The French Franc Between the Wars, 1919-1939*. (New York, 1951).

official rate. The IMF responded by blocking France's access to its resources until 1952.²¹

Meanwhile, under the tutelage of the United States, Great Britain, and to a smaller extent France, Germany began to reconstruct its economy.²² Reforms in 1948 established a new currency, the Deutsche Mark, to replace the worthless Reichs Mark and eliminate the black market and Lucky Strike economy.²³ Initially, Germany was heavily in debt, but through the Marshall Plan, the Korean War, foreign occupation, and masses of refugees who worked for low wages, the Federal Republic emerged with high industrial production and a hefty surplus. Unlike in France, inflation was not a problem and Germany established an export-oriented and highly competitive economy. Germans were earning less, purchasing less, and saving more. This kept inflation down, and kept German products cheap to produce and affordable in the foreign markets. The tax system encouraged citizens to invest in housing, shipbuilding, and businesses, and discriminated against the lower income brackets to keep spending down. Achieving a budget surplus, maintaining the health of the new Deutsche Mark, and building bank reserves were more important than domestic consumerism.²⁴

However, the concentration of reserves in German banks soon posed a problem. The economic miracle, or *Wirtschaftswunder*, had gotten the nation out of debt, but it also meant that the DM was now undervalued. In the mid 1950s, German politicians and economists sought to revalue the mark, but Chancellor Konrad Adenauer refused. Instead, the government tried to balance its payments surplus by lifting restrictions on

²¹ The authors point out that it made no such prohibitions towards Italy, which had adopted a similar policy. Bordo, Simard, and White, *France and the Bretton Woods International Monetary System*, 6; and Lieberman, *Growth of European Mixed Economies*, 16-23.

²² For a detailed discussion of Allied efforts to rebuild the German economy see Lieberman, *The Growth of European Mixed Economies, 1945-1970*. (New York, 1977).

²³ Richard J. Barnet, *The Alliance: America-Europe-Japan, Makers of the Postwar World*. (New York, 1983), 40. The Lucky Strike economy is borrowed from Barnet who writes, "Cartons of cigarettes became the accepted unit of capital. The publication *Europa-Archiv* was started with then cartons of cigarettes supplied by the Frankfurt bureau of the *International Herald Tribune*. On June 19, 1948, Lucky Strikes reached an all-time high, \$2300 a carton at the official exchange rate. Lucius Clay was asked by a persistent German reporter whether there was any substance to the rumor that the U.S. government was about to stabilize the economy with a loan of fifty million cartons of Lucky Strikes."

²⁴ Lieberman, *The Growth of European Mixed Economies*, 54.

export capital, reducing tariffs, liberalizing trade and compensating victims of the Nazi regime. These measures did little to ameliorate the discrepancies, but German officials insisted that the surplus was temporary and that changing the DM's parity would damage the German economy in the long run. In the meantime, investment capital rushed to German industry and accounts.

The institutional experience of the Bretton Woods system, and French and German efforts to comply with its guidelines had another consequence: the system's international structures prepared the European economies for integration, and in the 1950s there was renewal in political relations that were tied to economic concerns. Although there were several political skirmishes around the future of Germany's role in European defense, economics presented itself as a unifying force between the nations. Jean Monnet, an influential businessman who was responsible for France's early reconstruction plans, and French Foreign Minister Robert Schuman initially smoothed relations between the French and Germans in 1952. Their efforts produced the European Coal and Steel Community (ECSC), which put coal and steel production under one supranational authority. The ECSC mitigated disputes about industrial and energy production, served as a watchdog as these resources were central to war preparations.²⁵

The ECSC served important economic functions, but more significantly, the agreement demonstrated that French and German rapprochement was crucial in order for the entire continent to work towards an integrated Europe. In 1957, despite substantial controversies and suspicions from both French and German officials, the Treaty of Rome created the European Economic Community (EEC). Although no one could agree on what form European integration might take, here was at least the promise to try to coordinate interests and policies, which was unprecedented in French and German

²⁵ Selected works on the ECSC include William Diebold, *The Schuman Plan: A Study in Economic Cooperation, 1950-1959*. (New York, 1959); John Gillingham, *Coal, Steel, and the Rebirth of Europe 1945-1955: The Germans and French From the Ruhr Conflict to Economic Community*. (New York, 1991). For the Western European Union (WEU) see Arie Bloed and Ramses A. Wessel, *The Changing Functions of the Western European Union: Introduction and Basic Documents*. (Boston, 1995). For a condensed version of French and German relations at this time see Julius W. Friend, *The Linchpin: French-German Relations, 1950-1990*. (New York, 1992).

relations. French and German attitudes were moving towards more cooperative relations. The European treaties and institutions formed in the early years after the war were designed to ameliorate conflicts among its members. The Treaty of Rome was the next step in establishing a European independent voice in internal and, with an eye to the future, international affairs. For the time being, the Bretton Woods system accommodated these goals.

The United States Balance of Payments Problem

Straining the U.S.-European Relationship and the First Bretton Woods Band-Aids

Europe was well into recovery when Bretton Woods went into full effect in 1958. For the first time, the world could easily exchange currencies, and by the end of 1958, foreign investors and businesses turned in their notes for dollars that arrived en masse to European central banks, where they were promptly exchanged for gold, which translated into over \$2 billion in losses for U.S. gold reserves.²⁶ More significantly, that same year America reported its first balance of payments deficit. Because the U.S.D was the world's primary transaction currency, America could not run a balance of payments deficit without adversely affecting other currencies. As long as the U.S. held gold reserves to support the dollars in the market, the system could function, but there were signs of an increasing dollar glut that did not bode well for the longevity of the system.

As the aim of Bretton Woods was a faithful calculation of exchange rates that accurately reflected the strength of each country's economy, balance of payments had to reflect these values. Yet, disturbing patterns arose during the 1960s. Nations that held balance of payments surpluses refused to revalue their currencies, fearing inflation. They also used the U.S.D as their main currency of reserve, accumulating large amounts of dollars, thus flooding the system with more U.S.D, and weakening market confidence in the dollar. Consequently, banks feared devaluation of their dollar holdings and converted more dollars to gold. In 1960, Yale economist Robert Triffin illustrated this predicament, which became known as the Triffin Dilemma. Bretton Woods required the U.S. to issue dollars to stimulate global economic growth, but without an increase in

²⁶ Kunz, *Butter and Guns*, 98-99.

gold reserves or an ever-booming American economy to support these dollars, the system faced collapse.²⁷ The dollar glut, dwindling U.S. reserves, and the payments deficit also appeared to validate French preoccupations during the Bretton Woods conferences. The French delegates' attempts to keep currencies neutral and devise an alternative unit for liquidity seemed to have some authority. The need for reform kept monetary relations between the U.S. and France at odds throughout the coming decade.

Charles de Gaulle was the first French authority to instigate the monetary debates, ascended to the French presidency in November 1958.²⁸ He had refused to lead the Fourth Republic because its constitution provided for a weak presidency, and he used his election as a referendum to create a new republican government and set a new course for France. One of his first acts in office was to devalue the franc from 350 to 420 to the dollar – a 16.7 per cent reduction. As with previous devaluations, the move helped to ease the balance of payments deficit, but this would not become the standard remedy for French monetary troubles under de Gaulle's guidance. Many of his decisions were influenced by Jacques Rueff, a trusted advisor to de Gaulle and a veteran of political and financial circles. Rueff was critical of France's previous economic and monetary policies and linked the inflation to the budget deficit and foreign exchange. He reasoned that cutting social programs and government subsidies would balance the budget and introduce a credible exchange rate, and the president's economic plans reflected this premise.²⁹ The government coordinated economic policy with teams of modernization

²⁷ Robert Triffin, *Gold and the Dollar Crisis: The Future of Convertibility*. (New Haven, 1960).

²⁸For an account of the Fifth Republic under De Gaulle from a French perspective see Serge Bernstein, *The Republic of de Gaulle, 1958-1969*. (Cambridge, MA., 1993). The best biography of the General was written by Jean Lacouture, *De Gaulle: The Rebel, 1890-1944*. Vol. 1. Patrick O'Brian, trans. (New York, 1990); and *De Gaulle: The Ruler 1945-1970*. Vol. 2. Alan Sheridan, trans. (New York, 1991). The English translations were condensed from the French versions of three volumes. See also Charles Williams, *The Last Great Frenchman: A Life of Charles de Gaulle*. (New York, 1993). On De Gaulle's foreign policy see Robert O. Paxton, and Nicolas Wahl, *De Gaulle and the United States: A Centennial Reappraisal*. (Providence, R.I., 1994).

²⁹ Bordo, Simard, and White, *France and the Bretton Woods International Monetary System*, 8-9. A summary of Rueff's viewpoints and influence are included in Michael Loriaux, *France After Hegemony: International Change and Financial Reform*. (New York, 1991), 163- 168 and 186-187. See also Jacques Rueff, *The Monetary Sin of the West*. Roger Glémet, trans. (New York, 1972), [with Fred Hirsch] *The Role and the Rule of Gold: An Argument*. Essays in International Finance, no. 47. (Princeton, N.J., 1965),

committees comprised of industrial magnate, unions, agricultural leaders, and other experts. Together they focused on internal and external balances with an emphasis on social programming, a tax hike, and continuing modernization efforts. The economy hit most of its targets and production was higher than the European average.³⁰ Economic recovery put France in a position of power to act as a reformer of the imperfections of the Bretton Woods system. The stability of the Fifth Republic, and de Gaulle's belief that France would become an alternative power in the Cold War rivalry, fit neatly in this role.

As Europe regained political and financial influence, officials on both sides of the Atlantic began to acknowledge that the U.S. balance of payments deficit, exacerbated by the revival of the European economies and the expansion of the Common Market, and the Triffin Dilemma could be a persistent problem. John F. Kennedy was the first president who dealt with the payments deficit and labored for a way to maintain dollar confidence during a recession. In 1960, as unemployment rose to over 6 per cent, Kennedy promised Americans prosperity through "New Economics," a plan that emphasized domestic growth through more social welfare programs and deficit spending. Expanding the economy was the only way to stimulate productivity, expand U.S. trade abroad,³¹ and keep American investment at home. Kennedy's budget poured funds into the economy, and he proposed a tax cut in anticipation of a surplus, hoping the surplus would follow if consumers were given extra income and the government did its part.³²

Le lancinant problème des blances de paiements. (Paris, 1966), *Combats pur l'ordre financier: Mémoires et documents pour servir à l'histoire du dernier demi-siècle.* (Paris, 1972); and for reprints of his many articles that were published in newspapers around the world on gold and the dollar see both volumes of Rueff's *Politique économique.* (Paris, 1979).

³⁰ Lieberman, *The Growth of European Mixed Economies*, 169-173; and Patat and Lutfalla, 171-183.

³¹ For the Kennedy Rounds and the Trade Expansion Act of 1962 see Thomas B. Curtis and John Robert Vastine, *The Kennedy Round and the Future of American Trade.* (New York, 1971); and Ernest H. Preeg, *Traders and Diplomats: An Analysis of the Kennedy Round Negotiations Under the General Agreement for Tariffs and Trade.* (Washington, 1970).

³² Calleo, *The Imperious Economy*, 10-14. For more on Kennedy see Douglas Brinkley and Richard T. Griffiths, *John F. Kennedy and Europe.* (Baton Rouge, LA., 1999); Pascaline Winand, *Eisenhower, Kennedy and the United States of Europe.* (New York, 1993)

When the President addressed the payments problem, he had few options available. He could abandon gold dollar convertibility and with it the Bretton Woods regime, or he could continue the dollar's commitment to fixed exchange rates. A run on gold against the dollar in the fall of 1960 pressed the need for reform. In October 1960, because of the drain on U.S. gold reserves from central banks, investors feared a dollar devaluation and private demand for gold on the London gold market drove the price to \$40 an ounce. The U.S. Treasury denied any intention of changing the current parities, and in a week's time the price fell to \$36. The market reaction to the decline in reserves and dollar accumulations abroad was alarming and in 1961, the Treasury initiated an arrangement, which kept American control over international monetary policy and relieved some of the burdens on the dollar for being a reserve currency. Central banks would have to cooperate to stabilize the gold market. The Gold Pool divided the amount of gold allowed into to the private markets among the central banks of Belgium, France, Italy, the Netherlands, West Germany and Great Britain. These nations contributed 50 per cent of the gold in the Pool, with the remainder supplied through American sources. Each nation would try to maintain the \$35 an ounce price by selling and buying gold in the world markets. The Pool was supposed to shield U.S. reserves from banks that held excess dollars overseas and speculators.³³

As the financial community worked to soothe the world's dollar and gold problems, Germany's economic successes soon triggered other difficulties for exchange markets. The Bundesbank's high interest rates attracted short-term capital, and most of

³³ The Gold Pool used the Bank of England to act as an agent for the central banks of Belgium, France, the Federal Republic of Germany, Italy, the Netherlands, Switzerland and the United Kingdom. The Bank would buy and sell certain amounts of gold for each member of the pool. The U.S. contributed 50 per cent of the gold, with Britain, France and Italy held 9 per cent, Germany about 11 per cent, and the smaller countries the remaining 3.5 per cent each. The supply of gold was growing by 1.2 to 1.5 billion dollars a year, mostly from South Africa. The Soviet Union sold gold in the amounts of 200 to 550 million dollars a year. Susan Strange, *International Economic Relations of the Western World 1959-1971. International Monetary Relations. Vol. 2* (New York, 1976), 65-79; Brian Tew, *The Evolution of the International Monetary System 1945-1988*. (London, 1988), 109-111; Kunz, *Butter and Guns*, 103-104; Lieberman, *The Long Road to a European Monetary Union*, 42; above figures from Gordon L. Weil and Ian Davidson, *The Gold War: The Story of the World's Monetary Crisis* (New York, 1970), Chapter 6; and W.M. Scammell, *The Stability of the International Monetary System*. (New Jersey, 1987), 64.

it came in dollars. The U.S. pressured the Bundesbank and German government to lower interest rates, cease converting dollar reserves to gold, and revalue the mark.³⁴ However, the Federal Republic's economic boom and anti-inflation policies meant that while the high rates minimized credit in Germany, they did not maintain the external equilibrium that Bretton Woods required. In 1960, the German 5 per cent rate attracted huge investments, even though the Federal Reserve lowered its rates to encourage growth in the recession-plagued U.S. economy. The Bundesbank's Annual Report called the lack of international coordination "a deplorable coincidence." Much of the foreign capital coming from the U.S. as capital expenditures from abroad reached \$3.5 billion. It was only then that Germany attempted to discourage foreign investment because high interest rates attracted foreign money and therefore "imported inflation" from deficit nations (i.e. the United States) that could not correct their deficits. Now nonresident investors could not receive interest payments on deposits except in the case of individual savings accounts, and the Federal Republic's banks were prohibited from securing Germans investing abroad. Banks now had to include foreign assets in their calculations for minimum reserves, but this stipulation was soon abandoned as foreigners continued to

³⁴ In 1957, the Federal Republic created the German Bundesbank, a central bank to direct a federated system of regional banks to be "independent of instructions of the Federal Government." Despite the independence of the Bundesbank, it was and is expected to coordinate its monetary policies with the government's economic goals as long as they do not inhibit the Bank's charter to "safeguard the currency." The Bank remains independent from parties, interest groups and the public and controls monetary policy with three essential functions. These include setting the Lombard rate [borrowing rate charged to financial institutions] and discount rate [the charge made for cashing an immature banknote], as well as adjusting the minimum reserve requirements. Members of the federal government can attend Bank meetings but do not have voting privileges. For an easily understood description of the functions of the Bank, see C. Randall Henning, *Currencies and Politics in the United States, Germany, and Japan*. (Washington, 1994), 86 - 90. Henning also states that the autonomy of the Bank was not constitutionally set in the Basic Law, but rather in the Bundesbank Act of 1957, which can be amended by a majority of the Bundestag. Other studies of the Bundesbank include Eric Chalmers, *Monetary Policy in the Sixties*.; Ellen Kennedy, *The Bundesbank: Germany's Central Bank in the International Monetary System*. (London, 1991); *Deutsche Bundesbank, The Deutsche Bundesbank: Its Monetary Policy Instruments and Function*, 3rd ed., Deutsche Bundesbank Special Series No. 7 (Frankfurt, 1989); David Marsh, *The Bundesbank: The Bank That Rules Europe*. (London, 1992); and Peter J. Katzenstein, *Policy and Politics in West Germany: The Growth of a Semi-Sovereign State*. (Philadelphia, 1987).

invest in German securities because they expected a mark revaluation. The Bundesbank then reduced interest rates to 4 per cent in November and to 3 per cent in mid-1961.³⁵

It was not enough. Authorities finally had to revalue the mark by 5 per cent on 6 March 1961, hoping that the surplus and inflation would not damage German industry or its international payments position. The inflation issue was a special concern because the Federal Republic's entire economic strategy during the 1950s focused on curtailing inflation with restricted credit to keep money supply and prices in check.³⁶ Now the government hoped that exports would decrease, imports increase, and make more goods available to the domestic market and keep the supply up to hold down prices. Inflation did jump from 1.5 per cent in 1960 to 2.4 per cent in 1961 because of high capital accounts, but stayed below 3.5 per cent throughout the decade.³⁷

These measures controlled inflation, but the revaluation did not correct the surplus. This was partly because the Dutch guilder had also been revalued and investors thought this might trigger other exchange rate modifications, and so Germany's balance initially rose. Fortunately for the Bundesbank, international financial conditions and the Cold War helped the surplus to wane. Rising interest rates in the U.S. and Great Britain attracted capital flows, and German banks turned to giving credit abroad and using the surplus to pay debts and increase contributions to the World Bank. When the Soviets closed the boundary between East and West Berlin in August 1961, foreign capital dwindled from German accounts. By the end of the year, international payments had balanced, but the disproportions would prove to be a persistent problem.³⁸

Although Germany's attempts to correct its payments discrepancies certainly pleased the U.S., the mark's revaluation also triggered speculative pressure on the dollar

³⁵ The Bundesbank's Annual Report (*Monatsbericht*) quoted in Eric Chalmers, *Monetary Policy in the Sixties*, 140, and see 139-142. Securities are issued by corporations or government bodies or other entities that offer investors shares of ownership or a creditor relationship with those who purchase them.

³⁶ The German real growth rate was 8.0 per cent of GDP in 1960, and decreased in the years 1961, 1962, and 1963 – with 5.5, 4.0 and 3.5 per cent respectively. Chalmers, *Monetary Policy in the Sixties*, 172.

³⁷ Chalmers, *Monetary Policy in the Sixties*, 123, 141-142.

³⁸ Susan Strange, *International Monetary Relations*, 79-89. Strange relates the Basel Agreements to the U.S. attempt to help the British pound, and Chalmers, *Monetary Policy in the Sixties*, 140-143, ties it to the Deutsche Mark devaluation.

and forced the Treasury and Federal Reserve to think beyond managing gold through the Gold Pool. Gold reserves and capital were still slowly, but steadily, leaving American vaults. The issue now became how to safely deviate from gold as a reserve asset. Central banks began dealing in foreign exchange or “swaps” in what became known as the Basel Agreement. The agreement was not formal but, as Brian Tew observes, “...simply a public statement of intentions by central bankers intended to tranquillize and cool an overheated foreign exchange market.” Banks held a certain amount of each other’s currencies and swapped them to stabilize exchange rates, then reversed the transaction later, at the same exchange rate as the original transfer, when the currency was steady again. The Treasury also created ‘Roosa Bonds,’ to back the swap network where the U.S. “issued special certificates and bonds denominated in the currencies of the European central banks to which they were issued.”³⁹ European banks purchased the bonds with dollars, enabling the U.S. to borrow from foreign governments in their currency and repay loans in that same currency. If the dollar was devalued, foreign banks would not lose money on the loans. While these fixes did not remedy the U.S. payments deficit, they did keep more gold in its reserves and supported the dollar supply without contributing to their numbers abroad. The measures also indicated that gold was moving farther away from the structure of international monetary policy, and at the same time becoming more and more important to it.

Meanwhile, United States policy makers were not confident that the dollar’s relationship to gold was secure or even necessary. The Gold Pool seemed to solve the U.S.’s reserve predicament through international means, but this did not mean the U.S. debit was forgotten. The deficit did improve for a short time after the trade initiatives of 1962, but the American officials were left still grappling with the dollar/gold issue. The international community gave them no choice. Diane Kunz remarks:

Europeans, enjoying growth rates far higher than those of the United States, feared the possibility of a rapid end to U.S. balance of payments deficits because of the shock waves it would send through their own economies. They also remained shy of giving their currencies

³⁹ Tew, *The Evolution of the International Monetary System*, 111-114.

reserve status. Every system needs a large anchor, but no other country wanted that role.⁴⁰

Walter Heller, Chief of the Council of Economic Advisors, and Joseph Coppock of the State Department proposed “interim international monetary arrangements” that put “domestic economic priorities” over “foreign considerations every time.” They wanted to free the dollar from gold so that the government could “...engage in expansionary policies without having to be concerned with the outflow of gold, with all of its psychological ramifications.”⁴¹ The State Department and Bureau of Budget staff considered pushing the Treasury to suspend gold/dollar convertibility without consultation with the allies. Another plan involved getting foreign banks to agree not to convert a certain amount of their reserve U.S.Ds into gold.⁴² Proponents reasoned that the U.S. could win over its allies with threats of a downturn in the U.S. economy or a diminished role in European security, but the congeniality of relations could become less so. James Tobin of the CEA declared “neither God nor the Constitution set the value of the dollar in gold or other currencies, and the world would not come to an end if it were changed.”⁴³ Economic advisors also wanted Kennedy to improve the payments deficit by blocking long-term American investments abroad for a limited time and cutting American military commitments. The negative side of this strategy, however, was that Cold Warriors and businessmen could block the President’s upcoming re-election.⁴⁴ The Treasury Department and the Federal Reserve continued to reject unilateral measures and pressed for reforms with considerations from both sides of the Atlantic.

Despite the divergence of opinion within the Administration, the decision ultimately lay in President Kennedy’s public commitment to the Bretton Woods institutions. He preferred to pursue a diplomatic course that strengthened international

⁴⁰ Kunz, *Butter and Guns*, 105.

⁴¹ Joseph Coppock, the director of the State Department’s Foreign Economic Advisory Staff as quoted in *Ibid*, 105.

⁴² *Ibid*, 106.

⁴³ As quoted in *Ibid*, 107.

⁴⁴ Kunz, *Butter and Guns*, 107. For a detailed discussion of Kennedy’s policies see Susan Strange, *International Monetary Relations*, 207-215.

confidence in the dollar and simultaneously boost allied confidence in America's fight against Communism. Kennedy agreed with those who were concerned about the payments deficit and the fact that domestic investors, from individual to corporate accounts, were placing their money in more viable foreign markets. The resulting package delivered to Congress in July 1963 borrowed inspiration from both sides. He proposed a \$1 billion reduction in American foreign spending, arranged a \$500 million IMF standby agreement, an interest equalization tax (IET) that would raise the cost of foreign loans by one per cent, and a tax cut.⁴⁵

The Kennedy Administration's deliberations illustrate the strength that international commitments had within his presidency, but also reveal an emerging pattern in White House assessments towards international monetary policies. With few exceptions in the administrations that followed, the same agencies and departments would take their traditional stances in the international monetary debate. However, the conditions under which these proposals were made would remain the same. Whatever the recommendations for action, decisions on monetary policy would always lay between maintaining U.S. promises to its allies at the expense of the American economy, or looking out for conditions at home first. For the time being, America could afford to keep its promises.⁴⁶

The Fight for Liquidity and the Decline of the System

The French Challenge for Monetary Power During the General Agreements to Borrow and the Special Drawing Rights

Kennedy would not live to see his proposals in action. Lyndon Baines Johnson used the cooperative legislative atmosphere in the post-assassination months and his panache for cajoling members of Congress to obtain a tax cut in February 1964, which

⁴⁵ Kunz, *Butter and Guns*, 107.

⁴⁶ As cited in *Ibid.* See Memorandum; Gold Agreement Proposal; 24 July 1962; folder State Department and White House; Dean Acheson Papers, Harry S. Truman Library. Letter; Coppock to Gordon with enclosures; 10 August 1962; Gordon Papers; Box 32; John F Kennedy Library. *Foreign Relations of the United States*, Volume IX, No. 31 Letter: John Kenneth Galbraith to President Kennedy, 77-78, 28; August 1963; No. 57, Memorandum Heller to President Kennedy, 138-141, 9 August 1962.

reduced personal taxes by 21 per cent and corporate rates to 48 per cent.⁴⁷ As business investment and consumer spending rose, he curtailed U.S. investment going abroad. In July 1963, the Interest Equalization Tax, an excise tax⁴⁸ on purchases in the U.S. of new or outstanding foreign stocks or bonds, was the first attempt to interfere directly in capital accounts to restrict outflows like those that caused the first dollar crisis in 1960. Kennedy had hoped to keep long-term capital at home and undercut higher foreign interest rates by making borrowing in the United States more competitive with Europe, without raising interest rates for domestic borrowers. These investments were easily accessible in U.S. markets at the New York and Chicago exchanges. Similarly, foreign investors hit a wall of high borrowing costs. Congress approved the tax in August 1964 and made it retroactive to July 1963 to prevent foreign investment before that tax became law. Investment bankers, stockbrokers and Republican Congressmen opposed the measure because they felt government expenditures rather than private ventures, should be restricted. In 1965, the tax was extended with the Voluntary Foreign Credit Restraint Program (VFCRP) that discouraged corporations and banks from increasing their export funds by more than 5 per cent above what was outstanding as of December 1964. The Fed directed volunteers to increase exports and restrict capital transfers to foreign subsidiaries of American corporations.⁴⁹

The IET and its successor programs did have some effect in managing the dollar markets, but with mixed results. U.S. private long-term capital was leaving in increasing amounts – \$2.6 billion in 1961, \$2.9 billion in 1962, \$3.7 billion in 1963, and \$4.4 billion in 1964. There were more consistent figures in short-term capital flows. In 1962 and 1963 only \$500 million and \$800 million left the U.S. respectively, but jumped to

⁴⁷ Kunz, *Butter and Guns*, 108.

⁴⁸ Excise taxes or duties are usually “levied on home-produced goods, either to control consumption and thus influence spending, or to raise revenue.” In this case, the IET was assigned to the domestic dollar or domestic investment that was leaving the country. Definition from John Clark, *International Dictionary of Banking and Finance*.

⁴⁹ For a complete description of the IET and the VFCRP see Tew, *The Evolution of the International Monetary System*, 105-108; Calleo, *The Imperious Economy*, 225, footnote 29; and Joanne Gowa, *Closing the Gold Window: Domestic Politics and the End of Bretton Woods*. (New York, 1983), 55-56.

\$2.1 billion in 1964.⁵⁰ While critics of limits on capital investments could point to the irregularity of these figures, proponents of capital controls noted that the deficit dropped over a billion dollars in 1965.⁵¹ Whatever the interpretation, the president consistently used foreign investment legislation as a means of reducing the deficit and managing the balance of payments problem. The combination of tax cuts, the IET, and capital restrictions spurred the government to act on a rising trade imbalance, and pump money into expanding industries. Since the 1964 tax cut aided in the renewal of the economy, Congress reduced excise taxes and liberalized depreciation allowances, the rate at which companies determine the value of their capital holdings for tax assessment purposes and investment tax credits.⁵² According to figures, 1965 was one of the most prosperous years for the U.S.. The GNP rose 5.9 per cent and unemployment fell below 4 per cent.

Both Kennedy and Johnson chose Keynesianism, using government spending and taxation to aid private enterprise and encourage growth. Kennedy's New Economics was initially a success, but when Johnson funded the Great Society *and* troops in Vietnam, the government was spending more than it was getting back in revenues and the country accumulated a deficit. Nineteen sixty-five was the last year free of inflation and deficit free growth. That boom forced employers to increase wages in order to entice perspective employees, and helped the consumer price index⁵³ climb from 1.3 in 1964, 5.4 by 1966 and to 6.1 per cent in 1969.⁵⁴

⁵⁰ Calleo, *The Imperious Economy*, 226, footnote 30. Solomon, *The International Monetary System*. (New York, 1977), 46.

⁵¹ Gowa, *Closing the Gold Window*, 56; and Strange, *International Monetary Relations*, 288-289.

⁵² Calleo, *The Imperious Economy*, 26.

⁵³ The consumer price index, also known as the retail price index, is the "analysis of trends in retail prices...used to evaluate changes" in the price of goods. There are several factors that contribute to inflation. This includes a rapid rise in wages and prices so that a dollar buys less. During these times, workers will spend more and save less. There are two types of inflation – cost-push inflation and demand-pull inflation. In cost push inflation, industries will raise prices to cover higher wages, which produces a wage-price spiral. In demand-pull inflation, more borrowing and a high demand for credit pours more money into the economy and produces a boom that raises the Gross National Product and prices. Fitch, *Dictionary of Banking Terms*, and Clark, *International Dictionary of Banking and Finance*.

⁵⁴ Kunz, *Butter and Guns*, 105-110; Calleo, *The Imperious Economy*, 26; and Robert A. Degen, *The American Monetary System: A Concise Survey of its Evolution Since 1896*. (Lexington, MA., 1987), 134. Authors seem divided on Vietnam's role in the balance of payments issue, or specifically, *when* involvement impacted the U.S. economy. Calleo believes that the conflict did not have an impact on

The Federal Reserve sought to shrink the money supply⁵⁵ and to tame inflation by raising the discount rate from 4 to 4.5 per cent in December 1965. President Johnson strongly disagreed with the Fed's actions, and invited Chairman Martin to the LBJ Ranch for a stern discussion. Congress then launched into its own hearings on inflation.⁵⁶ The Fed switched to an expansive monetary policy in 1967, and the money supply grew at an annual rate of 8.2 per cent. Economic growth and deficit spending for Vietnam and the Great Society still encouraged inflation, but neither Capitol Hill nor the White House wanted to increase taxes. Meanwhile, defense spending rose to 9.5 per cent of GNP in 1967 and 1968.⁵⁷ The Fed changed its strategy in part because the president rejected the recommendations of his advisors to ask Congress for a tax increase in early 1966. Johnson did not want to instigate conservatives against the Great Society by raising taxes. Inflation went unchecked until the temporary income tax hike in

inflation until 1966. He states, "Defense outlays actually declined rather sharply from the end of fiscal 1964 through fiscal 1965. Rises did not begin until the latter half of 1965, and even then by a relatively modest \$3.5 billion. No doubt America's growing Vietnam commitment did begin to encourage inflationary expectations. And by the latter months of fiscal 1966, as defense outlays jumped \$13 billion, rising military orders unquestionably fanned the inflationary fire." (26). Kunz claims that "in December 1965, Vietnam induced balance of payments problems convinced American officials to raise the issue anew..."(168). The Treasury, putting forward Fowler's action plan against the balance of payments deficit, recognized Vietnam's impact, but believed that the factors leading to the deficit had existed before the Vietnam conflict. "When the fighting in Vietnam ends, the foreign exchange costs of our security efforts in Southeast Asia – now running at an annual rate of about \$1.5 billion – will drop and will help our balance of payments position. *But it is important to remember that we had a balance of payments problem before Vietnam, and the cessation of the fighting will not in and of itself effect a cure.*" (Emphasis indicates Johnson's highlighting.) Memorandum; Ernest Goldstein to President Johnson; Re: A resume of the Treasury paper of January 19, 1968; folder 1968 Balance of Payments 19-34; Box 54; National Security Files (NSF) Histories; Lyndon Baines Johnson Library (LBJL), Austin, TX.

⁵⁵ The Federal Reserve divides the money supply into M1, M2, M3 and L. Generally, M1 is the currency held by the public that includes travelers checks; M2 is M1 plus savings deposits, and money market mutual fund shares held by individuals; M3 is M2 plus large deposits and money market mutual funds by institutions; and finally L encompasses long term liquid assets (cash or anything readily convertible into cash), including M3, and non bank investments in savings bonds, short term Treasury securities and bankers' acceptances (used often in international trade where a bank draws on itself and agrees to pay the face value if the drawer of the draft does not pay. The bank can also sell acceptances on the money market when they mature. Importers or exporters obtain financing this way and the risk is minimal as the bank only deals with highly rates companies). Fitch, *Dictionary of Banking Terms*.

⁵⁶ Degen, *The American Monetary System*, 134.

⁵⁷ Calleo, *The Imperious Economy*, 27; and Okun, *Political Economy*, 84-86.

1968.⁵⁸ By then however, the tax and budget cuts failed, while inflation and deficit persisted.

In the first years of the Johnson Administration, as foreign investment was limited, the Treasury was continually engaged in negotiations for an IMF supplemental credit line to back-up the General Account. For many years, members of the IMF and its research staff became more vocal for an increase in country quotas. The 1960 gold crisis and speculative attacks on the British pound and dollar after the mark's revaluation, had nearly drained the Fund's resources.⁵⁹ The U.S. representatives, which included William McChesney Martin of the Fed, Robert Roosa, Robert Triffin and Walter Heller, led discussions on what would become General Agreements to Borrow (GAB) with members of the leading industrialized countries that would later become the Group of Ten, or G-10.⁶⁰ The British and Americans contributed to a plan that required these members to contribute a fixed amount of currency to be used at the Fund's discretion. Again, the U.S. continued to support currency loan agreements in place of gold, which pulled the system away from using gold to back currencies.

However, the EEC members were divided on the GAB. Throughout 1961, the Bank of France led the Community's contingent in questioning the wisdom of the GAB. They contended that the supplemental fund would undermine the guidelines imposed on individual nations, making national adjustments for the sake of the external balance less acceptable. France was also suspicious of U.S. motivations for expanding the Fund's resources and feared that the institution was becoming a means for the Americans to dominate international monetary policy, with British support. Because of this, France wanted to allow contributions on a regional basis, so each member region could hold a

⁵⁸ Gowa, *Closing the Gold Window*, 52; and Degen, *The American Monetary System*, 134.

⁵⁹ Strange, *International Economic Relations*, 108-109. After the Fund provided emergency help to the sterling in April 1961 "the Fund's total resources had consisted of a bare \$400m in pounds and dollars and only \$1,500m in other convertible currencies." She states further that when the British drew another \$1,500m that August it drained almost all of its remaining resources, forcing the IMF to sell \$500m of its gold.

⁶⁰ The G-10 was formed shortly after the GAB debate. Its members include the United States, Great Britain, France, Germany, Belgium, Canada, the Netherlands, Sweden, Japan and Italy. Switzerland is not a member of the Fund, but did become a GAB participant in March 1963.

veto over usage and thereby having some amount of control equal to the U.S. in the Fund. The Germans were comfortable with the U.S. and British proposal.

Yet, by the end of the year, European demands for more control over the supplemental line met with some success at the expense of the Fund's powers. After bilateral meetings between French and American leaders and in January 1962, the GAB won acceptance. The new supplement totaled \$6 million, with each member holding a vote proportional to its contribution. A member wanting to make a withdrawal would be under the scrutiny of finance officials from each G-10 country, and it took a majority vote for approval. The voting procedure gave the EEC veto power on the borrowing of both Great Britain and the U.S., assuming that the Europeans could muster the solidarity. Even with the lack of harmonious Community politics, France's challenge to the major reserve countries brought it to the forefront of international monetary reform and to "an enhanced role as watchdog."⁶¹ It was a role that France would use and sometimes abuse to meet its own needs.

Because of French provocations and the consistent troubles of the British pound, American officials were forced to look for tougher solutions for Bretton Woods' troubles. As early as 1961, French economist Jacques Rueff had been arguing that the system was heading for crisis. In several published articles, he argued for an increase in the price of gold, and for central banks to abandon their dollar reserves in favor of gold. Other economists did not support his position and considered his commentary nationalistic rather than a helpful critique.⁶² Rueff's suggestion was close to advocating a return to the classical gold standard, and while de Gaulle had not publicly come out in support for the idea, French banks did seem to be moving in that direction. According to

⁶¹ Strange, *International Economic Relations*, 105-117. Strange places the origins of the GAB within the Fund's management, but concedes that much of the action within the system was attributed to U.S. desires. (See page 102.) She also illustrates how the Fund's Managing Director Per Jacobsson's desires for the GAB slowly eroded in favor of an agreement with the French. Evidently, the need for additional resources was taken at the expense of the organization's power. In the end, the Director could only call a meeting of the G-10 to consider an application for the GAB's use. (112) It is also important to note that the GAB was a very exclusionary agreement. Only participants of the G-10 could use the function and there were no provisions for any other nation to be able to join. Quote from Bordo, Simard, and White, *France and the Bretton Woods International Monetary System*, 10.

⁶² Strange, *International Economic Relations*, 204-205.

IMF records, France had been steadily increasing its gold reserves at the expense of its dollar holdings, through the U.S. Treasury. French gold reserves jumped from \$812 million in January 1959 to \$1627 million by September of the same year.

Soon after Rueff's statements, the finance ministry began to criticize British and U.S. deficits. In September 1962, at an IMF meeting in Washington, Valéry Giscard d'Estaing stayed away from the gold price topic, but remarked that those responsible for reserve currencies should pay more attention to their balance of payments. When British sterling came under speculative attack in 1964, France converted a part of its dollar reserves into gold and heightened its public condemnation of the U.S. balance of payments all in a move to place gold into a more active part of international monetary politics. The Gold Pool dealt with France's dollar conversion and subdued speculative demand for gold, keeping the price at or below \$35.35 an ounce.

Even with the assurances of the Gold Pool, sterling's decline stripped the dollar's first line of defense. Great Britain was an international banker and policeman, in the words of Brian Johnson, "for fear that total responsibility for both these functions might topple the dollar."⁶³ This special relationship was tested throughout the 1960s, as America supported the pound's value, while increasing British dependence on the U.S.. Britain maintained a military presence in Malaysia and Singapore to contain communism in Asia and later to aid in Vietnam. In return for its exorbitant foreign defense expenditures,⁶⁴ the U.S. sustained the £2.80=\$1 rate that had been set in 1949. Central banks and organizations constantly intervened to maintain the pound's parity – in 1961, Britain received \$900 million from Europe and \$1.5 billion from the IMF, and a

⁶³ Brian Johnson, *The Politics of Money*, 234. For more on the role of the sterling in international monetary policy, see Sir Alec Cairncross, and Barry J. Eichengreen, *Sterling in Decline: The Devaluations of 1931, 1949 and 1967*. (Oxford, 1983); Benjamin J. Cohen, *The Future of Sterling as an International Currency*. (London, 1971); Richard N. Gardner. *Sterling-Dollar Diplomacy*. Expanded ed. (New York, 1980); Lawrence H. Officer, *Between the Dollar-Sterling Gold Points: Exchange Rates, Parity, and Market Behavior*. (New York, 1996); Susan Strange, *Sterling and British Policy: A Political Study of an International Currency in Decline*. (London, 1971) and also by Strange, *The Sterling Problem and the Six*. (London, 1967).

⁶⁴ Johnson, *The Politics of Money*, 236, says that overseas costs went from £147 to £449 million between 1957 and 1967. Despite military cuts after the Wilson Labor government took power in October 1964, the nation still spent over \$1 billion annually in foreign exchange abroad.

multinational \$1.4 billion rescue package in 1964 with the U.S. contributing \$400 million.

French-American relations were further strained by the resurgence of the liquidity question barely 3 years after the GAB debates. Opinions about creating a new reserve unit shifted as the GAB, Roosa Bonds, and the Gold Pool become inadequate to cope with national balance of payments problems. Progress was slow because the G-10 could not agree on whether to increase liquidity, or who would manage it.⁶⁵ France assumed that the U.S. could supply world liquidity for the foreseeable future, but wanted to participate in the talks because they believed that if the U.S. deficit decreased world trade would continued to increase. Germany was also against creating new reserve units, and Bundesbank representatives argued that national governments needed to pay more attention to stabilizing prices than to growth. The system worked fine, as long as members adhered to the rules and the IMF stuck to its lending policies.

The forum gave Giscard the opportunity to criticize the U.S. payments deficit, and disavow any French support to a scheme that would “discharge the major countries, particularly the U.S., from the obligation to balance their external accounts as soon as possible”.⁶⁶ Although concern over the payments issue was not exclusively French, these statements reflected French national interests in accordance with Jacques Rueff’s assertions. As Rueff had been clamoring to return to the classical gold standard since 1961,⁶⁷ France reasoned that exchanging dollar reserves for gold and increasing the gold

⁶⁵ There are many books on Special Drawing Rights see Stephen D. Cohen, *International Monetary Reform, 1964-1969: The Political Dimension*. (New York, 1970); Barry J. Eichengreen and Jeffrey A. Frankel, *On the SDR: Reserve Currencies and the Future of the International Monetary System*. (Berkeley, CA., 1996.); Dorothy M. Sobol, *Europe Confronts the Dollar: The Creation of the SDR, 1963-1969*. (New York, 1982); and Susan Strange, *International Monetary Relations*. (London, 1976). For specific plans of reform that were discussed during this time see Edward M. Bernstein, “The Reform of the International Monetary System,” *Moorgate and Wall Street* (Summer, 1965): 5-16.; Robert V. Roosa, *The Dollar and World Liquidity*. (New York, 1967); Jacques Rueff and Fred Hirsch, *The Role and the Rule of Gold: An Argument*. (Princeton, N.J., 1965.); and Robert Triffin, *The World Money Maze: National Currencies in International Payments*. (New Haven, CT., 1966).

⁶⁶ International Monetary Fund, *Summary Proceedings*, 1964, 208. As quoted in Sobol, *Europe Confronts the Dollar*, 315. Also, Cohen, *Organizing the World’s Money*, 53.

⁶⁷ See Bordo, Simard, and White, *France and the Bretton Woods International Monetary System*, 10-15, has a concise chronology of de Gaulle’s and Rueff’s statements about the dollar, gold and the IMF.

price would easily solve both the deficit problems and liquidity issue. The U.S. steadfastly rejected any change in the gold price as it would sever the dollar from the system and require an act of Congress. American delegates to the IMF and G-10 meetings made it clear that U.S. participation in the liquidity negotiation process was contingent on the members agreeing to maintain the current gold price.⁶⁸

Although France opposed creating a separate unit for liquidity, its forums enabled it to pursue national interests by negotiating for a unit that diminished the dollar's role in international monetary policy. Going back to a plan first devised by IMF research director Edward Bernstein, Giscard introduced a compromise in December 1963 called the Composite Reserve Unit or CRU. The CRU would be limited to the G-10 and Switzerland, and would be equal to the currencies of each member nation and in amounts equivalent to their gold reserves, with the ratio being one CRU to every nine units of gold. Usage of the CRU would only be achieved under a complete consensus. International accounts settled in gold and CRUs meant that the U.S. would lose a significant amount of its gold reserves unless it corrected its deficit. The value of gold would also rise and along with it, and in due time, the actual price. This penalized countries with dollars in their vaults.⁶⁹ In France's view, the other advantages of the CRU were that the unit would be a creation of the G-10, not a single nation, and, second, it placed the power to change the levels of CRUs in the hands of the group. In short, the CRU shifted power from the U.S. to the whole of the G-10. France's 1944 Bretton Woods strategy of keeping nations equal in monetary affairs shared some continuity with the CRU proposal, despite its thinly veiled attack on dollar dominance.

The U.S. rejected the CRU formula and its link to gold, but as Susan Strange pointed out, "the Americans had no scheme of their own in mind...the CRU was the only reform scheme to receive any detailed consideration in the deputies' discussions."⁷⁰ The G-10 could find no consensus, but the same time the Fund published a report

⁶⁸ See Sobol, *Europe Confronts the Dollar*, 315-316.

⁶⁹ Strange, *International Economic Relations*, 218; and Cohen, *Organizing the World's Money*, 49.

⁷⁰ Strange, *International Economic Relations*, 219.

advocating the increase of member quotas. The U.S. Treasury was more willing to negotiate a 50 per cent increase within the Fund than to continue with liquidity discussion and embraced the suggestion in 1964, but the EEC balked at the idea. Belgium and France rejected any increase, and Germany opted for only a 25 per cent rise, which was finally settled in 1969.⁷¹ The U.S. had achieved another success in the negotiations for more Bretton Woods Band Aids, because the Community failed to present a unified voice. Raising IMF quotas helped to correct payments deficits without threatening the dollar's international position or provoke devaluation.⁷²

Despite the quota agreement, liquidity deliberations continued as they waited for the latest G-10 study, but by 1965 France became more aggressive in its tactics to dethrone the dollar from its privileged perch. In February, President de Gaulle publicly echoed Rueff's commentaries, stating that the U.S. was no longer able to support the dollar as the primary reserve currency and that after consultation, the IMF should agree to return to the gold standard.⁷³ The President did not mention the CRU, but the French Finance Ministry did. By August 1965 Giscard argued in favor of the CRU plan, and now wanted the Bank for International Settlements to manage the unit, not the IMF.

⁷¹ France put another burden on U.S. gold reserves with a purchase of \$126million. Unlike De Gaulle's run on U.S. gold, this was not seen as an attack on the dollar's position, but there were still consequences to the sale. "The quota increase for all countries, which was decided last year, must be paid by December 15. Rather than dip into their own gold stock, the French are therefore buying gold from us to finance their payment... The French are fully within their rights to buy gold from the U.S. under the rules of the international monetary system and U.S. policy. The result, however, is that the U.S. winds up financing the gold portion of France's IMF quota increase. This is not a cause for concern per se, though it is a dirty trick on the part of the French, since they hold so much gold themselves (\$3.5billion)." Collection of Documents, National Security Council (NSC) Country Files: Europe; folder France vol. VII, 1 October 1970-March 1971; Box 677; Nixon Presidential Materials Staff (NPMS), National Archives, College Park, MD; especially – Memorandum; C. Fred Bergsten to Henry A. Kissinger (HAK); Re: French Decision to Buy U.S. Gold.; 10 December, 1970; and Memorandum; Helmut Sonnenfeldt to HAK; Re: Your Meeting with [French Secretary General Herve] Alphand, December 11; 10 December 1970.

⁷² Europe hardly presented a unified front. See Strange, *International Economic Relations*, 220-223.

⁷³ Telegram; Department of State to Department of the Treasury; Re: Dollar at De Gaulle Press Conference; 1 February 1965; folder Balance of Payments; NSF Subject Files; Box 2; LBJL. State warned of De Gaulle's statements 3 days prior to the speech and advised, "Washington might feel there is a tactical or strategic advantage in announcing implementation Gore amendment and any other measures under consideration prior Delphic pronouncements on Feb. 4." The Gore Amendment to the Civil Rights Act of 1964, would have prevented the federal government from withdrawing funds to schools that continued the practice of segregation. It was never passed.

Giscard continued to stand against an increase in the gold price, a marked departure from de Gaulle's sentiments.⁷⁴ The mixed signals made it difficult to decipher French objectives towards the unit or gold. Even so, the Bank of France was still accumulating gold reserves. By the end of 1964, gold accounted for 73 per cent of its holdings and de Gaulle made it an official goal in 1965 to clear all excess dollars from French vaults.⁷⁵ In 1966, that figure had risen to 87 per cent of gold holdings.⁷⁶ De Gaulle made the hard-line transition complete in January 1966, when he replaced Giscard with a Gaullist named Michael Debré, and the finance ministry's chief negotiator André de Lattre was sent to the Bank of France. The President chose to take a firmer position against the U.S. and after dismissing Giscard, he replaced de Lattre, making it clear that France was shifting its tactics. Amicably relieving the finance official from his position, de Gaulle told the American-friendly de Lattre, "You don't want to be around for this."⁷⁷

⁷⁴ Bordo, Simard, and White, *France and the Bretton Woods International Monetary System*, 14-16. For France's position after the Ossola Report see Strange, *International Economic Relations*, 225 and the *Financial Times*, 6 May 1965.

⁷⁵ Gordon L. Weil and Ian Davidson, *The Gold War*, 89. France repaid much of France's World War II debts to the U.S., which consumed surplus dollars. There were limits to the amount of dollars a nation could exchange since they were needed to purchase made abroad, and when dollars were not available, gold had to be used.

⁷⁶ Memorandum; C. Fred Bergsten to HAK; Re: French Decision to Buy U.S. Gold; folder France vol. VII 1 October 1970-March 1971; NSC Country Files: Europe; Box 677; NPMS. Bergsten states that France bought over \$2 billion of gold from the U.S. between 1963 and 1965. Paper; "Background Paper Visit of French Foreign Minister Couve de Murville, 3-4 October 1966."; 29 September 1966; folder International Classified: France; Box 68; Fowler Papers; LBJL. The paper noted "The present French policy is one of maintaining dollar holdings at their current level but converting all new dollars into gold the month following either acquisition."

French Dollar Holdings and Gold Purchases: [gold purchases from the U.S. are in parentheses () and given in millions of dollars]

	1960	1961	1962	1963	1964	1965	Aug 1966
TOTAL	2,070	2,939	3,610	4,457	5,105	5,459	5,963
Gold	1,641	2,121	2,587	3,175	3,729	4,706	5,209
Foreign Exchange	429	818	1,023	1,282	1,276	753	753
Gold Ratio	79.3 (173)	72.2	71.7 (459)	71.2 (518)	73.0 (406)	86.2 (884)	87.4 (567)

⁷⁷ André de Lattre, interviewed by Michelle Frasher Rae, tape recording. (February 2000) Paris, France. By many accounts, Giscard had fallen into disfavor with the Gaullist Party by this time. He was becoming more popular in French political circles and many thought that he would be de Gaulle's successor. However, Giscard began to disagree with many of de Gaulle's programs and after a short sabbatical, he returned to politics with a new party called the Independents.

As France shifted its strategy, the U.S. reversed its position, too. Lyndon Johnson appointed Henry Fowler as Secretary of the Treasury and assembled a team of advisers to discuss liquidity. Fowler signaled to the allies that the U.S. was willing to consider a new unit and with the institution of the IET, it looked as though the Americans were serious about the payments deficit. The Germans had also moved into a position of prominence since Dr. Otmar Emminger, a member of the board at the Bundesbank who had served as the German representative to the Fund in the early 1950s, took control of the G-10 deputies' chair in 1965. Throughout the liquidity debates, Germany's position remained constant, arguing that there was no liquidity shortage, but if there was to be a new unit, it should reflect the needs of the entire system, not the demands of one or two members. Like the French, the Germans believed the U.S. payments deficit was serious. However, unlike the French, the Germans saw little reason to destroy the dollar's position; instead, they sought to control it with existing guidelines. The Federal Republic rejected making gold the only means of managing exchanges, fearing that increasing the gold price to correct payments deficits would destabilize prices and create inflation – causing the members to change the gold price repeatedly in the future. Germany preferred to use reserve currencies in limited amounts with a basket of monies used for payments purposes. As to gold's role in relation to a new reserve unit, Karl Blessing of the Bundesbank supported close ties in some ratio. The German reputation for economic success and financial prudence, and the backing of the Netherlands, Belgium, and Italy lent this position credibility. This, combined with Germany's position as France's European partner in the EEC and its special relationship with the U.S. made Emminger an arbitrator for the French-American divide.⁷⁸

So it seemed that while the French had abandoned the liquidity proposal, the Americans were closer to accepting the need for it. For much of the first year of the Emminger chairmanship, France chose not to participate in IMF or EEC discussions, while Jacques Rueff inundated the international press with calls to *double* the price of

⁷⁸ Cohen, *Organizing the World's Money*, 79-88.

gold.⁷⁹ Emminger tried to construct a compromise, but the EEC members could not accept an agreement without French participation since it demonstrated an obvious rift in Community unity. France's unwillingness also tethered the U.S. from making any progress on reform since any arrangement required EEC involvement. By 1967, the French refusal to participate in the G-10 bred confusion and discord in international circles. The EEC was unable to form a common policy until France ceased demanding a gold price increase and was willing to consider the liquidity issue.

Acquiescing to re-enter reform discussions did not mean France's objectives had changed, only its diplomacy, and now it had the strength of the majority of the EEC membership. By the January 1967 meeting of the EEC Finance Ministers, the members agreed to study reform only in regards to expanding existing credit institutions. What this meant was, as Susan Strange puts it, "that the French were stealing the clothes worn by the Americans when they set out in 1964 to get a 50 per cent increase in Fund quotas, only to meet then with bitter French opposition."⁸⁰ The EEC outlined its position in April stating that although there was no need for liquidity assets at that time, there were sufficient circumstances to warrant a mechanism that required some repayment, and also took payments deficits into account. This meant giving no preferential treatment to members who had outstanding payments needs, but extending some programs for the health of the entire system. The ministers also asserted the Community's desire to be an active participant in the management of any drawing rights, which included veto power for the six.⁸¹

The U.S. felt that this was a step backward, and Fowler blamed the Germans. He believed that they had bowed to France's conservatism in monetary reform, and soon both sides were courting German favor. The Treasury pressed the liberal line with

⁷⁹ Strange, *International Economic Relations*, 239. The articles appeared in *Le Monde* (Paris) and *The Times* (London) in the autumn of 1966 and are reprinted in Rueff's memoirs listed above.

⁸⁰ Strange, *International Economic Relations*, 243. See also Cohen, *Organizing the World's Money*, 119.

⁸¹ Cohen, *Organizing the World's Money*, 123-129. The voting procedures of the IMF gave the U.S. 22 per cent of the 80 per cent vote needed for quota increases and amendments. The EEC feared that placing the reserve unit in the IMF would block European influence in decision making as their 16.5 per cent bloc was not sufficient to halt undesirable uses, thus, they recommended increasing the majority vote to 85 per cent.

Chancellor Kurt Kiesinger, Emminger, and Economics Minister Karl Schiller, telling them to be firm with the French. Arguing that it was counterproductive for the EEC to hold up policies and bend to the stubborn will of one dissenter, the U.S. stressed that the usual credit facilities would not be sufficient for the unavoidable shortages to come. New liquidity had to be as good as the dollar, and equally strong so that banks would trust it. Still, the Germans stuck to their European promises, but assured the Americans that there was room for agreement with the EEC, and even France.⁸²

They were right. After some time, the U.S. realized that it could not break the EEC's solidarity on voting rights, and agreed to alter IMF voting on new liquidity to give the Community veto power. In turn, the Germans and Italians supported the Americans on the amount of reserves a nation could use and how long it could wait for repayment. France finally acquiesced on the Canadian suggestion of five years and 70 per cent, meaning that the member only had to pay 30 per cent of its drawing rights. These concessions led to agreements at the IMF meeting in Rio in September 1967, where the EEC expanded its voting power to include decisions on the price of gold and obtained a gold guarantee and an interest rate on the Special Drawing Rights or SDRs. Still, it took two more years for the IMF to acquire the necessary votes to establish "paper gold." The SDR served as currency in place of bar gold, with its own accounts, separate from the General Account and the General Agreement to Borrow. Yet this was currency with a twist, as SDRs existed only on computer. While SDRs did not alter the price of gold, they were priced in terms of gold at a $0.888671=1$ SDR equivalent. The U.S. won its battle to reform the IMF in more liberal terms. Now it could use the drawing rights in place of dollars and not drain its gold reserves.⁸³ The French had a reason to celebrate, too, having acquired the drawing rights' connection to gold. However, as the SDR was also equal in value to one dollar, the French hope of an

⁸² See, Memorandum of Conversation; Karl Schiller, Economic Minister, Germany and W.W. Rostow; 1 May 1967; folder International Classified: Germany Schiller June 1967; and Memorandum of Conversation; Treasury and the German Finance Ministry about International Liquidity; 19 June 1967; folder International Classified; Fowler Papers; Country Files (CO): Germany 1967; Box 69; LBJL.

⁸³ Strange, *International Economic Relations*, 248-252; and Cohen, *Organizing the World's Money*, 134-147.

alternative to the dollar-dominated system was squashed. Still, the Europeans had gained something from the arduous negotiations. France and Germany bolstered Community veto power in the IMF, and kept a united demand for the reduction of U.S. and British payments deficits.⁸⁴

The System Teeters on Collapse

Revaluations, Devaluations, and the 1968 Gold Crisis

The SDR agreement had been finalized amid monetary and political crises that touched both sides of the Atlantic, and seemed to confirm the need for the unit. In 1967 the British sterling had another round of trouble even though the IMF already constructed many rescue packages including one in which the U.S. spent \$106.3 million to support sterling in only two days of July 1966. This time, the Six Day War in the Middle East prompted Britain to withdraw its defense commitments in the area, damaging exports and diminishing Europe's supply of oil. The United Kingdom's debts and commitment to U.S. requests for defense in Asia and the Middle East finally caught up with the sterling, prompting a rush of speculation. In October 1967, a 14 per cent sterling devaluation finally put an end to Britain's role as banker, and stripped away the dollar's first line of defense in the market.⁸⁵

Although the British had currency troubles throughout the 1960s, the 1967 devaluation relegated the pound to weaker currency status, which put it under the dependence of the dollar's strength, rather than its role supporting that strength. As a result, defending fixed parities became increasingly difficult for both the U.S. and Europe in the following years. Depreciation of the pound placed a strain upon the dollar, and it was now up to the U.S.D to maintain its strength at home and abroad for the sake of fixed parities in the system. No longer able to depend on the pound, the depreciation could only heighten the already growing concern over gold supplies that were necessary to keep the gold/dollar stability.

⁸⁴ W. M. Scammell, *The Stability of the International Monetary System*, 64-71, and in Kunz, *Butter and Guns*, 113, and footnote, 54, page 353.

⁸⁵ For a detailed description of the U.S. response to the British crises, see *Ibid*, Chapter 8 'Fighting the Good Fights'.

The Treasury urged dollar reserve countries, especially the Germans, who held a large amount of dollars in reserve, to stop buying gold from the U.S. in the spring of 1967, even though Fowler described the U.S. reserve position as “strong” with nearly \$15b, or about 20 per cent of world reserves, even after losses of the past few years.”⁸⁶ Lyndon Johnson continued to finance the Great Society, keep up defense commitments in Europe, and finance the Vietnam War using currency swaps and other Bretton Woods ‘Band-Aid’ arrangements. These policies sent more dollars out into the system, and spurred the demand for gold, which soon overcame new supplies. As stores declined, central banks sold gold privately to keep the market price, but it continued to slip from the vaults. France ceased to participate in the Gold Pool in 1967, leaving the Americans to pick up its 9 per cent share. This fact was not publicized, as it would have contributed to the growing opinion of speculators that the dollar could not maintain its set value because of the U.S. payments deficit.

From December 1967 to March 1968, the Gold Pool lost \$3 billion in gold, with the U.S. share at \$2.2 billion, and much of this occurred in the first three months of 1968.⁸⁷ Official gold reserves had increased throughout the 1960s, but de Gaulle’s campaign against the dollar stimulated private demand for gold. The Soviet Union cut supplies further when it stopped selling on the London Gold market. Speculators feared a dollar devaluation, because there were too many dollars, and not enough gold to

⁸⁶ Fowler quotes in Memorandum; Ernest Goldstein to President Johnson; Re: A resume of the Treasury paper of January 19, 1968; folder 1968 Balance of Payments 19-34; Box 54; NSF Histories; LBJL. The German agreement was made as a part of the Tripartite Agreement among the U.S., Great Britain, and Germany which included monetary and defense issues. The Germans had not converted dollar holdings into gold since 1960, except in one case when the Italian lira had troubles in 1964. U.S. officials feared that Germany might fall in line with French policies and accumulate gold reserves in place of dollars. Susan Strange points out that although this was reported in the U.S. press and in the Treasury Bulletin, the Bundesbank made no mention of it in its public reports. The Bank also agreed to buy medium-range (between 5 and 15 years) U.S. government securities with their dollar holdings. These securities functioned as a loan to be paid from the U.S. government. The provisions were made to cover the cost of keeping U.S. troops in Germany and the Federal Republic got control over arms purchases. See Strange, *International Economic Relations*, 270-272; and *The New York Times*, 3 May 1967.

⁸⁷ See Kunz, *Butter and Guns*, 115.

sustain the circulation,⁸⁸ even though the Johnson Administration and members of the Pool pledged their allegiance to the current gold price and the value of the dollar. Johnson also announced an ambitious plan to improve the payments deficit in January 1968. He cut foreign investments, focused on exports, and imposed restrictions on banks that dealt with foreign lending and targeted American tourism abroad. The president also asked Congress to eliminate the 25 per cent gold requirement that was mandated by law to back all domestic notes.⁸⁹ Congress complied, releasing \$10b in gold that could then be used to defend the dollar's parity. Market confidence was still low, however, due to the escalation of U.S. involvement in Vietnam, and another notice that the payments deficit had risen again. Private demand for gold drained U.S. reserves of nearly \$200m a day, and left \$11b by mid-March.⁹⁰

The London gold market was hastily closed, and members of the IMF, Bank of International Settlements managers, and central bank governors from Belgium, Italy, the Netherlands and Switzerland rushed to a weekend meeting in Washington. They disbanded the Gold Pool and replaced it with a two-tier system that allowed the market price for gold to exceed \$40, while banks would only conduct business at the official rate of \$35 an ounce. Authorities of the Pool agreed not to buy or sell gold from the private market, nor to sell to nations who chose to sell on the private market. Thus, investors who still wanted to speculate against the gold price were raising the price only among themselves and could not affect the price pertaining to currencies. The new Pool also demonetized gold, as only amounts already in reserve counted as gold available to

⁸⁸ Weil and Davidson, *The Gold War*, 128 and 132; Bordo and Eichengreen, eds., *A Retrospective on the Bretton Woods System*, 70; and Lieberman, *The Long Road to a European Monetary Union*, 57. See Milton Gilbert, "The Gold-Dollar System: Conditions of Equilibrium and the Price of Gold." *Princeton Essays in International Economics*. (Princeton, 1968); and Harry G. Johnson, "The Sterling Crisis of 1967 and the Gold Rush of 1968." *Nebraska Journal of Economics and Business* 7 (Autumn 1968): 3-17.; and Bordo and Eichengreen, *A Retrospective on the Bretton Woods System*, 71-72.

⁸⁹ Memorandum; CEA to President Johnson; Re: Responses to Your Balance-of-Payments Program; 6 January 1968; folder 1968 Balance of Payments; Box 54; NSF Histories; LBJL. The business community and Congress were positive. Germany expressed reservations about reaching the military offset target and the French felt that it was "discrimination against Continental Europe".

⁹⁰ Strange, *International Economic Relations*, 288-289; Paper; Gold Crisis 1968; no date (n/d); folder Gold Crisis 1968; Box 53; NSF Histories, LBJL. The paper cites that on 11 March gold losses were \$200m and reached \$400m by 13 March.

central banks and the IMF. New gold supplies had value on the second tier of the pool, but were not currency in the international monetary system. However, the two-tier system was flawed since only a few banks had to break ranks and buy gold from the U.S. Treasury at \$35 and sell it on the London market at a profit to split the arrangement.⁹¹ Even though gold was now demonetized, currencies still had ties to gold. The official dollar/gold ratio still determined parities. Par value adjustments to the dollar would require changing the gold price. The two-tier arrangement stalled an inevitable dollar devaluation that the U.S. found undesirable. Officials hoped instead that the two-tier arrangement and SDRs would lessen, or at least mitigate, gold's central importance.⁹²

De Gaulle denounced the two-tier Gold Pool even though France was no longer a part of it and had no input in the decision. The Americans returned France's animosity, and blamed part of the crisis on French actions. A Treasury department summary noted that "France chose the first business day following the sterling devaluation to announce that it had withdrawn from the gold pool – an action which it had in fact taken some months earlier."⁹³ During the crisis, Giscard, who was now head of the finance committee of the National Assembly in France, blamed the gold run on a confidence crisis because of the U.S. payments deficit and commented that this crisis was unlike previous problems because this time there was a "crisis of confidence vis-à-vis [the]

⁹¹ Scammell, *International Monetary Policy: Bretton Woods and After*. (New York, 1975), 180.

⁹² Weil and Davidson, *The Gold War*, 133. See pages 134-141 on how South Africa and Zurich, which did not participate in the Gold Pool agreement, played a cat and mouse game with the price. South Africa had traditionally sided with French views hoping that the price of gold would rise as producer of three-quarters of the free world's gold. By refusing to sell on the free market, the Africans hoped to decrease the gold supply and bust the two-tier system, while the U.S. knew that the Africans could not survive without the gold trade income. Zurich tried to break London's monopoly over the gold market after the system was split. For policy considerations during the emergency meeting in Washington, see Strange, *International Economic Relations*, 290-295.

⁹³ The Treasury paid close attention to French statements regarding monetary policy. See the following documents in International Classified: CO France 1968; Box 68; Fowler Papers; LBJL; Airgram; Department of State Treasury and Federal Reserve; Re: Jacques Rueff [statements and rebuttals towards Rueff's criticisms against the gold exchange]; Telegram; Department of State to Treasury; Re: De Gaulle on International Monetary Situation; 21 March 1968. The Johnson administration also attributed the crisis to the 1967 pound devaluation. See Paper; Gold Crisis Summary Book 1; n/d; folder Gold Crisis; Box 53; NSF Histories; LBJL.

entire monetary system.”⁹⁴ Finance minister Debré defended France’s actions from critics that claimed it was increasing problems for reserve nations:

That accusation is totally baseless. Without renouncing our diagnosis and without stopping our proposals for solutions we have many times provided an appreciable support to the United States and Great Britain. For the United States I recall that France from 1962 to 1966 made advance debt payments of more than \$1.1 billion, representing nearly the whole of the external debt. Conversions of dollars into gold were stopped in August of 1966, at which time the percentage of gold in our reserves had reached a level already realized by several other countries.⁹⁵

The fact that the French had been so public with their critical commentaries embittered the Johnson Administration against France. The U.S. saw de Gaulle’s actions and words as concerted attacks on the dollar’s weakness to force reforms that served European and French interests. Despite Debré’s assurances, keeping gold in the center of discussion held certain advantages for the French. The Bank of France had accumulated gold that constituted over 86 per cent of reserves mostly at the expense of the U.S. Treasury. The French president and his economic advisors feared that the U.S. balance of payments problem would damage the franc, and strip away de Gaulle’s economic successes. Whether U.S. disgust with the French was warranted or not, the lack of American-French consensus over the liquidity scheme at the time of the pound and gold crises contributed to the speculation on the dollar.⁹⁶

Despite France’s disapproval of the two-tier Gold Pool, by the spring of 1968 they had lost their momentum in international monetary affairs. Workers and students were rioting in the streets of Paris in part because of de Gaulle’s economic policies. Labor unions and students demanded comprehensive social and economic reforms to raise wages, lower taxes to cope with inflation. The General’s efforts to make France an independent and strong voice in defense and monetary affairs had exacted a harsh

⁹⁴ Telegram; Department of State to Treasury; Re: Giscard D’Estaing on Present Monetary Crisis; 19 March 1968; folder International Classified: CO France 1968; Box 68; Fowler Papers; LBJL.

⁹⁵ Memorandum; Rough Translation of Debré [sic] Statement, *Agence France Presse*, Friday, March 15, 1968; n/d; folder International Classified: CO France 1968; Box 68; Fowler Papers; LBJL.

⁹⁶ Bordo, Simard, and White, *France and the Bretton Woods International Monetary System*, 16-20.

economic toll on his citizens, increasing the gap between rich and poor and placing most of the tax burdens on the latter.⁹⁷

The domestic strife was detrimental to French monetary aspirations. Speculators dumped francs in favor of the German mark until exchange controls were employed at the end of May. As the French government had devalued the franc so many times in the past, the market saw little reason why it would not do so now, but de Gaulle adamantly resisted devaluation and turned to IMF resources to save gold reserves. He withdrew \$885 million in June and obtained a standby \$1.3 billion credit line from G-10 central banks the following month.⁹⁸ He then implemented export subsidies and import taxes, which made French goods more competitive abroad and soaked up disposable income at home by raising prices on imported goods. All of these measures met with the approval of the French electorate in a general election held at the end of June 1968, but the victory came at a cost. When laborers returned to work, they managed to produce enough goods to save the country's exports, but the income hike boosted spending on imports, contributed to inflation, and weakened international confidence in the franc. The precarious position of the franc was made worse when de Gaulle lifted exchange controls and shifted to a growth oriented economy, and then reinstated the controls, cut industrial subsidies, and froze wages and prices -- all in less than 3 months.⁹⁹

The General did not have economic schizophrenia; rather he was responding to German pressure to devalue the franc. In the late 1960s, Germany's restrictive monetary policies led to a mild recession in 1966, but the economy recovered in 1967 increasing imports, but expanding exports which produced record trade surpluses.¹⁰⁰ By November 1968, the Bundesbank had received over \$2.5 billion in foreign exchange to the

⁹⁷ Weil and Davidson, *The Gold War*, 142-147. For the French Riots see Hervé Bourges. *The French Student Revolt: The Leaders Speak*. (New York, 1969); Kristin Ross. *May '68 and Its Afterlives*. (Chicago, 2002); J. J. Servan-Schreiber. *The Spirit of May*. Ronald Steel, trans. (New York, 1969); and Daniel Singer, *Prelude to Revolution: France in May 1968*. (New York, 1970).

⁹⁸ Weil and Davidson, *The Gold War*, 148.

⁹⁹ Strange, *International Economic Relations*, 323-333; Weil and Davidson, *The Gold War*, 151-152; and Loriaux, *France After Hegemony*, 189-191.

¹⁰⁰ For German monetary policy see Chalmers, *Monetary Policy in the Sixties*, 148-158.

determent of the pound and franc.¹⁰¹ This was a problem for the Germans as well as the French, but neither would alter their parities. France refused to buckle to German conditions of financial support and by November 20, the franc-mark affair became an international concern. The German refusal to revalue followed the same line as their previous criticisms of other foreign monetary crises –responsibility lay with national policies, not with the German government. Since the German economy was healthy, it was up to the rest of the world to reform. The U.S. was interested in redefining parities, but realized that forcing devaluation might provoke dollar speculation.¹⁰² Instead, Germany applied a 4 per cent tax on exports, and 4 per cent concession on imports, which was a de facto revaluation. Speculators began buying marks.

Thus, de Gaulle's flip-flop lay in his determination not to succumb to German dictations, but his defeat in a second referendum in April 1969 removed him as an obstacle to monetary adjustment. Georges Pompidou succeeded him and devalued the franc by 11.11 per cent, and Valéry Giscard d'Estaing returned as finance minister. Giscard announced a \$1b withdrawal from the IMF to back depleted gold reserves, which had now returned to 1958 levels. These decisions had been made in July, but officials kept this fact from the EC and the IMF, reasoning that secrecy protected the franc from further speculation. They believed that at consultations that previous November in Bonn, delegates had come to an informal understanding that the franc would be devalued at 11.11 per cent, and this had fulfilled France's obligations to confer with its allies.¹⁰³ Devaluation did not solve the franc's problems, but the trade imbalance did improve, even though the threat of inflation meant that the finance ministry and central bank had to tighten monetary and fiscal policies.¹⁰⁴ Still, restricting

¹⁰¹ According to Weil and Davidson, *The Gold War*, 150-151, the German trade surplus was at \$1.3b in 1965, \$2.9b in 1967 and \$5.75b in 1968. German authorities insisted that the trade surplus was only part of the story and stated that the "outflow on the services account had reduced the current balance to \$2.875b and this current surplus had been almost wiped out by an outflow of long term capital of \$2.825b.

¹⁰² *Ibid*, 152-153.

¹⁰³ *Ibid*, 166-169.

¹⁰⁴ Loriaux, *France After Hegemony*, 192-193. Monetary policy is the control of the availability of credit and the cost of goods through the control of the money supply. Fiscal policy concerns the taxation and spending of the federal government by adjusting budgetary deficits or surpluses to influence the economy.

credit and spending had vary little impact on investments and the French GDP remained at 8 per cent in 1969 and 6 per cent in 1970. Some of the press commented on the devaluations necessity and the reemergence of the French 'fix all' for monetary troubles. *The Economist* stated, "France devalued when the franc, if overvalued in terms of confidence, was not seriously overvalued in terms of trade. France thus emerged once again with an undervalued currency, an old recipe for success."¹⁰⁵

The devaluation of the franc did not ease pressure on the mark, but the debate about revaluation was getting louder in anticipation of the general elections in September. In May, the German cabinet held a meeting with the Bundesbank, but Chancellor Kiesinger decided against devaluation after the Bank convinced him that maintaining the current parity would temporarily solve Germany's trade imbalance, since Germany could continue its "competitive advantage...year after year." Bank officials did suggest that there be some small adjustments to the mark's value over a period of years, and Professor Karl Schiller, the Minister of Economics, argued for a large 7 per cent revaluation, but both of these suggestions were voted down. Ultimately, a statement concluded that there would be no parity changes -- "final, unequivocal and for all eternity".¹⁰⁶

The market did not share that confidence in the finality of this decision, and the general elections of September 28 pushed Chancellor Kiesinger's Christian Democratic Union (CDU) into action. The Social Democratic Party (SPD), which favored revaluation, gained seats in the Bundestag and formed a coalition with the smaller Free Democratic Party (FDP), which gave the group a certain majority vote in favor of a parity change. However, days before the elections, Kiesinger ordered Schiller to close German exchange markets to halt the flow of speculative funds until after the elections. After the voting, the markets took in nearly \$250m. The Bank and Schiller convinced Kiesinger to keep the exchange open and allow the mark to float to find its own parity with the demand. The mark floated until October 24 and the new parity was set at 3.66

¹⁰⁵ As quoted in *Ibid*, 198.

¹⁰⁶ Weil and Davidson, *The Gold War*, 160-161.

DM to the dollar – a reduction of 9.29 per cent. German reserves declined by \$2.2b immediately after the revaluation and in November and December it withdrew \$1.05b from the IMF. Despite this fact, the German economic miracle and the trade surplus showed few signs of deteriorating.¹⁰⁷

Conclusions

The conference at Bretton Woods successfully created an institutionalized system for international currency management that was more reliable than the gold standard. Yet, almost immediately, the durability of the system came into question. Expanding economies' needs for liquidity, the reliance on fixed exchange rates, the tie of the dollar to gold, and the lack of an ample gold supply, combined to create difficulties for the international community and threatened to constrain American economic prosperity and restrain its actions in foreign policy. Thus, the centrality of the dollar to the system limited the U.S. president's policy choices. Presidents Kennedy and Johnson chose to keep America's commitment to convertibility, while funding their domestic and foreign agendas, but at a cost of a payments deficit. Having a deficit destroyed the external equilibrium so pivotal to Bretton Woods, and it seemed impossible to fix the U.S. payments deficit and support the value of the main reserve currency, while maintaining allied interests around the globe. The U.S. was not alone in its dilemma, however, as surplus nations such as Germany, should have corrected their imbalances according to the system's rules. The fears of the French delegation at the Bretton Woods conference, that one currency's dominance in the regime could throw the arrangement off balance, seemed to have come true. Multiple devaluations and revaluations of major currencies confirmed that the system needed constant improvement.

The reform negotiations of the 1960s that resulted in the Gold Pool, the General Agreements to Borrow, and Standard Drawing Rights, demonstrated the inadequacies of the system, and the fractious relations between the U.S. and Europe, and among the Europeans themselves. The debates reflected an antagonistic relationship between France and the U.S.. De Gaulle and his supporters enacted a campaign to break the

¹⁰⁷ Strange, *International Economic Relations*, 328-329; and Weil and Davidson, *The Gold War*, 172-174.

system from the dollar's dominance, for reason of political prestige and French economic security. They understood that the franc could not supplant the dollar, as the French economy was no rival for the U.S. in size or strength. Rather, France attempted to make the main reserve currency a unit that was more neutral than the dollar – gold. In this campaign, the French held enough influence to act as a watchdog for France's own interests, those of Europe, and of smaller states around the globe to extract concessions from the Americans during the negotiations. This strategy was interconnected with France's aims to enhance its image as the alternative power in the bipolar Cold War era. Therefore, its challenge to the U.S. was not designed actually to destroy the dollar, but to heighten France's prestige in international monetary circles. France's strategy contrasted greatly with Germany's friendly relationship with the Americans. The close German-American ties and the strength of the German economy, set the Federal Republic apart from France. As a result, the Federal Republic often had to make policy choices that threatened to alienate either its American allies or its European neighbors. In turn, European national agendas prohibited Germany and France from making any plans for integration beyond tentative promises.

After a decade of successive crises under Bretton Woods, despite numerous reforms, significant parity shifts and endless wrangling for power over the course of reform, the U.S., Germany and France felt battered but not yet ready to scrap the system entirely. They held the hope that the U.S. deficit would recede, correcting the external imbalance that Europeans were sure caused much of the reserve currency's problems, and that recent currency alignments would successfully ameliorate parity discrepancies. The nations also held true to the course of reform and their belief in fixed exchange rates, even though the German mark's latest revaluation had shown that markets could successfully operate under these conditions. For the time being, floating was a risk they were not willing to consider – conditions had not deteriorated to this point and the president of the United States, who ostensibly controlled convertibility, had not decided on the demolition of the Bretton Woods. Yet.

CHAPTER III
BRETTON'S SINKING SHIP: 1969-1970

The German float brought governments and the finance community to two conclusions. First, that floating currencies did not lead to assured economic disaster; and second, that fixed parities were no longer certain. These realizations, and the rash of Bretton Woods reforms -- the GAB, currency swaps, and SDRs -- confirmed the need for a permanent overhaul of the system that went far beyond these measures. The governments of France and Germany worked to reorganize the system, but also tried to strengthen their power in international monetary relations through European integration. Both reform and integration progressed slowly, and dialogues were full of conflicting national interests. The differences of European economies insured that national interests would often thwart the Europeans from speaking with a united purpose in the Bretton Woods discussions, and stall plans for integration. The U.S. supported European integration in the hope that the continent would emerge as a worthy partner to share in the burden of Western defense. Early administrations committed themselves to cooperation in the international negotiations, despite some of the disadvantages to the U.S. economy.

This trend changed when Richard M. Nixon assumed the U.S. presidency. Although each administration had considered abandoning Bretton Woods by closing the gold/dollar window, to do so was an extreme option -- a last ditch effort amidst many choices. For decades, leaders on both sides of the Atlantic tried reform rather than replacement, but Nixon's attitude about junking Bretton Woods assured him a place in economic and monetary policy history. The choice fit the character of the Nixon camp -- bold, visionary, powerful, decisive, and nationalist. Nixon was not against cooperation, but he preferred to handle global difficulties in a manner that benefited American interests. Allen J. Matusow acknowledged, "He conceived his purpose not to resist the emergence of a multipolar world but to manage its consequences." Nixon was not above forcing some of that change on the world through his foreign policies, and in his

economic agendas. Nixon's goals included keeping unemployment and inflation at a minimum to insure votes for the Republican Party, and maintaining U.S. power abroad, both of which would credit his leadership and his legacy. If the demands of the international monetary system ran counter to these goals, then international demands would suffer. Thus, Nixon's attitude towards the system contrasted with his predecessors', and his domestic economic policies reflected these changes. Although he did not understand the complexities of international finance, and did not desire to, he gravitated towards advisers who presented the dollar's troubles in terms of U.S. power and politics. Therefore, his international choices became extensions of his domestic agenda.

When Nixon entered office inflation and high unemployment forced him to devote his attention to the economy. The president focused on recovery to win votes and ensure American dominance in world markets. For Nixon, economic policy was political economy -- the diplomacy of economics. He left the technical workings of the economy to his advisors and cabinet officers, and only became directly involved in economic and monetary matters when it involved a decision that would affect U.S. power or his position at the helm of that power. He chose to leave the Keynesianism of Kennedy and Johnson in favor of monetarism, that is, the management of the economy through the money supply and the restriction of government spending. The administration was to control inflation and unemployment while stimulating the economy.

Unfortunately for Nixon, the crumbling Bretton Woods would give him no respite from monetary concerns at the international level. The system's turbulent record of the 1960s, and the position of the dollar in that system, would force Nixon to spend a lot more time on monetary issues than he would have liked. Here too though, he had choices. Much like other presidents, he did have the power either to cooperate with the allies for reforms and continue to adhere to the U.S. commitment to convertibility and fixed rates, or he could decide that the limitations to his policy choices and to the U.S. economy were too great to justify the sacrifice.

Nixon's Domestic Economic Agenda

Gradualism, The Federal Reserve and Easy Money -- European Style

Nixon saw how economic stagnation restricted Johnson's choices in foreign policy and turning public opinion, so he turned to Milton Friedman, who was a leader of the monetarist group of economic theory, for guidance. Friedman believed that the amount of money in the system controlled the business cycle through the availability of credit to encourage private enterprise. This school of economic thought criticized Keynesians for over-stimulating the economy by relying too much on government funding and taxation, believing that this caused high inflation and contributed to sharp boom and bust business cycles. The new administration turned to what CEA Chair Paul McCracken termed "gradualism."¹⁰⁸ Gradualism required the Fed to use monetary restraint, while the government restricted spending.

The plan was politically and economically desirable for two reasons. First, the U.S. economy was steadily growing with heavy inflation. The administration hoped it could manage inflation, while avoiding recession and keep unemployment at about 3 to 4 per cent. Nixon was most concerned with inflation and surmised that it might open the administration and the Republican Party to criticism in upcoming elections. He understood that while the causes of inflation confused voters, any rise in unemployment was immediately recognizable to the electorate. If lowering inflation triggered higher unemployment, gradualism would be a political failure. "You can make every argument in the world economically but you have to consider the political timing. Whenever political considerations are not present we can afford to look at things purely from an economic standpoint. But that will not be often."¹⁰⁹

¹⁰⁸ For an excellent description of gradualism see Allen Matusow, *Nixon's Economy: Booms, Busts, Dollars, and Votes*. (Kansas, 1998). Herbert Stein, *Presidential Economics: The Making of Economic Policy from Roosevelt to Reagan and Beyond*. (New York, 1984) quotes McCracken claiming to be "Friedmanesque," that is he leaned towards the monetarist belief in the money supply but still believed that fiscal measures held purpose in economic policy. (139-140).

¹⁰⁹ Report of the Cabinet Committee on Economic Policy, 10 April 1969, personal papers of William Safire. As quoted in Matusow, *Nixon's Economy*, 16. Looking for a way to shed a positive spin on the relationship between inflation and unemployment, McCracken and the President were careful to discuss how gradualism should be portrayed in the media and to Congress. When McCracken sold gradualism to

Soon after the president chose to follow gradualism, Federal Reserve Chair William McChesney Martin raised discount rates and reserve requirements. Although Nixon's advisers agreed that this was consistent with the administration's goals, the President thought Martin went too far.¹¹⁰ As corporations demanded easy credit and did not get it from the Fed, they looked abroad to the Eurodollar market. Eurodollars were U.S. dollars deposited in the foreign branches of American banks that had been sent to Europe to pay for imports. There were no reserve requirements or interest rate limits on Eurodollars, and they became a source of short-term investment for the U.S.. Indeed, these funds improved U.S. balance of payments figures in 1969 -- U.S. banks took in \$6.9b Eurodollars in December 1968 and then \$14.3b in September 1969. This enabled banks to extend more credit, but the Fed's higher discount rate attracted repatriated Eurodollars and foreign investment that further fueled a U.S. boom. The Eurodollar market undercut domestic anti-inflation efforts, and the price index increased from 4 per cent in 1968 to 5.2 per cent in mid-1969.¹¹¹

With so many Eurodollars returning to the U.S., European banks suddenly had a shortage of dollars, as opposed to a chronic glut. Central banks dipped into dollar reserves and gold began to flow back to the U.S. along with these greenbacks. High U.S. interest rates attracted short-term investors, but forced the Europeans to raise rates to maintain their dollar reserves. The ease with which Eurodollars could affect the U.S. balance of payments was another signal that the system was failing to provide stability for the currency markets. It was also a means for the U.S. to improve its payments

the Joint Economic Committee of Congress on 17 February 1969, he predicted that the price of all goods would fall, and assured senators that unemployment would not jump over the 4 per cent mark. "The 1969 Economic Report of the President," (1969), U.S. Congress, Joint Economic Committee Hearings, 284-332.

¹¹⁰ Matusow, *Nixon's Economy*, 20-22, says that the Fed was struggling to recover some of its credibility from the Johnson years when it tried to slow the boom and rapid inflation and then abruptly switched its course and actually quickened the inflation rate. Nixon never trusted Martin, and blamed the Fed's policies for his defeat in the 1960 election. For commentary on Nixon's feelings about Martin see, Matusow, *Nixon's Economy*, 18-19 and 25-27.

¹¹¹ Eurodollars is somewhat of a misnomer, as the term refers to dollars anywhere outside the U.S.. Strange, *International Monetary Relations*, 332; Matusow, *Nixon's Economy*, 23; and Tew, *The Evolution of the International Monetary System*, 139-144. For more on Eurodollars see E. Wayne Clendenning, *The Euro-dollar Market*. (London, 1970); and Norris O. Johnson, *Eurodollars in the New International Money Market*. (New York, 1964).

balances at the expense of its allies. In short, the Eurodollar market was an easy, and temporary, way to manage the decline of the dollar without reforming the system. The fluidity of investments demonstrated how effortlessly any change in discount rates could trigger the flight of dollars across borders, which made currency markets harder to control. The Fed was unhappy with the Eurodollar fluctuations, as it severely undercut its tight money policy, and European central banks were discontented about the Eurodollar's effects on their own interest rates and the drain on gold reserves. For these reasons, Martin imposed Eurodollar reserve requirements that interrupted the lure of easy credit in June 1969.¹¹²

The Nixon International Agenda

Domestic Priorities vs. International Interests

Despite the pressure the Fed might have felt from the Europeans to manage interest rates and put a lid on the Eurodollar markets, Nixon wanted to keep monetary policy loose, and felt no pressure in doing so over the objections of the Europeans. Inherent to Nixon's new staff was a feeling of independence from the international obligations of Bretton Woods. When McCracken prepared a series of memorandums to explain the international monetary system to the President before his first trip to Europe in February 1969; he focused on unilateral remedies. One idea was clear – if cooperation was no longer possible (i.e. advantageous to the U.S.), the only remaining option was to suspend gold convertibility.¹¹³

The second sign of change in attitude came from Paul Volcker, Undersecretary of the Treasury for Monetary Affairs, and the head of the so-called Volcker Group. In the late 1960s, Volcker chaired a task force composed of representatives from the Treasury, the Federal Reserve, the Department of State, the CEA and the Assistant of National Security Affairs to assess the current international monetary situation and prioritize

¹¹² Gowa, *Closing the Gold Window*, 147; Strange, *International Economic Relations*, 332-333; Matusow, *Nixon's Economy*, 130; and Kunz, *Butter and Guns*, 196.

¹¹³ Kunz, *Butter and Guns*, 194. See also Memorandum; re: Europe; 20 February 1969; folder FI; Box 54; White House Central Files (WHCF);NPMS.

issues according to the national interest.¹¹⁴ Volcker approached the decline of Bretton Woods with foreboding, but admitted that “controls and financing gimmicks had been pretty well exhausted.” Even with this acknowledgment, he was not in favor of junking the system either. In his memoirs, he weighed the reasons why the U.S. had arrived at its position in the regime. Some of the blame rested on the Johnson Administration and its involvement in Vietnam. Volcker also believed that any monetary regime that depended so heavily on one country would inevitably fail.¹¹⁵ Yet, whatever the reason the U.S. found itself in trouble with the current system, Volcker was convinced that scrapping Bretton Woods was unnecessary, and that the U.S. could work for change within the current framework.

Volcker’s chairmanship of the Group produced a balanced analysis of the difficulties of using the dollar as the main global reserve currency and the strain it caused on the U.S. economy. The committee discussed the various ways the system could be reformed that would be beneficial to the United States. In its report titled *Basic Options in International Monetary Affairs*, released on 23 June 1969, the Group concluded that devaluing the dollar would prompt other nations to devalue their own currencies in proportionate amounts and cancel any benefits of an adjustment. There was good evidence that this would happen. Volcker mentions a conversation that CEA member Henrik Houthakker had with a European Community official about a scenario in which the dollar was devalued. How would the European Community respond? The

¹¹⁴ As a new appointee to the Nixon Treasury, he was instructed by National Security Memorandum Two to report directly to NSC Chair Henry Kissinger. He, and Treasury Secretary David Kennedy ignored this thinking that “papers on the intricacies of international monetary affairs ended up at the bottom of Kissinger’s in-tray.” Instead, they trusted that Kissinger’s capable staff could keep him informed, and nothing else about the matter was mentioned to Treasury. See Paul Volcker, *Changing Fortunes: The World’s Money and the Threat to American Leadership*. (New York, 1992), 65.

¹¹⁵ He quotes Sam Cross of the Treasury, “If you postulate a system that depends upon one country always following the right policies, you will find sooner or later that no such country exists. The system eventually us going to break down.” Volcker, *Changing Fortunes*, 63.

official responded, “All European currencies would be devalued by the same percentage on the same day.”¹¹⁶

The report also discussed changing the price of gold, but concluded that it would undercut the SDR, and give an advantage to countries that held more gold in their reserves than dollars. France was the most obvious beneficiary of this move; South Africa and the Soviet Union would also gain as the largest gold producers. Nations like Japan, which held the majority of their reserves in dollars, would be hit the hardest. However, there was a larger issue to consider when interfering with the gold price, and that was the loss of confidence in the dollar as a reserve currency. The Group calculated that even a ten per cent change in the price would do little to remedy the dollar problem and even “undercut the willingness of foreign central banks to hold dollars.” Volcker was against the idea, and only included the option for the sake of balance.¹¹⁷

The Volcker Group suggested an “evolutionary approach” through the use of SDRs and the introduction of more flexible options for exchange rates. Volcker hoped that increasing liquidity through SDRs would alleviate burdens on the U.S. deficit, while the two-tier gold arrangement would keep more gold from flowing into central banks. SDRs had been created, but not yet employed, and this part of the report did come about in 1970 when the U.S. drew a large amount. Using SDRs would buck up international confidence in the markets – “to demonstrate that we could work together to strengthen the system.”

The second part of the “evolution” was more alarming to America’s allies. Although the notion of flexible exchange rates had gained some acceptance in academic circles, policy makers had been cool to the idea. Now the academic community constituted a good part of Nixon’s new economic and monetary team. Volcker never received clear word that the administration was leaning in this direction, but he believed that rumors of the “unofficial-official” attitude of the administration came from

¹¹⁶ See The Volcker Group Report 23 June 1969 “Basic Options in International Monetary Affairs.” For a detailed analysis of the report, see Gowa, *Closing the Gold Window*. For Houthakker’s conversation with the EC official see Volcker, *Changing Fortunes*, 66-67.

¹¹⁷ Volcker, *Changing Fortunes*, 66-68.

Houthakker, who supported it, and Arthur Burns, former CEA chair and close advisor to the President. Still, the Undersecretary himself was not convinced that flexibility was the answer. Any public discussion about the possibility triggered speculation, and any attempt to introduce small parity changes might spur larger alterations that no central bank could control. And if officials in the U.S. were secretive about their partiality for flexibility, Europeans were more vocal about their abhorrence for the idea. Volcker was warned by one OECD official, “If all this talk about flexible exchange rates brings down the system, the blood will be on your American head.”

The stern warning came in the middle of the 1969 French devaluation and the drama of the struggle of the Federal Republic’s elections and revaluation. As the new French government under Pompidou labored to place France back into monetary order, it was in no position to do so amid talk of more flexibility in the system. Likewise, the Germans continued to maintain that the problem with the dollar lay with U.S. policy, and were content with leaving their brush with floating rates as a one-time occurrence.¹¹⁸ For the time being, the allies need not have worried about the survival of Bretton Woods in the hands of the Americans. Officials in the Nixon Treasury and CEA had no immediate desire to replace it. However, in comparison to previous administrations, the seeds of noncompliance with the status quo were in place as soon as Nixon took office.

The Economic Team Develops with Changes in Monetary Strategies

Arthur Burns and George Shultz Confront the Validity of Gradualism

The McCracken memo and the Volcker Report conformed to Nixon’s vision for a strong America, but the president was most concerned with remedying the flagging economy. Nixon was determined to lower unemployment and maintain growth, and he instructed Treasury Secretary David Kennedy to remove the capital controls on overseas U.S. investments that Johnson had implemented.¹¹⁹ When the restrictions were loosened

¹¹⁸ For Vocker’s summary of the report, the passages quoted above, and his opinions on flexibility see 67-69.

¹¹⁹ This would also pick up the slack from the limitations put on the Eurodollar market in June 1969. For the discussion on lifting the controls see Memorandum; HAK to President Nixon; Re: Reductions of Controls on U.S. Capital Outflows: Foreign Implications and a Note of Caution; 17 March 1969; folder

in April 1969, this meant that the Fed had to maintain high interest rates to keep capital from slipping into Europe.¹²⁰ Lifting the controls deviated from the Fed's efforts to tighten credit, and Nixon watched as Martin slashed the growth of the money supply to nearly zero in the second half of 1969.¹²¹ When Martin's term expired in 1970, and the country had slipped into recession, Nixon put Arthur Burns into the chairmanship of the Fed.¹²²

Burns was immediately confronted with a financial crisis that pushed gradualism further off course. The Penn Central Company, a merger of the Pennsylvania Railroad and New York Central only a year before, was unable to meet its debts. The collapse of the company, the seventh largest corporation in the U.S., could further damage an already shaky economy because of the volume of outstanding commercial paper it held. Investors turned to these investments, which were really short term IOUs, in times of tight money, and because commercial paper generally carried lower interest rates than traditional bank loans.¹²³ If holders could not redeem their paper then the corporate cash shortage could worsen. Sherman Maisel of the Federal Reserve Board reasoned that "corporations unable to borrow would shut down. Massive unemployment could ensue." Nixon's team tried to save Penn Central using the Defense Production Act of 1950, which provided companies with industries pivotal to defense with guaranteed loans. Defense Secretary David Packard refused, declaring it too risky, and the company declared bankruptcy.¹²⁴

Burns was worried that corporations might draw upon their bank credit lines to pay for their paper, and that banks would be strapped for funds to manage the rush. First, he lifted the limitation on interest rates for large amounts of certificates of deposit,

Balance of Payments; Box 309; NSC Subject Files; NPMS; and Memorandum; C. Fred Bergsten to HAK; Re: Relaxation of Balance of Payments Controls; 1 April 1969.

¹²⁰ Kunz, *Butter and Guns*, 193-194; and Gowa, *Closing the Gold Window*, 140;

¹²¹ Sherman Maisel, *Managing the Dollar*. (New York, 1973), 243-248; and Wells, *Economists in an Uncertain World*, Appendix I.

¹²² See Matusow, *Nixon's Economy*, for commentary about Richard Nixon's feelings towards Arthur Burns.

¹²³ Definition from Fitch, *Dictionary of Banking Terms*.

¹²⁴ Maisel, *Managing the Dollar*, 8. As quoted in Matusow, *Nixon's Economy*, 74.

which increased bank holdings by \$10b. These funds replaced the need for Eurodollars and they began to flow back to their foreign branches. The money supply grew by 5.5 per cent in 1970, far exceeding the expected 4 per cent target. The Fed had abandoned its tight money policies, and with it, gradualism.¹²⁵

The Penn Central affair did not doom the economy, but according to Matusow, it lessened Burns's enthusiasm for monetarism, since a committed monetarist would have ignored finance, and he chose instead to intervene. Nixon was now more determined to bend the economy to his will and prevent financial chaos from ruining his reelection. In that same year, during a reorganization of the executive offices, Nixon appointed George Shultz to the new Office of Management and Budget (OMB). Initially, Shultz convinced the president that gradualism could achieve full employment if the administration limited spending to the revenues that they would collect if the country reached full employment. This meant that a deficit was acceptable as long as expenditures did not exceed projected taxes when full employment had been attained. Shultz vied for Nixon's favor against the original architects of gradualism -- the CEA. The advisers had abandoned gradualism and anti-inflation and now advocated steady growth through increased money supply. They argued that this was the only way to achieve full employment in time for the 1972 election. The CEA's push for quick growth was exactly what Shultz opposed, but Nixon chose the expansionary course to full employment over Shultz's warnings.¹²⁶ Thereafter, the administration and the Fed were committed to fueling the economy and lowered interest rates to encourage investment and reduce unemployment.

However, there were consequences in choosing to follow the CEA strategy. Lower interest rates affected the delicate balance of short-term capital that had given the Fed such a headache in 1969. Now that money was easily obtainable again, and Burns had lifted restrictions on certificates of deposit, Eurodollars were no longer in such high demand. The combination of attractive interest rates, looser regulations on CDs, and the outflow of Eurodollars back to the foreign banks, began to flood the dollar market and

¹²⁵ Matusow, *Nixon's Economy*, 75; and Strange, *International Economic Relations*, 180 and 332-333.

¹²⁶ Matusow, *Nixon's Economy*, 75-79; and Stein, *Presidential Economics*, 145-147.

foreign reserves. This increased the U.S. balance of payments deficit and the gold/dollar ratio once again became a central concern for central banks.

European Parities and the Issues of International Reform

The U.S. Tries to Establish its Monetary Position in Europe

The waxing and waning of U.S. policy contributed to the tensions in transatlantic monetary relations, and the Europeans were in no mood to launch new cooperative measures either with the Americans -- or among themselves. During Nixon's search for gradualism's merits, the French had weathered the Paris riots and lost their own currency battle that led to the franc's sharp devaluation (see above). CEA chair McCracken believed that the turbulence of the franc devaluation had been a missed opportunity for the dollar. As advisers had reviewed the president's options for international finance, nearly everyone in the CEA, Arthur Burns (before he ascended to the Fed), the Volcker Group, and White House staffer John Brown, thought that the U.S. should spearhead new initiatives to reform the system with or without the cooperation of the Europeans. They saw the franc's devaluation as an opportune moment to act on reforms. The timing would be politically and financially advantageous, as the U.S. would look as though it was responding to a crisis in Europe. The franc's dip also affected the sterling and the dollar. Acting now would help the dollar in the long run, as interest rates could not keep the money supply in check indefinitely. There needed to be concrete reforms, not a reliance on the quick fix.¹²⁷

¹²⁷ Kunz, *Butter and Guns*, 194-195. See also Memorandum; Richard N. Cooper (Yale University, Economic Growth Center) to HAK; Re: Contingency Planning for International Monetary Crisis; 8 January 1969; folder FO-4: Secret Files (SF): Financial Relations [1969-1970]; Box 43; WHCF; NPMS. . . Cooper enumerated the different policy options available to the French and possible U.S. responses or initiatives. He suggested "...the United States should lead major financial countries to "recycle" the currencies back to where they came from. This can be done as a central bank operation, whereby central banks receiving large amounts of foreign funds re-lend them to central banks losing such funds. The real problems arise if either the British or the French feel compelled to change their exchange rates. . . French action would be the more complicated politically, but British action would have more profound economic effects." (1) Cooper noted that whatever the U.S. chose to do -- "The differences of view within those [Europe's] countries are greater than the likely differences between their governments and the United States, although some European countries would probably lean more toward an increase in the price of gold than should the United States." (4) Only in the case of a British devaluation did Cooper see suspension of convertibility or exchange rate realignment as a policy option. Convertibility "would be

Briefing papers for Nixon's first European visit indicated that the president should seek European suggestions on balance of payments issues and assure the allies that the new administration would be cooperative with rather than contrary to European needs. The discussions avoided any change in the price of gold or parity flexibility. Arthur Burns warned,

You have been correctly advised to show no interest on our part in an increase in the price of gold. Let us not confuse, however, what we say to others and what we say to one another. Messrs. Fowler, Martin, Barr, and company have made a new theology out of the Treasury's \$35 an ounce price of gold. Our own thinking must be pragmatic, not theological. By all means, let us try to keep the official price as it is, but let us also watch carefully the costs that we may incur through such a policy. And whatever else we may do, let us not develop any romantic ideas about a fluctuating exchange rate: there is too much of history that tells us that a fluctuating exchange rate, besides causing a serious shrinkage of trade, is also apt to give rise to international political turmoil.¹²⁸

Avoiding the gold issue also meant steering away from any concrete discussions on long-term reform, especially with France. The administration felt that, for the time being, Europeans were not partial to substantial reforms in the system because they might undermine the stability of Bretton Woods or finance U.S. payments deficits. France was willing to consider reform, but in a way that was clearly unacceptable to the Americans – a higher profile for gold with a hike in price, and “limits on the ability of the United States to finance a deficit through increases in foreign dollar holdings.” The Treasury advised Nixon to stress monetary cooperation in his meeting with de Gaulle and evade talking about gold entirely. McCracken, however, believed that the U.S. had to be a little less rigid on this point, and told Nixon that the U.S. might be favorable to a

regarded as an unfriendly act, since it would force a number of Europe countries to choose between accumulating dollar (thereby “financing” any expenditures the United States wishes to undertake abroad) and allowing their currencies to appreciate (thereby weakening the competitive position of their products in world markets). To European countries the implicit threat of this outcome would represent a strong incentive for an agreed realignment of exchange rates.” (6)

¹²⁸ Background Papers; Arthur Burns to President Nixon; 22 February 1969; folder *SECRET* Trip to Europe February-March 1969; Box 443; NSC Trip Files; NPMS. Handwritten underlining in original text.

change in the gold price with a comprehensive package of reforms beneficial to the dollar. Only in the context of a “total package” could the U.S. consider French demands.¹²⁹ As the Nixon visit occurred before de Gaulle’s fall from the French public’s grace in the second referendum, the U.S. team feared that the General would employ his characteristically aggressive tactics and force a change in the gold price through “a large unilateral devaluation...aimed at disruption of the monetary system...” They hoped that approaching him with a “package deal” would avoid such a maneuver.¹³⁰ Thus, the true purpose of the French visit was to see “how much de Gaulle wants better relations with us.” Nixon and the French president agreed that when talking about monetary policy they would exchange ideas through informal channels.

Nixon had assured deGaulle about his stance on Europe, saying, “[our] policy would be not to have our Government play as active a role as in the past in attempting to determine the shape and form of Eu[r]ope. We had ideas which we would submit, but we felt that this was essentially a matter for Europeans.” He delivered that same promise to Germany.¹³¹ The administration was supportive of the European Common Market as a means to expand the world economy and an organization that would someday form the basis for a unified and stronger Europe to aid in the defense of the continent. The Nixon staff put great importance on maintaining open communication between the U.S. and the EC Commission, which had occurred regularly since 1967. While these meetings were important opportunities to discuss the American concerns about trade wars on agricultural and other products, “trade relations...provide[d] a better

¹²⁹ Memorandum; List of Important Problems in France; 13 February 1969; folder Trip to Europe February-March 1969; Box 443; NSC Trip Files; NPMS. Memorandum; Talking Points – French; 20 February 1969; folder Trip to Europe February-March 1969; Box 442; NSC Trip Files; NPMS. Memorandum; Staff Secretary to HAK; Re: Dr. McCracken’s memorandum for the President re De Gaulle and the price of gold; n/d; folder President’s February-March 1969 Trip to Europe; NSC Trip Files; NPMS.

¹³⁰ Memorandum; Boon to President Nixon; Re: List of Important Problems in France; 13 February 1969; folder *SECRET* Trip to Europe February-March 1969, France; Box 442; NSC Trip Files, NPMS.

¹³¹ Memorandum of Conversation; General De Gaulle’s Office – Elysee Palace, Paris; folder Memcons – Europe 23 February – 2 March 1969; Box 447; NSC Trip Files; NPMS. Report; Germany: Economic Situation and Outlook and Objectives – Germany; 14 February 1969; folder folder Europe 23 February – 2 March 1969; Box 442; NSC Trip Files, NPMS.

atmosphere in which to pursue U.S. political objectives in Europe.”¹³² In short, European unity benefited the U.S. by strengthening the European capacity to burden-share and expand the global economy. If America could keep open lines of communication on trade issues vis-à-vis the Community, it could assure itself some influence in its affairs and perhaps some power in other areas of policy decision-making.

Europeans Try to Advance Common Interests

Georges Pompidou and Willy Brandt at The Hague

Nixon’s trip did not forge a cohesive international monetary position with the allies on monetary policy, and U.S. unilateral actions emerged a greater possibility. Europeans could not reach an agreement suitable for American tastes, but still there was little doubt that the allies were concerned with the problems of international currency management. For the time being, the French and Germans turned their attention to rekindling an interest in monetary cooperation on the European continent. The EEC had made little progress on economic coordination and even less on a common monetary policy since the Treaty of Rome.¹³³ In the first years following the signing of the Treaty, the Community created a Monetary Committee and several short-term economic policy groups. The members recognized that creating a common market would require a degree of policy coordination, but the short and medium term planning sessions served

¹³² Report; Background on Bilateral Issues European Communities – U.S.-EC Consultations on Economic Problems; 13 February 1969; folder *SECRET* Trip to Europe February-March 1969, Belgium; Box 443; NSC Trip Files; NPMS. Memorandum; U.S. Support for European Unity; 13 February 1969; folder *SECRET* Trip to Europe February-March 1969, General Background Papers; Box 443; NSC Trip Files; NPMS. Close consultations with the Commission became regular since the Kennedy Rounds. The trade negotiations “provided a framework for discussion” and commenced between 1963 and 1967.

¹³³ The Treaty does not specifically call for economic or monetary union to establish a common market. D.C. Kruse, *Monetary Integration in Western Europe: EMU, EMS, and Beyond*. (London, 1980), 13-14; points out that policy coordination may be a ‘logical’ conclusion to forming the market, but the signatories are not bound to “the maintenance of fixed and unchangeable parities.” Instead Article 107 states that the members should share a “common concern” regarding exchange rates, and it does permit changes in these rates to “ensure equilibrium of the overall balance of payments and to maintain confidence in its currency, while taking care to ensure a high level of employment and a stable level of prices.” The treaty is vague in this manner so not to restrict national control over exchange rate policies. It does, however, state that convertibility not be restricted “for the purposes ‘of any payments connected with the movement of goods, services, or capital, and any transfers of capital or earning to the extent that the movement of goods, services, capital and persons between Member States has been liberalized pursuant to this Treaty’.” See *The Treaty of Rome*, Articles 104, 106, 109, and 145.

as forums for discussion rather than consultations for establishing a cohesive community policy. At this stage, Europe could not hope for a high level of economic and monetary coordination because of devaluations, revaluations, and the disparities between their economies.¹³⁴

Instead, the Community concentrated on setting up the customs union and the Common Agricultural Policy (CAP). The CAP regulated subsidies to agriculture that fixed prices within the member states, and comprised over 50 per cent of the EEC's budget. The prices were fixed to "European Units of Account" (UA) defined in gold, but prices within each of the countries were set in terms of the national currency. Whenever there was a change in parity for a currency, the national prices would have to be adjusted by the difference. Therefore, the CAP depended on stable exchange rates, and the exchange rate problems of the 1960s motivated the members of the European Commission and the European Council to focus more on the creation of an actual monetary union.¹³⁵ In February 1969, the Commission completed the Barre Report¹³⁶, which was the first official appeal for coordinating national economic policies and a mechanism of mutual financial assistance. The Report recognized that if national policies were not harmonized they could damage what the Community had already

¹³⁴ There are too many books on the history of the EEC and EU to place them here. For a good detailed introduction see Desmond Dinan, *Ever Closer Union: An Introduction to European Integration*. 2nd ed. (Boulder, CO., 1999); Stephen George, *Politics and Policy in the European Community*. 3rd ed. (Oxford, 1996); John McCormick, *The European Union: Politics and Policies*. 2nd ed. (Boulder, CO., 1999). For the organization's history see Jonathan Pinder, *European Community - The Building of a Union*. 2nd ed. (Oxford, 1995); R. McAllister. *From the EC to EU - An Historical and Political Survey* (New York, 1997); and Derek Urwin, *The Community of Europe - A History of European Integration*. (Reading, MA., 1995). A full account of the CAP can be found in Grant Staff, *The Common Agricultural Policy*. (New York, 1997). For external relations see , Martin Hollanded, ed. *Common Foreign & Security Policy: The Record & Reforms*. (London, 1997); Peter van Ham, *The European Community and Central Europe: Integration, Collaboration & Discord Since 1947*. (New York, 1993); Ole Nrgaard, Thomas Pederson, and Nikolaj Peterson, *The European Community in World Politics* (New York, 1993); Simon J. Nuttall, *European Political Cooperation*. (New York, 1992); and Christopher Piening, *Global Europe: The European Union in World Affairs* (Boulder, CO., 1997).

¹³⁵ Kruse, *Monetary Integration in Western Europe*, 19-22; and Lieberman, *The Long Road to a European Monetary Union*, 52-53. Lieberman also suggests that the implementation of fixed prices for cereals in December 1964 convinced Europe that they indeed had created a 'de facto' monetary union, and that this was a deterrent to national parity changes.

¹³⁶ Formally named *On the Co-ordination of Economic Policies and Monetary Co-operation within the Community*.

accomplished, and might stagnate future endeavours toward unity. In the event that a central bank had parity troubles and was unable to manage with its available reserves, the Report suggested an arrangement where it could borrow from other members. Although this already existed with the IMF, the creation of such a fund within the EEC would be a source of European solidarity and identity.¹³⁷ European leaders were now thinking about independence from the international system by establishing a voice outside of the control of the United States.

However, individual nations were not yet willing to implement these ideas. National objectives, especially the divergent goals of the French and Germans, skewed the course of monetary integration, and European leaders focused on solving monetary problems at the international level through negotiations in the IMF. The idea of a united Europe, and the economies of the six, were not strong enough to part from the U.S. led system, and despite the instability of the 1960s, a crisis of confidence in Bretton Woods had not reached a sufficient level to unite the continent to a common cause.

A change in leadership in France and Germany brought new possibilities for European unity in 1969. After the tumultuous rule of Charles de Gaulle, Georges Pompidou won the French presidency and wanted to return France to a supportive role in uniting Europe that began with the ECSC and the Treaty of Rome. The new German Social Democratic Chancellor Willy Brandt was receptive to putting Europe back on track and later would refer to the inactivity of the ECC as a crisis:

Feelings of disgruntlement, disquiet and plain indifference were rife in the countries of Western Europe, which needed and wanted to unite but seemed incapable of doing so. Realism prompted one to ask whether what had been accomplished would grind to a halt unless there was a break-through to fresh ground.¹³⁸

¹³⁷ For a complete analysis of the Barre Report see Kruse, *Monetary Integration in Western Europe*, 22-29.

¹³⁸ Willy Brandt, *People and Politics: The Years 1960-1975*. J. Maxwell Brownjohn, trans. (New York, 1978), 244-245.

Bilateral meetings between the two leaders and representatives from various ministries soon established some common ground concerning the future of the Community.¹³⁹ This commonality was paramount to a productive conference since there would be no action on any fundamental issues, such as enlargement and monetary union, unless its largest members could come to an accord. Their efforts were partly responsible for an EEC summit held at The Hague in December 1969. Schmidt acknowledged, “Western Europe needs a success at The Hague...and it depends on Paris and Bonn that that result is obtained.”¹⁴⁰

Success would not come easy. There were serious disputes over monetary policy and whether to allow Great Britain into the EEC. Under de Gaulle, France vetoed Britain’s admission twice, because he wanted to keep France at the center of the Community and exclude America’s closest partner from having an intra-European influence. Pompidou’s France favored British membership as a means to counterbalance Germany’s economic power, and complement France’s political strength in Europe. Countering German influence had become an important strategy since Brandt was pushing for better relations with the East through *Ostpolitik*. Britain might serve as a counterbalance to the German initiative to the East, and the Chancellor undoubtedly understood that he needed to agree to some diplomatic concessions to make the West

¹³⁹Haig Simonian, *The Privileged Partnership: Franco-German Relations in the European Community 1969-1984*, 83. Brandt actually suggested a meeting in July 1969 during his visit to Paris and through a series of meetings between the German and French Foreign Ministers, much of the two nations’ agenda that was agreed upon during The Hague (i.e. British admission to the EEC) was the result of these private contacts. On Pompidou see J. Bredin, *La République de Monsieur Pompidou*. (Paris, 1974); Charles Debbasch, *La France de Pompidou*. (Paris, 1974); Edward J Kolodziej, *French International Policy under de Gaulle and Pompidou. The Politics of Grandeur*. (Ithaca, NY., 1974); Gilles Martinet, *Le Système Pompidou*. (Paris, 1973); Georges Pompidou, *Entretiens et discours*. Eduard Ballardur, ed. 2 vols. (Paris, 1975); Stéphane Rials, *Les Idées politiques de Président Georges Pompidou*. (Paris, 1977); and Eric Roussel. *Georges Pompidou*. (Paris, 1984). For a French perspective of Brandt’s Germany see Henri Ménudier, *L’Allemagne selon Willy Brandt*. (Paris, 1976). For Brandt see his memoirs *People in Politics: The Years 1960-1975*. J. H. Brownjohn, trans. (London, 1978). A German perspective on Pompidou’s France can be found in Jürgen Schwarz, *Die Europapolitik Frankreichs unter Georges Pompidou als Problem der westeuropäischen Gemeinschaftsbildung*. (Ebenhausen, Germany, 1973).

¹⁴⁰ *International Herald Tribune*, 29-30 November 1969.

more comfortable with his plans.¹⁴¹ The French people had shown a great deal of support for cooperation with the EC partners. Pompidou also knew that a pro-Europe stance would placate the Centrists and Independent Republicans who governed in coalition with his Gaullist Party.¹⁴² However, the issue that held more importance to the French, and was a major contention with the Germans, was the effect of monetary reorganization on the CAP. Pompidou needed to retain these subsidies to keep the French agricultural sector competitive on the European and world markets, and to secure the farmers' vote.

Discussions about British membership and the CAP were productive, but opinions on the course of currency union were more difficult. Germany had been content to manage monetary issues at the international level, but currency fluctuations and their effects on the EC customs union now forced the Germans to look for European solutions.¹⁴³ Brandt and his finance advisers felt that the EEC could no longer ignore the lack of economic consultation between nations as it was undermining the stability of national currencies and the possibility of European monetary union. The Germans, with the Dutch and Italians, wanted state coordination of economic policies, but France, Luxemburg, and Belgium felt that monetary policy coordinated at the community level should be the route to EMU. The Hague participants eventually accepted the German view.¹⁴⁴

After The Hague

The Werner Plan and European Monetary Union

In accordance with the agreements made at The Hague, the Council of Ministers began to implement the provisions of the Barre Report that had called for a mechanism

¹⁴¹ Enlargement discussions in the EEC were not confined to UK admittance, but also Ireland, Denmark and Norway.

¹⁴² Simonian, *The Privileged Partnership*, 79-80. Brandt, *People and Politics*, 246, asserts that Pompidou and he did not reach an agreement about the British until the end of the first day of the summit.

¹⁴³ Simonian, *The Privileged Partnership*, 81-82, says that the "French imposition of export subsidies and selective import quotas in 1968" was a leading factor in this decision.

¹⁴⁴ For a concise and excellent account of the events at The Hague and how they influenced European integration see Kenneth Dyson and Kevin Featherston, *The Road to Maastricht: Negotiating Economic and Monetary Union*. (London, 1999), 102-112.

of short-term monetary support within the EEC, and set to work on proposals for coordinated economic planning for the next five years.¹⁴⁵ Two strategies emerged in the debate that would influence the Werner Report –the grand strategy that would hopefully guide the Community to EMU in the coming decade. The Schiller Plan, headed by German Economics Minister Karl Schiller, advocated a multi-step plan where each nation would coordinate economic policies, using common goals and statistical measurements, in conjunction with monetary policies supported by the Governors of Central Banks Committee. Supranational institutions would eventually become building blocks for European political integration. These bodies would provide through a European Reserve System that resembled the American banking organization. Finally, exchange rate margins would get smaller until currencies were fixed, and no parity changes would be permitted without the consent of all member countries. The French proposal preferred to gradually give the Community powers and keep political and economic control within national governments. According to the ‘second’ Barre Plan, the Six would forego exchange rate fluctuations by banding together in the international monetary stage. Building on the first Barre Plan, short and medium-term credits would correct balance of payments irregularities, with an initial reduction of parities of half a per cent. In the following stages, countries would gradually adopt the economic planning formed by the Commission and limit currency fluctuation to one per cent. By 1976, the Community would have broad powers to create a banking system and taxes and capital would more freely across borders in preparation for a common currency.¹⁴⁶

The EC requested Pierre Werner, Luxemburg Minister of Finance, to study the Schiller and Barre proposals, as well as offers from the other Community members.

¹⁴⁵ The notable exception to the support of the Barre Plan’s creation of an inter-Community monetary fund was the Bundesbank. Its officials believed that it would increase international liquidity, which they felt was already sufficient. They also argued that they would be forced to commit a good part of German reserves to such an endeavor and this could restrict their options on the international level by restricting the amount of liquidity they had at their disposal for adjustments outside the Community. In the end, they agreed to a shorter-term mechanism with a limited amount of funds. See Kruse, *Monetary Integration in Western Europe*, 56-57; and Karl Klassen, “Die Verwirklichung der Wirtschafts- und Währungsunion aus der Sicht der Deutschen Bundesbank.” *Europa-Archiv XXV* (1970): 453-458.

¹⁴⁶ Lieberman, *The Long Road to a European Monetary Union*, 64-67.

When the Werner Committee¹⁴⁷ released its Interim report in June 1970, the committee members were themselves divided between the two Plans and neither contingent was happy with the results. The Interim plan did not give detailed directives of each stage for EMU. It advocated the establishment of an “Exchange Stabilization Fund” like the Barre Plan had suggested, but advocated narrowing instead of widening exchange rate margins. All national monetary policies would gradually be supplanted by plans constructed at the Community level. The supporters of the Schiller Plan opposed narrowing parities or planning at the Community level until national economies had been adequately harmonized. Yet, this did not mean that the Interim Report entirely sided with the French-led opinion. It also recognized the need for strong, central institutions to supersede national sovereignty over economic and monetary issues.¹⁴⁸

Thus, the members wanted EMU, but could not agree to the terms of getting there. After months of heated debate, especially between Minister Schiller and French Finance Minister Giscard d’Estaing, the Werner Group was sent back to revise its report and try to smooth out the differences between the economists and monetarists. In October 1970, the final Werner Report outlined implementation of EMU by 1980, with responsibilities shifting to Community levels, and the formation of new institutions.¹⁴⁹ The report did not advocate specific strategies. The committee altered the language of its original report to soften the differences between the two sides. The French, or monetarists, accepted that some sort of policy coordination could be done during the first stages of preparation, and the Germans, or economists, acknowledged more cooperation at the international level, a small reduction in exchange bands, and some type of European monetary fund. The compromise, referred to as “parallelism” by D.C. Kruse,

¹⁴⁷ The committee included representatives of the EEC Commission, the chairman of the Monetary Committee, the Committee of Governors of Central Banks, the Medium-Term Economic Committee, the Short-Term Economic Policy Committee and the Budget Policy Committee. Lieberman, *The Long Road to a European Monetary Union*, 67-68.

¹⁴⁸ Kruse, *Monetary Integration in Western Europe*, 54-58 and 62-70.

¹⁴⁹ For an in depth discussion of the Werner Plan see Ibid, 70-79. See also, Peter B. Kenen, *Economic and Monetary Union in Europe: Moving Beyond Maastricht*. (Cambridge, 1995), 5-6. A reprint of the Werner Report can be found in Alfred Steinherr, *30 Years of European Monetary Integration From the Werner Plan to EMU*. (New York, 1994), 10-28.

worked because it was so vague that it could be interpreted in “...six different ways – one to suit each member’s tastes. Like EMU itself, the compromise formula was acceptable precisely because it was vague enough to mean whatever the user intended.”¹⁵⁰

However, it wasn’t vague enough. Although a majority of the members supported the Werner Report, the recommendation that Community institutions gain more power at the expense of national sovereignty angered Pompidou and induced hostile reactions from the Gaullists. France's representative to the Werner Group, Bernard Clappier, was strongly pro-European and not been given any restrictions in his opinions to the Group by the Pompidou government. Pompidou then tried to shift discussions from new institutions and political coordination to focus on the implementation of the first stages of the EMU at the national level. These were not separate issues to the Germans. Brandt did not feel that strengthening EC institutions and formation of EMU could develop independent of each other. The Germans trusted strong institutions because of their federalist government and this was the route Germany believed the Union should take. The differences were evident in the EC finance ministers meeting in December 1970, when Schiller took a strikingly aggressive stance towards Giscard, and blamed the French for stalling Community efforts.¹⁵¹

Some kind of conciliation would have to come from bilateral efforts between Brandt and Pompidou. Pompidou seemed to back away from the once promising Franco-German initiative, yet Brandt needed to secure French support for *Ostpolitik*, and to quiet domestic criticisms that his government was ignoring allied relations in favor of Eastern detente.¹⁵² Brandt described the conciliatory conversations he had with Pompidou in January 1971:

Pompidou said that, like me, has was presupposing a period of ten to twelve years and concurred with the German demand for parallel co-operation in economic and monetary policy. He hoped that national

¹⁵⁰ Kruse, *Monetary Integration in Western Europe*, 73.

¹⁵¹ Simonian, *The Privileged Partnership*, 89-90.

¹⁵² *Ibid*, 90.

currencies would be automatically linked after an initial phase of roughly three years, a concomitant of this process being support for weak currencies. I interjected that we wanted an agreement on future procedure before the initial phase ended, and that this entailed the formulation of political objectives.

We both favoured a precautionary or safety-clause during the initial phase, in case a national currency became effectively devalued and the government in question was unwilling to take the necessary remedial measures. We both assumed, therefore, that the creation of a monetary union would take at least a decade and be dependent on the steady growth of economic integration.¹⁵³

The meeting smoothed some of the disagreements, but at the cost of a strong and clear strategy to guide future Community policy. The Chancellor accepted Pompidou's national attitude towards monetary unity, and responded that the German government did not demand perfect and whole EEC institutions to manage a new system.¹⁵⁴

Brandt's courtship of France's ideas kept the Community focused, even if that focus still failed to carry a clear strategy. By March 1971, the EC adopted measures for EMU from the Werner Report and agreed to implement its provisions by mid-June. Exchange rate bands were to be narrowed. Instead of creating new institutions, the Six were to increase consultations regarding national economic policy coordination, which included talks on the standardization of industries, and liberalizing the movement of goods and services across community borders. The members were confident that these measures and their economies were strong enough to achieve their goals, but they were also cautious. In case one nation was not satisfied that there had been sufficient progress in monetary matters during the first stage, it could opt out of moving on to the second stage. Although the Chancellor accepted Pompidou's no-institutions view of the Community, Brandt had insisted on the arrangement to quiet German fears about financial commitments to EMU in the second stage if the EEC could not agree on a strategy for the next phase.¹⁵⁵ Both men received some political and economic insurance

¹⁵³ Brandt, *People and Politics*, 254-255.

¹⁵⁴ *The International Herald Tribune*, 26 January 1971.

¹⁵⁵ Kruse, *Monetary Integration in Western Europe*, 74-83; and Simonian, *The Privileged Partnership*, 93.

to declare a victory for their respective visions of united Europe, but at the cost of a clear design for the future of EMU.

Conclusions

Persistent inflation and high unemployment in the U.S. economy challenged the Nixon presidency. The administration initially turned to gradualism, a monetarist inspired strategy to manage the economy by controlling the money supply through the Federal Reserve. However, the effectiveness of gradualism was undercut by the availability of Eurodollars, which caused a dollar shortage abroad, forcing European banks to deplete their dollar reserves and raise interest rates that threatened to stifle their economies. This improved the U.S. payments position, but it was a temporary fix and demonstrated how easily interest rates could affect the operation of Bretton Woods. When the Fed imposed and then lifted controls on these funds, it showed that the U.S. was willing to use loopholes in the system to improve its position on the backs of its allies. Gradualism was abandoned altogether when Arthur Burns responded to business crises by easing credit and the CEA advocated more money to spur growth.

The international monetary community was not entirely misguided in its assumption that the Nixon team would be more eager than previous administrations to eschew cooperation in international monetary affairs when unilateralism suited U.S. interests better than collaboration. Officials approached problem solving and reform from an “America first” perspective, by looking for agreements with its allies on U.S. terms. The “evolutionary approach” endorsed by the Volcker Group combined cooperative and confrontational elements in its plans for reform. The SDR was part of an international effort, but the suggestion to introduce flexibility was anathema to the Europeans who feared what fluid exchange rates would do to their smaller economies. The idea of more flexible exchange, although not presented to the allies for fear of their negative reactions, could not have come at a worse moment. The notion of flexibility during the French political and monetary chaos and the (albeit stable) German revaluation, was an indication of the difference among the allies.

The U.S. did not act on the Volcker suggestion or push it at the reform table. This was probably because a) it was unsure of the actual market reaction to a floating currency would be. The mark may have been stable, but its impact on world exchange was minor compared to what the dollar's float might bring; and b) the dollar had not been affected enough to spur action. Evidence of this fact was seen during the franc's 1969 devaluation when Nixon, despite his advisers' urgings to act, stayed silent on monetary affairs. Until the markets directly attacked the dollar, the administration would not respond.

The Europeans were also thinking of protecting themselves and creating a forum strictly for their own interests. De Gaulle had taken the lead in challenging the dominance of the dollar, but his tactics left U.S.-French and at times French-European relations in turmoil. As Georges Pompidou and Willy Brandt ascended to leadership in 1969, they attempted to repair European relations through a rekindled interest in integration. However well-meaning their intentions though, they were unable to overcome the hurdles that separated them to agree on a fixed plan for European monetary integration. First, Europe's economies were too unequal. Without coordinating policies, they could not hope to close these gaps and align their exchange rates, which were crucial for EMU. Second, the Germans and French held different visions of the shape of European integration. The controversies around the Barre and Werner Plans demonstrated Germany's desire for tangible institutions to guide the EC and the French abhorrence of this in favor of a loose confederation of states. In the end, the language of integration was so vague that it accommodated every voice of the Six as individual nations, rather than a united continent. Therefore, while the symbolism of the European agreements was strong, their substance as an independent proclamation for Europe in international monetary affairs was weak.

The struggle for integration also helped to define the French and German relationship. The gold crisis and the franc devaluation diminished France's power as a champion for monetary reform, and French power was now more firmly embedded in its role as the political counterweight to Germany's economic prowess. France used

European integration as the centerpiece of its efforts to establish a European identity in monetary politics. On the continent, France was able to take the lead in creating a monetary regime for Europe, and exclude direct American influence. This was a role that Germany, although controlling the most powerful economy in Europe, could not take. Politically, the Germans needed to show that they were dependable and peaceful partners for the future of Europe. The Federal Republic needed to have France as its partner to make German intentions trustworthy. In monetary circles, Germany's insistence on strict guidelines for monetary integration lent the EEC credibility in international circles. Here, integration served as a mechanism for the balance of power between France and Germany in Europe, and agreement between these two nations would determine if Europe would be a stronger influence in international monetary issues. In this equation, uniting Europe depended greatly on the survivability of Bretton Woods, and whether the U.S. chose to cooperate with the continent in reforms, or take advantage of the dollar's privileged position and opt for unilateral actions.

CHAPTER IV

BRETTON WOODS BREAKING POINT: 1970-1971

At the start of the 1970s, the EC hoped that they could achieve EMU by 1980. Success depended on four components – Bretton Woods, the United States, and France and Germany. Bretton Wood's fixed parities were the anchor for Community rates, and the stability of the system was paramount to success. The U.S. economic picture that was so central to keeping the dollar's privileged rate maintained the system's exchanges, and so Europeans were keenly interested in keeping the dollar stable. Finally, political and economic cooperation between France and German was critical to construct the EC's future.

Yet this structure for European monetary union was built on a house of cards. The Bretton Woods system had needed many reforms in the previous decade. The U.S. payments position had been slipping since 1958, but the American trade surplus had kept the dollar's parities somewhat stable. Successive American presidents committed themselves to the fixed parities, but the years of external imbalances, the desire to maintain the system at the expense of the U.S. economy, deficit spending to fund the war in Vietnam and the Great Society, which had all aided to deteriorate the dollar's position. By the summer of 1971, the Nixon administration had already looked at reforms and hoped that it could make an agreement with EC cooperation that was favorable to U.S. interests.

But these efforts failed. With the trade surplus turning into a deficit and new pro-American leadership in the Treasury, the Nixon team was forced to detach the dollar from its fixed foundations and obligations. Europe could no longer depend on the U.S. or the markets to maintain fixed rates, and years of reform negotiations ensued. However, the members of the Community were not ready for EMU. Germany and France could not agree on what European integration meant or how they should coordinate their diverse economies to make currency alignments possible. Bretton Woods, with its familiarities and fixed parities, was the only constant they could rely on

when making EC policies, and with its demise, Europe had to learn to speak with one voice if it was going to have a united monetary future that operated independently from U.S. policy but in harmony with an international system.

The Bretton Woods Parities Waffle

Markets push for Adjustments and EMU is Jeopardized

While the governors of Europe's central banks agreed to limit parities against the dollar, leaders looked for promises from Richard Nixon that the U.S. would still adhere to Bretton Woods. Nixon pledged cooperation in international monetary affairs in a February 1970 speech, but he made it clear that he expected Europeans to do their share. He linked the health of the U.S. economy to worldwide prosperity, saying, "Good U.S. economic policy is good U.S. foreign policy" and "our approach is a sharing of international responsibilities."¹⁵⁶ Pompidou was less confrontational with the dollar than de Gaulle had been, and Nixon's concern about the system, and strengthening the dollar's position, was a welcome help to the EC's efforts to narrow its parity bands. According to the Werner Plan, European currencies would narrow their parities to a +/- 1.2 band around the dollar. Since the stability of European exchange rates depended on a steady dollar, a U.S. Treasury memorandum asserted that Pompidou understood

that the U.S. dollar is the pivot or the reference point on which the international monetary system rests. He feels that the system can only function well if the dollar maintains a stable value. Failure of the United States to preserve price stability forces all other countries either to accept inflation in their own countries or to revalue their currencies – an action which, he said, was politically extremely difficult.

The French president also stressed that individual nations had to address payments difficulties, but not by infusing flexibility in the system. He feared that introducing flexible exchange rates might wreck the chances of a workable parity structure among the Community currencies. An international system based on fixed rates installed some

¹⁵⁶ Report; U.S. Foreign Policy for 1970's: A New Strategy for Peace. A Report by president Richard Nixon to the Congress; 18 February 1970; folder Fiscal Policy for FY 1971; Subject Files; Box 167; WHCF:SMOF:Stein, NPMS.

confidence and organization in the EEC's plan. The Treasury, echoing the views of the Volcker Report,

...assured President Pompidou that we did not look upon increased flexibility of exchange rates as a means of escaping the responsibility of achieving and persevering general price stability in the United States. We did feel, however, that the possibility of employing techniques for limited exchange rate flexibility to strengthen the monetary system ought to be carefully examined.¹⁵⁷

While the attention that the U.S. paid to the payments problems might have calmed the nerves of cautious Europeans in their first attempts at currency union, it was a short-lived relief. The stresses of the Bretton Woods system were about to force fundamental changes to these plans. Nixon's desire to keep the U.S. economy expansionary and the money supply liquid through lower interest rates in 1970 proved to be the final undoing of the dollar. In the beginning of 1971, the financial community started to dump dollars, still believing it to be overvalued. Speculators, who had already started buying DM in 1970,¹⁵⁸ began to exchange more dollars for marks because of the Bundesbank's anti-inflation program that kept interest rates high. The capital flow increased in April 1971, when the major German economics research institutes published reports that the mark was undervalued and more dollars flooded into German banks.

¹⁵⁷ Memorandum; Treasury to President Nixon; Re: Meeting with President Pompidou; 2 March 1970; folder CO 50 France (1969-1970); Box 4; WHSF:SU:Confidential Files [CF]; NPMS. . While the EEC was concerned about the impact of U.S. policy on their currency plans, the Nixon Administration noticed the Community's development. It supported the expansion of the EEC but not at the expense of U.S. trade and even studied the possibility of establishing a common market among the U.S., Canada, the UK, Scandinavia and Portugal. See National Security Decision Memorandum (NSDM); NSDM 68 U. S. Policy Toward the European Community; 3 July 1970; Box 363; NSC Subject Files, NPMS; Memorandum; Alexander Haig to [C.] Fred Bergsten; Re: Alternatives to the Common Market; 10 November 1970; folder European Community vol. 1 1969-1970; Box 322; NSC Subject Files; NPMS; Memorandum from C. Fred Bergsten to HAK; Re: Alternatives to the Common Market – Your Request for My Views on a Possible Study (Tab A); 11 December 1970; folder European Community vol. 1 1969-1970; Box 322; NSC Subject Files; NPMS.

¹⁵⁸ The Bundesbank put a 30 per cent reserve requirement on non-resident bank deposits in April 1970, and reduced the discount rate in November and December 1970, and then again in March 1971, but this did nothing to stave off speculation. See Kruse, *Monetary Integration in Western Europe*, 86.

On 5 May 1971, over \$2b came into the German exchange, forcing the Bundesbank to close the market and suspend dollar operations of the central bank.¹⁵⁹ The cabinet was divided on how to act. Bundesbank President Karl Klassen supported economic controls and had the backing of the business community that did not wish to see the value of their exports rise with a revaluation. Agriculture Minister Josef Ertl and Foreign Minister Walter Scheel were for implementing controls also. Ertl feared what revaluation might do to the CAP, and Scheel was concerned that floating the mark again, which effectively meant jumping to the next stage of EMU, would damage relations within the Community. Finance Minister Schiller argued for floating because it would relieve the DM from supporting the dollar, and since Germany held a trade surplus, devaluation could balance the current account and combat inflation by reducing the prices of imports and increasing the amount of goods and services to meet heightened market demand. Schiller also hoped that suggesting a float amidst a crisis would alter the EMU agreements and push the French to the German line of nationally coordinated economies.¹⁶⁰

In the end, the cabinet decided on a float and advocated a joint Community parity change at the ECC Commission meeting a few days later. Schiller pressed for quick action to restore the monetary balance and tried to convince the French to accept the idea. A joint float would keep the mark's parity stable against the European currencies, and the adjustment would effect Community parities vis-à-vis the dollar, while maintaining CAP prices and sticking with the goals of EMU – albeit a bit sooner than planned. The French, however, were resolute against the joint float. They were accustomed to imposing administrative restrictions on capital and the surplus France enjoyed was in concert with its expansionary economy. Appreciating the franc would cut the surplus and might affect the steady flow of easy credit or weaken French competitiveness. There was also a political issue in that a joint float would essentially

¹⁵⁹ Holland, Switzerland, Belgium, and Austria had the same influx of dollars and closed their markets the same morning. See Memorandum; HAK to President Nixon; Re: International Monetary Developments; 5 May 1971; folder Balance of Payments; Box 309; NSC Subject Files, NPMS. .

¹⁶⁰ Simonian, *The Privileged Partnership*, 102-103.

link the franc to the mark and create a German currency zone, and be a benefit to the Americans at the expense of Europe.

France's aversion to floating because of the advantages to the dollar was understandable. Through benign neglect, the U.S. was bullying the allies into actions that would hamper European initiatives. While none of the six confronted the same concerns, Germany had by far the most to gain and lose. Brandt needed to keep European relations friendly because of *Ostpolitik* and EMU, but he also had to maintain healthy U.S. ties because German security relied on the American military commitment in Germany, and the U.S. Congress was considering a reduction of troops. After much debate, the Community agreed that it would *tolerate* a temporary German float, and on 11 May the Bundesbank let the mark adjust to market conditions. The Dutch joined the Germans in letting the guilder float, while France, Britain and Italy chose to maintain their current parities.¹⁶¹

As expected, the float wreaked havoc on the CAP, and at an emergency meeting of the agricultural ministers days later, Monetary Compensatory Amounts (MCA) were implemented. Now that the value of the mark was higher than the agricultural unit used to determine prices, farm imports into Germany were cheaper and exports more expensive. MCAs employed a system of "border levies and subsidies" to preserve common agricultural prices, and in accordance with German anxieties about the EEC budget (especially as its contribution was the highest), there was no time limit on the Amounts – they were renewed on a monthly basis.¹⁶²

If ever there was a sign that the "spirit" of The Hague had waned, the disunity of the May crisis was proof of its demise. Immediately following the float, Pompidou made his dissatisfaction clear by criticizing the U.S. for its neglect of the international monetary system and, in Gaullist fashion, asserting that Europe needed to find its own way in monetary affairs absent from the dollar. He went even further to single out

¹⁶¹ Strange, *International Economic Relations*, 334-336; Lieberman, *The Long Road to a European Monetary Union*, 74-75; Simonian, *The Privileged Partnership*, 102-106; and Kruse, *Monetary Integration in Western Europe*, 87-89.

¹⁶² Simonian, *The Privileged Partnership*, 106-107.

German responses to the May crisis, believing that the float went against Community goals.¹⁶³ However, the president's discontent with events did not permanently cloud relations with the Germans. In a few months, Giscard remarked that the deutschemark float was "a decision which was perhaps necessary to normalize a certain situation."¹⁶⁴ Yet the finance minister's remarks, and the support of the float by some French economists, could not ease an agreement on monetary affairs between the two nations when Pompidou and Brandt met again in July. Brandt refused to put a time limit on the float as Pompidou had hoped, and the French had refused to take part in the coordination of national economic policies in the medium-term. The only proposals that emerged from the Commission and made it to the review of the Council were plans to reduce the short-term capital movements that had caused so much disruption to national currencies, but these were only implemented with major changes the next year.¹⁶⁵

The U.S. Plans for the Defense of the Dollar

John Connally and Peter Peterson Redefine and Redirect American Benign Neglect

Nixon and his financial team were not alarmed by the disunity of the Europeans or the mark's float. Nor were they pressed to interfere directly in the crisis, as Bundesbank President Karl Klassen had written to Fed Chairman Arthur Burns days before the EC finance minister's meeting, "Proposals have been made which I oppose of course, but which if they are pushed through will mean a change of the actual world monetary system. It is only possible to counter this if positive items can be said about the willingness for cooperation on your part."¹⁶⁶ However, the administration felt no hurry to respond to Klassen's pleas. During the crisis, Kissinger advised Nixon not to act.

...no policy decisions are required on our part at this time. The sharp disparity between U.S. and European interest rates has been a major

¹⁶³ Ibid; *The Guardian*, 27 May 1971; and *International Herald Tribune*, 28 May 1971.

¹⁶⁴ *Le Monde*, 10 July 1971.

¹⁶⁵ Kruse, *Monetary Integration in Western Europe*, 90; and Simonian, *The Privileged Partnership*, 108-109

¹⁶⁶ As quoted in Kunz, *Butter and Guns*, 199; and GFL, Burns Papers, Box B60, Klassen to Burns, 4 May 1971.

cause of the large short term capital flows from the U.S. to Europe, but are obviously essential to pursue our domestic economic objectives. There is also concern that we do not attach much importance to our balance of payments situation and that, since a dollar devaluation is technically impossible, other currencies are bound to move up in value at some point in the future.¹⁶⁷

The capital flows stemmed from domestic economic plans that were in the president's interests and that since the U.S. could not devalue, the administration could be content to wait for Europeans to take the lead to correct parity problems with a revalue. Acting CEA Chair Herbert Stein declared, "The changes in European currencies this weekend represent a major success for our international economic policy. We have been trying to promote a realignment of parities ever since this Administration took office, but progress was rather slow until now." An adjustment of the stronger currencies, currencies that the U.S. had long maintained needed parity changes, but whose governments had steadfastly refused to do so, could only benefit the dollar. By letting capital markets take the initiative, the administration had achieved a small tuning of exchange rates without devaluing.¹⁶⁸

The administration wanted to improve the international monetary system, but not at the expense of American prosperity, or Nixon's reelection. The German revaluation was the first in a long line of crises during 1971 that forced the Nixon team to think and

¹⁶⁷ Memorandum; HAK to President Nixon; Re: International Monetary Developments; 5 May 1971; folder Balance of Payments; Box 309; NSC Subject Files; NPMS.

¹⁶⁸ McCracken supported the mark's devaluation, believing that it would benefit the dollar, while Volcker did not, feeling that such piecemeal changes in parities failed to bring about the real reforms needed in the system. See Kunz, *Butter and Guns*, 199-200; and Volcker, *Changing Fortunes*, 74. For quote see, Memorandum; McCracken to President Nixon; Re: European Monetary Developments; 10 May 1971; folder CO 1-5: Europe; Box 3; WHCF:Secret Files (SF); NPMS. McCracken was in Europe during the EEC talks on floating and defended U.S. economic policy saying that they "reflect due regard for our balance of payments problems, and that they are consistent with U.S. obligations to the international trading and financial system. (We cannot and should not say that balance of payments problems have priority over domestic economic matters.)" Memorandum; McCracken to President Nixon; Re: The Recent International Monetary Disturbances and Some Suggestions; 17 May 1971; folder Petersen, Peter [1971-1974], Box 16; White House Special Files (WHSF):WHCF: SU: CF: FG 6-11-1 CF; NPMS; and Memorandum; Hendrik Houthakker to Peter G. Peterson; Re: CEA Suggestions re Administration Responses to Questions Raised by the Subcommittee on International Trade of the Senate Finance Committee; 27 May 1971; folder International Economic Policy Council; Box 32; WHCF:SMOF: Houthakker: SU; NPMS.

act more critically regarding the future of the dollar.¹⁶⁹ It also firmly defined the structure of influence among Nixon's advisers. The Treasury was in the executive's favor in the beginning of 1971, when the president appointed John Connally as secretary. He quickly earned the president's trust and admiration through his take-charge personality, and sheer flattery.¹⁷⁰ Within months of coming into the Treasury position, Connally became, by Nixon's direct order, *the* voice of American monetary and economic affairs – bypassing CEA Chair McCracken and George Shultz of Budget. Connally's wunderkind in economic affairs was Peter Peterson, the first director of the newly created Council for International Economic Policy (CIEP),¹⁷¹ who entered the administration on the suggestion of Shultz. The arrival of Peterson and Connally did not change the U.S. "benign neglect" towards international monetary affairs – it merely redefined it.

Following the spring DM crisis when the U.S. decided not to respond to the capital movements or parity difficulties, McCracken sent a memo to the president, believing that the U.S. had "just muddled through another international crisis and suggesting that the CIEP publicly reassert the U.S. belief in IMF reforms to introduce more flexibility." Nixon forwarded McCracken's views to Connally and asked that he consult with the CEA Chair, as well as with Arthur Burns, George Shultz, and Peterson for a recommendation of action. He added his own direction by rejecting using the

¹⁶⁹ A White House memorandum outlined the problems that the DM float presented to U.S.-EC relations. There were four political trouble points – 1) "European resentment against the United States for our balance of payments policy, which contributed to the crisis; 2) U.S. Congressional hostility toward German revaluation, which will increase costs of troop support in Europe; 3) Internal strains within the Common Market over delay in EC monetary unity and particularly over inevitable adjustments in the Common Agricultural Policy; and 4) Spill over effects on British entry negotiations." See Memorandum; Ernest Johnston to HAK; 10 May 1971; folder EC Market 1971-9172; Box 322; NSC Subject Files: EC Market 71-72; NPMS.

¹⁷⁰ Connally was very popular in the Treasury because he opened debate on new policies and devoured briefing information, which quickly brought him up to speed on the workings of the bureau. As for his relationship with the president, he appealed to Nixon's self image and called him the "most misunderstood man in public life." Nixon, in turn, would say, "He understands me." See Matusow, *Nixon's Economy*, 108-109; and William Safire, *Before the Fall*. (New York, 1975), 497-508; and James Reston, Jr. *The Lone Star: The Life of John Connally*. (New York, 1989). For Volcker's opinion on Connally in the Treasury see *Changing Fortunes*, 71-73.

¹⁷¹ The Ash Council proposed the CIEP in 1971 with the reorganization of the executive branch.

CIEP, stating, “No, this is too large a group with too many people who talk alot [sic] about subjects they know little about.” He continued: “Connally 1-man responsibility route is best. This is an area in which he should be the lead man. Peterson, of course, should be consulted.” Connally responded strongly and negatively to McCracken’s assessments. The administration did not “muddle through,” it had focused the “crisis” on Europe and “...helped deflate concern over a ‘dollar crisis’.” Spotlighting the German element in the DM run limited the “repercussions on the dollar and set the state for maintaining the IMF’s role in exercising surveillance over exchange rate practices.” Thus, in the Treasury secretary’s opinion, the U.S. had already achieved McCracken’s objective to bring the IMF into the fold, and he saw no reason to extend the CIEP’s influence into the matter, preferring to keep the Treasury at the head of the effort.¹⁷²

Connally chose to redefine “neglect,” which for him meant that the Treasury now redirected the causes of crisis to their roots – their European roots -- so that the dollar was not targeted for speculation in the markets. He had steered the Treasury in this direction months before the McCracken memo, and now reiterated this position to the president. U.S. economic and monetary policy was now set to correct trade imbalances as a means of improving payments problems. Writing to Peterson in March 1971 in preparation for the first CIEP study into the problem, he commented,

The United States has reached a watershed in its trade affairs. Hitherto this country could frequently afford to sacrifice its trade interests to attain broader political military and economic goals, while its trading partners concentrated on rebuilding or expanding their economies and their trade. That is no longer the case....In line with the Nixon doctrine, other countries must assume their share of economic responsibility.¹⁷³

¹⁷² Memorandum; McCracken to President Nixon; Re: International Monetary Reform; 2 June 1971; folder Peterson, Peter. [1971-1974]; Box 16; WHSF:WHCF:SU:CF FG 6-11; NPMS; Memorandum; Hon M. Huntsman (Staff Secretary to the President) to John Connally; Re: International Monetary Reform Memorandum submitted to the President June 2, 1971 by Paul W. McCracken; 8 June 1971; folder FI-9 [1971-1974]; Box 28; WHSF:WHCF:SU:CF; NPMS; Memorandum; Connally to President Nixon; 8 June 1971; folder JBC Chronology June 1971; Box 77-353B; Connally Papers; LBJL.

¹⁷³ Memorandum; Connally to Peter G. Peterson; Re: CIEP Study Memorandum No. 1, March 8, 1971; 29 March 1971; folder JBC Chronology Files March 1971; Box 77-353A; Connally Papers LBJL. .

Peterson's December 1971 report showed that declining American trade was due to the unfair allied practices in global markets.¹⁷⁴ The main "culprits" of unfair trade were the Federal Republic of Germany and especially Japan, which had taken over more and more markets where once the U.S. had enjoyed an advantage.¹⁷⁵ Although the balance of payments had been in disequilibrium since 1958, averaging \$3b a year and reaching to \$22b in 1971,¹⁷⁶ U.S. trade figures had been in surplus from 1896 until April 1970. The surplus dipped to \$70m in 1968 and recovered in the next few years, only to show a deficit of \$804m in the second quarter of 1971.

The trade deficit was an alarming development for the Nixon team, and most of the executive advisers soon turned their attention to trade, although some coupled it with the money or devaluation issues. Devaluation alone would not return America's economic competitiveness. By August 1971, McCracken noted that an overvalued dollar made American goods too expensive abroad and imports cheaper for domestic consumption. An emphasis on tearing down barriers for trade with the Common Market and Japan could restore the surplus.¹⁷⁷ Market confidence in the dollar had been declining for years, but a continuing trade deficit *coupled* with the established balance of payments issues could be the final push for devaluation. While the administration realized that the dollar was overvalued, it did not want to be forced into action by the markets. Nixon had to maintain U.S. control over the fate of the dollar firmly within the executive. Thus, re-establishing the U.S. share of the global trade pie was important for both monetary management and political prestige. This view coincided with Nixon's

¹⁷⁴ Report; Peter G. Peterson; "The U.S. in the Changing World Economy." 27 December 1971; folder Council of International Economic Policy (CIEP); Box B24; Arthur Burns Papers; GRFL.

¹⁷⁵ Much of these efforts concentrated on 'offset agreements' that were suppose to increase foreign procurement of U.S. military hardware. See Strange, *International Economic Relations*, 270-275; and Gregory F. Treverton, *The Dollar Drain and American Forces in Germany*. (Athens, OH., 1978).

¹⁷⁶ Scammell, *International Monetary Policy*, 219.

¹⁷⁷ Kunz, *Butter and Guns*, 201. Memorandum; McCracken to President Nixon; 22 July 1971; Box 85; POF; NPMS; and Memorandum; McCracken to President Nixon; 25 August 1971; Box 85; McCracken Papers; NPMS.

nationalist view of international trade and monetary policy. The U.S. had to challenge states directly that were eating away at its national interests.¹⁷⁸

Connally unveiled U.S. initiatives on trade at a bankers' conference¹⁷⁹ in Munich in May 1971, directly following the DM currency crisis. The U.S. would no longer accept sole responsibility for the security of the continent, and the Europeans were expected to participate more rigorously in their defense, while accepting more American goods. Connally and Peterson's tutelage of U.S. monetary and economic policy meant that American policy would get more confrontational with its allies in regards to protectionist (in the U.S.'s view) trade practices and burden sharing in European security matters.

The Treasury Tries to be Flexible

Paul Volcker Cautiously Gauges the European Reaction to Wider Margins

Connally remained devoted to trade relations, but the Treasury did not completely turn its back on monetary issues. Paul Volcker, who had chaired the Volcker Group that advocated change without devaluation or a change in the price of gold, was circulating studies on the overvaluation of the dollar (said to be between 10 and 15 per cent) and the possible change in parity with adjustable rates.¹⁸⁰ Volcker had written another set of concluding remarks for Connally's Munich speech that mentioned flexibility, but Connally nixed them. Trade was the focus of the administration's monetary policy, but as he told Volcker, "That's my unalterable position today. I don't know what it will be this summer."¹⁸¹ However, by June the U.S. economy still had not recovered, and the time for unilateral action seemed to have arrived by the mid-summer. Volcker prepared officials for the inevitable failure of the system, quietly circulating

¹⁷⁸ Matusow, *Nixon's Economy*, 130-133.

¹⁷⁹ Volcker, *Changing Fortunes*, 74-75, sited it as an International monetary Conference and Susan Strange says it was an American Bankers' Meeting.

¹⁸⁰ *Ibid*, 72. The report Volcker refers to was written by senior economist John Auten, a former professor, who Volcker had brought to the Treasury.

¹⁸¹ *Ibid*, 74-75.

reports on the viability of flexible exchange rates, and closing the gold window.¹⁸² In contrast to his earlier views, he now favored suspending convertibility as a “prelude to a large exchange rate realignment and necessary reforms in the system.”

The Treasury discussed its views about flexibility with the Europeans but avoided talking about gold. Volcker met with French and German monetary officials on the possibility of introducing flexible rates at the September IMF meeting, but it was apparent that European differences were too broad to accommodate the autumn schedule. At a mid-July 1971 meeting with Volcker, Claude Pierre-Brossolette, Director of the Treasury, made French reservations clear. Germany was still floating the DM, and although the French had initially agreed to the float, they were now demanding that the Germans fix parities within Bretton Woods limits before any discussion concerning flexibility. Having recently failed to reach agreement on the exact time when the DM would stop floating, Giscard announced that France refused to “link European monetary problems to international monetary problems and places priority on settlement [of the] European situation....” France worried that the EEC’s efforts to narrow its margins against the dollar would be compromised if there was greater flexibility in the entire system. This was a politically charged issue for the French, as the Community would have to decide where to anchor its parities – with the stronger deutschemark or with a weaker franc. It was a contentious subject, as Pompidou had recently declared, “French monetary policy is not made in Bonn.”

Brossolette was curious to note the interest that the U.S. had shown in flexible rates, believing that “it was something that was primarily of interest to other countries.” and “that the widening of margins would do much to dampen short-term capital movements, except for relatively minor flows, which would not be of any real concern to anyone. In any case, why should the United States worry about short-term capital movements?” On this point, Volcker concurred, and admitted that it did not prohibit the

¹⁸² For an example of these memos see, Paper; George H. Willis to Members of the Volcker Group; “Limited Exchange Flexibility (Draft Position Paper).” 29 June 1971; folder Meetings (General) Volcker Group Meeting 7-15-71; Box 88; WHCF:SMOF: Stein: Meeting Files; NPMS.

administration from pursuing its current agenda, but it was mindful of criticisms abroad and from businessmen in the U.S., who wished to avoid controls. These were the same concerns that McCracken had posed in his Connally-rebutted memo to the president.¹⁸³

Volcker was careful not to hint of any preparations for alterations in the system. In his Congressional testimony to the Senate Finance Committee on the balance of payments issue, he testified that there was no crisis, “only a temporary emergency created by short-term capital movements.” He rejected the premise of “benign neglect” by pointing out that the U.S. had issued \$3b in bonds to attract excess European dollars.¹⁸⁴ Likewise, Connally agreed to disseminate Volcker’s proposals and participated in the debates about devaluation, but publicly maintained that the U.S. still held its commitment to current economic measures. He was still not convinced that devaluation would help the dollar and not damage American integrity in the markets. Politically, he saw the move as risky and was wary of damaging Nixon’s reputation during an economic downturn.

Burdens Too Heavy to Bear

Speculation and Trade Imbalances Force U.S. Action

However, market conditions would soon change Connally’s mind. The cautious and European centered reaction from the French was evidence that the U.S. would have to push for action unilaterally if it was to achieve its goals. The U.S. economy continued to slide, and the money issue refused to go away. U.S. gold reserves had dipped to their lowest point since 1936 and were now at under \$10b.¹⁸⁵ Amidst the spring crises of

¹⁸³ Memorandum with attachment; George H. Willis to Members of the Volcker Group; “Memorandum of Conversation Volcker and Claude Pierre-Brossolette, 9 July 1971.” 15 July 1971; folder Meeting Files (General); Box 88; WHCF:SMOF:Stein: Meeting Files (General), NPMS; and Telegram: “French Finance Minister Outlines French Position on International Monetary Questions.” 8 July 1971; folder Meeting Files (General); Box 88; WHCF:SMOF:Stein: Meeting Files (General), NPMS. Giscard’s statement followed the Brandt-Pompidou summit of 5-6 July 1971.

¹⁸⁴ Volcker, *Changing Fortunes*, 75. In addition to his efforts within the Treasury and the executive economic advisers, he worked with the U.S. director at the IMF to draft a working plan for suspending gold convertibility. See Gowa, *Closing the Gold Window*, 148-149; and Matusow, *Nixon’s Economy*, 142.

¹⁸⁵ The Treasury’s figures for July 1971 held that the gold stock stood at \$10.507b, but IMF claims reduced this number to \$9.979b. See Gowa, *Closing the Gold Window*, 149, and *The New York Times*, 27 July 1971.

1971, European banks had pressed the U.S. to convert some dollars into gold. Since 1968, the two tier gold agreement had separated private sales of gold from reserve holdings, so banks could not convert their reserve dollars into gold in the markets. However, in the event that nations needed to contribute or pay the IMF, the U.S. was obligated to provide that gold when requested. In March, France asked for \$282m and Switzerland, Holland, and Belgium requested smaller sums, having reached their quota of SDRs. Germany had also tried to get repayment for over \$500m in gold that the Bundesbank lent in 1969, but abandoned the request once it was reported in the media.¹⁸⁶ Moreover, by June 1971 it was clear that the trade deficit was going to be the first year-long deficit. The markets would most likely dump dollars.

Now Volcker began to work with William Dale, the U.S. executive director of the IMF, and Assistant Secretary of the Treasury John Petty, to construct a workable plan for closing the gold window. The intention was to act before a crisis forced them to do so, and the final strategy reflected much of what already had been debated in the preceding months – suspending convertibility and then using aggressive diplomacy to force foreign governments to make parity adjustments.¹⁸⁷ Connally supported drastic and forceful actions and favored coupling monetary measures with fiscal and economic packages, but was still unsure about devaluation despite market conditions -- until he read a report by Treasury consultant, Edward Bernstein. Bernstein argued that depreciation would stimulate the economy and create half a million jobs in the process. A float seemed to offer a solution. The link between political advantage and devaluation now complete, he recommended suspending convertibility, taxing imports, tax cuts, and wage-price controls to the president.¹⁸⁸ Nixon accepted all of the proposals with the

¹⁸⁶ Strange, *International Monetary Relations*, 334-335.

¹⁸⁷ Matusow, *Nixon's Economy*, 145.

¹⁸⁸ Matusow, *Nixon's Economy*, chronicles the academic debate of whether domestic considerations played a part in closing the gold window in Connally's decision making. He cites Linda S. Graebner, "The New Economic Policy, 1971." *Commission on the Organization of the Government for Control of Foreign Policy, Appendices*. vol. 3, (June 1975): 160-184, who says that Bergsten stated that Connally was domestically motivated. However, Susan Strange, "The Dollar Crisis, 1971," *International Affairs* 48 (April 1972), and John Odell, *U.S. International Monetary Policy: Markets, Power, and Ideas as Sources of Change*. (New Jersey, 1982), 233-239, 263-267, discounts the domestic thesis. While Matusow notes

exception of the border tax. They postponed immediate action during the Congressional recess, choosing to close the gold window on 8 September 1971, which would coincidentally give the U.S. an edge at the bargaining table for greater flexibility at the IMF meeting that same month.

On 28 July, the June trade figures showed a deficit and speculators began selling dollars. The situation worsened a week later, when the Reuss congressional committee issued a report that supported dollar devaluation, which coincided with the French announcement that they would purchase \$191m in gold from the U.S. Treasury for an IMF repayment. Germany and the Netherlands were still floating their currencies and were protected from the wave of short-term capital. However, the surge in trading did affect their parities and by 12 August the DM had risen to over 8.1 per cent of its original rate and the guilder over 5.1 per cent. The Bank of France tried to cope with the steady increase of dollars by lowering interest rates and suspended interest on non-resident accounts of less than 90 days, but these measures proved useless. Foreign reserves grew by \$66m in May, \$27m in June, and \$500m in July, which deposited more than \$1billion in foreign currency in French banks by mid August.¹⁸⁹

The massive flow of capital brought pleas, both private and public, from foreign governments for the administration to act. Giscard confided to Arthur Burns that France

that none of the authors had access to the Haldeman Diaries or John Ehrlichman documents that support the domestic motivation, he neglects to mention more contemporary works such as Gowa, *Closing the Gold Window*, which was published in 1983.

On the subject of the import surcharge see Matusow, *Nixon's Economy*, 145-146; Gowa, *Closing the Gold Window*, 149; and Volcker, *Changing Fortunes*, 75-76. Volcker disagreed with the surcharge and initially tried to dissuade Connally by delaying the memo.

Volcker also felt that the lack of consensus among the French and Germans regarding flexibility made it a dead issue. The decision of whether to push it or not was left to Connally. See Memorandum; Deane R. Hinton to Peter Peterson; Re: Volcker Group Developments; 16 July 1971; folder FI 9 [1971-1974]; Box 55; WHSF:WHCF:SU:CF FI 9; NPMS.

¹⁸⁹ Kruse, *Monetary Integration in Western Europe*, 91; Lieberman, *The Long Road to a European Monetary Union*, 78; "Action Now to Strengthen the Dollar," Joint Economic Committee, Report (August 1971); *The New York Times*, 9 August 1971; See Daily Reports; folder FO 4-1 Balance of Payments 8-1-71 to 12-31-71 [1971-1974]; Box 33; WHSF:WHCF:SU:CF, NPMS. Memorandum; McCracken to President Nixon; "Report of International Finance." 12 August 1971; folder [CF] FO 4-1 Balance of Payments; Box 33; WHSF:WHCF:SU:CF; NPMS. Germany took in \$39m on 12 August despite floating. France accumulated \$45m and \$100m on 9 and 12 August respectively.

would like to see the U.S. “take leadership in bringing about a realignment of the exchange parities of major countries,” and the Japanese ambassador signaled that the Japanese government would revalue the yen in combination with an international agreement. The foreign press mirrored official concerns. Germany’s center-rightist *Die Welt* predicted, “The question no longer is whether the dollar will be devalued, but when and in what way.” The leftist Berlin *Telegraf* criticized U.S. monetary policy as “passive and observing. It takes no initiative to restore the health of the international currency system and continues to have the Europeans share the costs of the Vietnam War.” The independent *Times* of London took an international stance – “It is not exclusively the U.S.’s mess and the U.S. cannot clear it up without the full-hearted cooperation of at least Japan and the Western European powers.” The liberal *Guardian* offered a bleaker view – “The world still seems content to let things drift in the hope that they will improve without radical intervention. It is a vain hope and a dangerous illusion.” By far the most critical reactions came from France. Describing the crisis as the “collapse of the dollar,” commentators remarked that the dollar should be devalued, but doubted that the U.S. would take the necessary actions so close to an election year. Conservative newspapers warned that France could not let its economy slip to save face for the dollar, and even the moderate *Le Figaro* saw an opportunity for European monetary union. “The crisis of the currency which serves as a world standard...offers a unique chance of welding the European currencies together, of constituting as of now the European reserve fund contemplated by the Werner plan.”¹⁹⁰

Forging a New Economic Policy at Camp David

A Working Weekend

The frenzy of market activity forced the U.S. to borrow nearly all of its gold tranche from the IMF to support the massive currency exchange. September would be

¹⁹⁰ Memorandum; McCracken to President Nixon; “The Dollar on European Money Markets.” 9 August 1971; folder FI-9 Executive [EX] Monetary System July-October 1971; Box 55; WHCF:SU:FI [EX] FI9; NPMS. The U.S. supported EC efforts but had serious doubts about the Werner Plan. The Federal Reserve saw it as a guideline for intentions, but offering no concrete rules or agreements for the future of EMU. See Memorandum; Charles J. Siegman to Robert Solomon; Re: Comments on the Werner Report” 6 November 1970; folder: Werner Committee Report; Box B114; Arthur Burns Papers; GRFL.

too late to act on the gold window.¹⁹¹ Finally, Volcker alerted Connally, who was vacationing in Texas, and the Treasury Secretary promptly returned to Washington to arrange a confidential meeting for Camp David that weekend. Connally told Nixon that there was “no panic – but getting worse and worse...losing initiative.”¹⁹² The participants had been told to keep their weekend open and to tell no one of the meeting.¹⁹³ On 13 August, at 2:30 Friday afternoon, Connally, Volcker, CEA Chair McCracken and CEA vice-Chair Herbert Stein (who would soon replace McCracken), Fed Chair Arthur Burns, CIEP Chair Peterson, Nixon’s speechwriter William Safire, Office of Management and Budget Director George Shultz, and the Chief of Staff H. R. Haldeman and John Ehrlichman, Assistant to the President for Domestic Affairs, arrived at Camp David by helicopter, some departing from Anacostia to maintain the gathering’s secrecy.¹⁹⁴ The months of preparation and debate on the survival of Bretton Woods now

¹⁹¹ Strange, *International Economic Relations*, 337. Notes; folder June-September 1971 Part I; Box 44; WHSF:SMOF: Haldeman; NPMS. Haldeman recorded the notes from Connally’s conversation with Nixon that day that suggested that they might close the gold window that day and “wait til[sic] Mon. on domestic front...have to show lot of planning and pre ” During the week McCracken sent Nixon frequent updates on the deteriorating position of the dollar and even a memorandum detailing his solutions to the crisis on 9 August. It is not clear whether the CEA was privy to the plans Volcker and Connally had been making, but many of McCracken’s proposals mirrored Volcker’s work with the addition of a border tax for imports. Memorandum; McCracken to President Nixon; 9 August 1971; folder FO 4-1 1/1/71-12/31/71 [2 of 3]; WHCF:SF: FO 4-1; NPMS.

¹⁹² Notes; folder June-September 1971 Part I; Box 44; WHSF:SMOF: Haldeman; NPMS.

¹⁹³ Volcker, *Changing Fortunes*, 77, did call Charles Coombs, an official at the Federal Reserve Bank of New York, who had “spent most of his working life as a vital part of the Bretton Woods system. He promised Coombs a few minutes with Connally or Nixon to argue for the survival of the system. There is also evidence that the secrecy of the meeting and its intent was not so solid. Andre de Lattre, a high ranking official with the Bank of France, received a call from his liaison in Washington, where he was living at the time, informing him of the meeting and indicating that this very well could be the end to gold convertibility. Andre de Lattre, Interviewed by Michelle Frasher Rae. February 2000. Paris, France.

¹⁹⁴ Neither National Security Advisor Henry Kissinger nor Secretary of State William Rogers were present. Kissinger was on his way to meet with the Vietnamese for secret negotiations in Paris, and Nixon had typically excluded the State Department from executive decisions. The president had a dim view of State’s interests in foreign affairs, seeing the department as taking the interests of the other side more than to the U.S. advantage. “State invariably looks at this [trade] from the point of view of other countries.” “State traditionally leans the other way.” See Gowa, *Closing the Gold Window*, 159, footnote 21. Quotes are from Nixon’s meeting with the Cabinet Committee on Economic Policy on 7 March 1969 from the files of William Safire, Chevy Chase, MD. The summary of the Camp David meeting was taken from H. R. Haldeman, *The Haldeman Diaries: Inside the Nixon White House*. (New York, 1994), 339-346; Notes; folder July 1971-December 1971; Box 44; WHSF:SMOF: Haldeman; NPMS; Gowa, *Closing the Gold Window*, Chapter 6; Matusow, *Nixon’s Economy*, Chapter 6; William Safire, *Before the Fall*, Chapter 5; and Volcker, *Changing Fortunes*, 77-80. See Haldeman and Matusow for more complete debates of the

came down to this weekend and it was clear from the start where each participant stood on the issues.

The men gathered in the President's lounge in the Aspen cabin, and Nixon directed Volcker to begin with a recap of the current gold crisis on the international markets. Within a summary of the past months' market activities, the undersecretary reported that that morning Great Britain had requested \$3b of gold for its dollar reserves.¹⁹⁵ With this in mind, Nixon stated that in the previous months the economic team had come to a "general agreement" that something needed to be done in dealing with international monetary developments, and the domestic issues that caused them. While he vaguely targeted inflation, "fiscal problems, tax problems, and wage/price problems" among these factors, the president seemed to have already decided in favor of Connally's surcharge tax and wanted to have something ready to send to Congress by the end of the weekend.

The committee next spoke of what to do with the dollar and gold. Connally proposed that suspending convertibility and floating the dollar was the best strategy. Volcker, McCracken, Stein, Peterson, and Shultz agreed with his position while Arthur Burns dissented.¹⁹⁶ Burns argued passionately for the survival of convertibility and

domestic aspects of the plan. Herbert Stein, *Presidential Economics*, provides a disappointingly sketchy account of the Camp David meeting.

¹⁹⁵ Volcker, *Changing Fortunes*, 77. There was some confusion on the meaning of the message in that it was first perceived to be a request to exchange the British held dollars for gold, but London was really asking for assurances that the U.S. could cover the value of their dollars. Volcker states that he wasn't told the real meaning of the British intent until "later." He also discounts stories that London's appeal for gold hastened the decision to suspend convertibility. "That was not true. Demands for gold had been building from other, smaller countries. The momentum toward the decision was by the time, in my judgment, unstoppable. There was, however, a sense in which those last requests for gold and guarantees were helpful; no one could argue that the United States had reached its decision frivolously." Volcker did not perhaps equate vigor with the European opinion that American non-action in the international system had predictably forced the crisis situation. Some of the works that were part of the debate around the British request include, Kenneth W. Dam, *The Rules of the Game: Reform and Evolution in the International Monetary System*. (Chicago, 1982), 187; Robert Solomon, *The International Monetary System*, 185; Charles A. Coombs, *The Arena of International Finance*. (New York, 1976), 217-218; and Martin Mayer, *The Fate of the Dollar*. (New York, 1980), 186-188.

¹⁹⁶ Burns had sent Nixon a memo following the May 1971 crisis and implored him to "plan ahead." He suggested that suspending convertibility be used as a "last resort and to present a public image of a cool-headed government responding to ill-conceived, self-defeating actions of others....It is therefore desirable to pay out gold and other reserves in substantial amounts – perhaps two billion dollars – before a

believed that IMF members would cooperate with the U.S. to arrange new parities *while* the gold window was still open. In the event that the markets got too hot, they could easily close it. However, he doubted this would happen since the domestic economic package would calm speculation and signal to investors and foreign governments that America was taking care of the problems that had led to international difficulties. Burns added ominously that if they decided to go ahead with the suspension, “*Pravda* will headline this as a sign of the collapse of capitalism” and bankers, businessmen and foreign governments would blame Nixon for devaluation and eliminating gold from international monetary affairs. He then associated the gold issue with the import surcharge, saying that trade would suffer with the float by cutting profits, while other nations would retaliate with some protectionism of their own. American unilateralism would damage allied relationships and hurt prestige at home and abroad. No, it was best to implement the rest of the plan and send Volcker over to Europe to do some economic diplomacy, and let him and the Fed handle the negotiations.

McCracken believed that it was impossible to separate the domestic economic plan from the gold issue.¹⁹⁷ Since the economic policies would stimulate the economy and the wage-price features would be temporary, there was bound to be an increase in the balance of payments deficit. He reasoned,

that if there’s one lesson you can draw from history, it’s that wage and price controls don’t stop inflation....I think we got that message across to the president: all you’ve done is buy yourself a temporary respite. If you look at the history of wage and price controls, you get a flattening out of the price level and then you get an explosion. And, to pursue that, at that point the dollar would have been scuttled in the worst of all possible circumstances. Then you would have had disorder.

suspension.” Seeing as the U.S. had found itself in this position, with a depletion of gold stocks to \$10 billion as recommended by Burns, one wonders how much of a crisis the Fed Chair required to close the gold window. Memorandum; Arthur Burns to President Nixon (cc: John Connally); 19 May 1971; folder FI-9 Monetary Systems [1971-1974]; Box 55; WHSF:WHCF: SU:CF FI-9; NPMS. For the Burns/Nixon relationship see, Safire, *Before the Fall*, 490-496.

¹⁹⁷ See Gowa, *Closing the Gold Window*, 167-170. Haldeman’s notes do not mention McCracken’s input during this discussion. Gowa’s information came from interviewed sources, namely McCracken himself.

Achieving permanent rather than temporary recovery depended on closing the gold window to protect the dollar in light of the speculative pressure that had built up in the last months and what might follow in the next weeks.¹⁹⁸ The administration had to think about domestic recovery first, and this should take precedence over the potential negatives of public opinion. The CEA chair also saw a conflict between the surcharge tax and suspending convertibility. While the aim of closing the gold window was to force a depreciation of the dollar through revaluing other currencies, the surcharge would decrease the demand for imports and strengthen the dollar. Connally admitted that the policies conflicted, but he hoped the tax would put him in a stronger position at the international negotiation table. Nixon having already made up his mind on the subject agreed, “The border tax is not too damned aggressive, just aggressive enough.”¹⁹⁹

Nixon questioned Burns, saying that speculators would surely continue to attack the dollar and that temporarily cutting gold out of the picture might be necessary for “domestic opinion.” Connally felt that the administration had no other option, and as the main problem was gold, there was no reason to leave the dollar exposed by applying only parts of the plan. They had to act using all the elements in the proposal. If there was a pause between the international and the domestic policies, the dollar would be at the mercy of “the money changers.” Besides, the current press continued to report on the inability of the U.S. to cover itself, so the Treasury secretary reasoned, the international community had already given a reaction and should not be surprised. Burns asserted that no matter what the headlines said, it would still look like they were taking actions against allied interests.

Although Burns stood out as the dissenting voice in the gold discussion, some did share his concerns. Paul Volcker sympathized with Burns’s characterization of foreign opinion, but he parted company with the Fed chair about gold, as this was exactly the kind of crisis that the Volcker Group had foreseen as the perfect situation for

¹⁹⁸ Shultz led the discussion on the subject of the price-wage freeze.

¹⁹⁹ Safire, *Before the Fall*, 515.

the U.S. to close the gold window – that now things were so bad it looked like the situation had forced the decision. This did not mean that the undersecretary welcomed a suspension of convertibility, but privately he winced at the notion that the president did not include a specific statement asserting that the U.S. would not consider a change in the price of gold. The president had the authority to suspend convertibility, but he could not permanently sever gold/dollar ties or devalue the dollar because that would change the price of gold. This required Congressional approval. By not committing to the current price of gold, the administration was leaving the door open for devaluation and the end to the current system.

By the end of the nearly four hour-long meeting, the president still had not made a decision. After everyone retreated to the Laurel cabin for dinner, Burns remained to “make a personal pitch against floating the dollar” with the president, but also pledged to support whatever decision he ultimately made. Following their talk, Nixon told Haldeman that he agreed with Burns’s assessment, and he wanted Ehrlichman and Shultz to convince Connally this was the right decision. Nixon felt that Connally was the swing vote on the subject.²⁰⁰ The president retired for the evening around 9:45, and later Connally divided the participants into three groups – price controls, surcharge tax and trade, and monetary. Nixon informed Haldeman that he would be available in the morning for further consultations, but to wake him at 3:00 a.m. to read notes of the speech he had been preparing. Saturday morning, Connally sat in meetings with each group that produced reports for presidential discussion that afternoon. Ehrlichman and Shultz had not been able to persuade Connally toward Burns’s position, because when the advisers met again that afternoon to the gather reports for Nixon, Connally cited the gold question as one of the decisions that had yet to be made. The president decided to meet with the Quadriad, comprised of the Treasury, CEA chair, OMB director and Fed chair, to talk more about the gold option. By that afternoon, he decided to go ahead and suspend convertibility.

²⁰⁰ Safire states that the President had made a decision on gold before he turned in for the night.

Unilateralism Revealed

The NEP Puts America First

That Sunday night Nixon unveiled a New Economic Policy to the world that had barely changed from Connally's original proposals.²⁰¹ Nixon's speech purposely emphasized the domestic program over international aspects. To protect and encourage the U.S. economy, there would be a ninety-day wage and price freeze with a price review board.²⁰² Tax cuts, the end of the 7 per cent excise tax on automobiles,²⁰³ and budget cuts that curtailed 10 per cent of foreign aid and 5 per cent of federal employment rounded out the domestic initiatives.²⁰⁴ The response from the American media, the business community, and the public was favorable.²⁰⁵ The president's domestic agenda was a political risk,²⁰⁶ but the setting for the message was choreographed to show the president as a decisive leader, and John Connally "quarterbacking this operation." Haldeman's action paper summarized, "The main point here his the outstanding leadership of the President in pulling together the various diverse programs putting them into one, overall program, that met the three needs of

²⁰¹ For the text of the speech see Speech; "The Challenge of Peace – Economic Speech." Sunday, August 15, 1971; folder The Challenge of Peace; Box 68; WHSF:POF:Personal Files: Speech Files [1969-1974]; NPMS. See Benjamin J. Cohen, *Crossing Frontiers: Explorations in International Political Economy*. (Boulder, CO., 1991), who argues that the NEP was launched because of the inability of the U.S. government to manage monetary policy effectively due to the divisions of power among – or bureaucratic confusion -- agencies responsible for economic and monetary policy. I do not agree with this view, and believe that he missed key parts of Nixon's monetary relations, which were Connally's influence and Nixon's views on power.

²⁰² For analysis of the wage price freeze and its impact on business and labor see Matusow, *Nixon's Economy*, 158-164; Joseph C. Goulden, *Meany*. (New York, 1972); and Arnold Weber, *In the Pursuit of Price Stability: The Wage-Price Freeze of 1971*. (New York, 1973).

²⁰³ The automobile industry was something that Connally was particularly worried about. In the first meeting he told the group that there was no need to continue the excise tax if they get "assurances from the industry that they'll pass this through in price reductions. This he feels should affect 10 million people who will be new car buyers this year." Haldeman, *Haldeman Diaries*, 341.

²⁰⁴ Per centage figures from Strange, *International Economic Relations*, 338.

²⁰⁵ For press and business reaction see Memorandum; "Responses to Speech New Economic Policy."; n/d; Box 150; WHSF:SMOF:Haldeman: Subject Files; NPMS.

²⁰⁶ The price controls and the soon to be named 'Cost of Living Council' were a complete reversal of policies that the administration had stood firmly against in the months prior to the announcement. This is also why the tax cuts and the budget were roughly equal. The cuts went against the full employment strategy that Nixon had adopted under Shultz's influence (less than a year earlier), where "Expenditures must not exceed revenues that would be collected at full employment." See Matusow, *Nixon's Economy*, 151. For more on the Cost of Living Council see Weber, *In the Pursuit of Price Stability*.

dealing with unemployment, inflation, and the dollar problems abroad.” U.S. headlines praised the NEP and the stock market jumped thirty-two points.

Yet the decision that would have the largest impact on the U.S. and world was glossed over in the American press – the suspension of gold/dollar convertibility.²⁰⁷ The strategy for handling the issue according to a Haldeman memo was to “stay off point in talking with people of the international monetary question and stay on the things that people are for – the tax reforms, the wage price freeze, etc....” Nixon diverted U.S. responsibility by blaming “international money speculators.” Only a handful of nations were briefed hours prior to the speech and were informed that none of their dollar holdings would be exchanged for gold, and the Treasury would refuse to consider altering the official gold price. The Fed also suspended the swapping dollars with foreign banks for other reserve currencies, and even limited the movement of U.S. SDRs.²⁰⁸ Exchange markets closed for the week to halt speculation and allow foreign banks to do what the U.S. hoped for -- currency adjustments that altered the ‘imbalance’ in exchange rates. These actions, coupled with the 10 per cent import surcharge, the president said, were temporary measures to combat “unfair exchange rates” and would be lifted as soon as foreign countries stopped their unfair trade practices.

European Reactions

²⁰⁷ The deed was done rather unceremoniously with a short half-page letter from Connally to Pierre-Paul Schweitzer, Managing Director of the IMF. “This is to notify you that, with effect August 15, 1971, the United States no longer, for the settlement of international transaction, in fact, freely buys and sells gold under the second sentence of Article IV, Section 4(b). The United States will continue to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations. This letter supersedes the letter of May 20, 1949, to the Managing Director from the Secretary of the Treasury and Chairman of the National Advisory Council on International Monetary and Financial Problems.” Letter; John Connally to Pierre-Paul Schweitzer; 15 August 1971; folder JBC Chronology August 1971; Box 77-353B; Connally Papers; LBJL.

²⁰⁸ Paper; Haldeman to Staff; “Action paper – General Guidance, Heads of Government to be Briefed.” 15 August 1971; folder August 1971 A-I; Box 197; WHSF:SMOF:Haldeman; Chron Files; NPMS; and Strange, *International Economic Relations*, 338. Secretary of State Rogers, who hadn’t even been invited to attend the economic summit, was instructed to call the leaders of Great Britain, France, Japan, Germany, Canada, Mexico, Italy and Spain.

U.S.-French Monetary Differences Continue

Volcker flew to Europe to explain the administration's goals personally and to gauge opinion on the possibility of reform. France was to be his hardest sell for the NEP. Of all the nations Volcker visited that week, France was the least impressed with Nixon's unilateral actions.²⁰⁹ Monetary relations had never been harmonious between the U.S. and France, and Giscard was a veteran of the international reform negotiations. When he met with Volcker two days after the cessation of convertibility, he was resolute in his belief in the retention of fixed parities and the dangers that Nixon's actions had posed for the system. After some hesitation, Volcker explained that the aim of Nixon's program was to keep fixed exchange by arranging for better conditions for currencies to operate under the system. Giscard rebuked him:

By making the decision to adjust your external payments while letting your currency float, you took a serious risk with regard to the international monetary organization and fixed parities. The possibility of returning to the practices of competitive devaluations of the Thirties is not excluded. The recent German experiment shows the dangers that there to the functioning of currency's fixed parity.

When Volcker assured Giscard that Nixon was aware of the disadvantages of his actions, Giscard pressed the issue further:

Your decision will basically modify the operating conditions of the international monetary system; the dollar's float is settled, central banks will not acquire unlimited dollars at parity; and they will refuse to exchange dollars against the SDR, you will attack...the mechanism that finances the American balance of payments.

²⁰⁹ Marc Viénot, France's IMF administrator had telexed Paris on 16 August about the Nixon decision advising that the major cause of the decision is the imbalances of exchange rates and that new rates should be negotiated as soon as possible with discussion about the temporary widening of parity bands. Concerning gold, "early clarification of the system of rates of exchange of currencies in terms of each other and in terms of gold is necessary not only to give a solid basis for international transactions, but also to permit the effective functioning of the Fund's general account and its special drawing account." Telex; Viénot to Finance Ministry; 16 August 1971; B52111; Papers of President Giscard d'Estaing; French National Archives. My translation.

Volcker replied, “Yes, but we want to be free to maintain payments surpluses without touching our reserves.”²¹⁰

Giscard’s statements are interesting in that they show he assumed that the administration’s program was headed to unilaterally floating the dollar, or that U.S. actions would cause floating and change the gold price. In doing so, the U.S. would improve its payments position on the backs of other currencies and might spur competitive devaluations seen during the Depression. France did not see the German experiment with floating rates as a calm success; rather it was a dangerous precedent that caused havoc with the French economy and the EC’s efforts to align their parities. The apocalyptic view of floating extended to the liquidity reforms, and threatened the workability of the SDR. Giscard believed that banks would no longer take in dollars and refuse to use SDRs, thereby cutting the effectiveness of the unit as a strong and stable provider of liquidity. As the SDR was created to provide world liquidity and to ameliorate the burdens of the dollar as a reserve currency, destroying this delicate balance through some flexibility would undermine its use to the U.S. and the world.

However, the French preoccupation with the gold issue went to the heart of France’s monetary consciousness, and the French Finance Ministry had with each currency crisis prepared stratagem for the possibility of gold suspension. During the 1966 sterling crisis, France concentrated on the legality of suspension as noted by IMF guidelines, and worried that the U.S. might try to float the dollar. In the case of a dollar devaluation, France would institute a franc zone. The French finance ministry reasoned that the U.S. payments deficit would eventually force the end to convertibility, but fretted that it would do so unilaterally and that floating would be “temporary and dangerous.” For France, fixed exchange rates were the only hope for stability in the international system.²¹¹ Thus, according to papers, France had expected the cessation of

²¹⁰ “Compte-rendu de l’entretien du mardi 17 août M. Giscard d’Estaing et M. Volcker.”; 17 August 1971; B52111; Papers of President Giscard d’Estaing; French National Archives.

²¹¹ March des changes 1966, ministere de l’economie et des finances, direction due tresor, affaires internatinales note: pur le minister (confidential); “Objet: dispositif d’urgence mis en place pur faceé une éventuelle devaluation de la livre sterline ou d’une suspension de la convertibilité en or du dollar des

convertibility for a long time, but this did not mean the French welcomed it. Documents suggest that France was willing to wage an all out price war for gold against the U.S.. In the weeks after the suspension of convertibility, officials from the finance ministry's international, monetary, and economic sections gathered to discuss a possible strategy to meet with the American unilateral action. They rejected the U.S.'s complete control of the situation and offered an aggressive plan to alter the landscape of monetary relations.

Finance Ministry papers also refuted the argument that the U.S. controlled the gold price, and posture one way that the world could change the dollar's parity, on their own terms, though the use of gold.

The countries other than the U.S. still have the possibility to devalue their currencies with respect to gold, and to consider the dollar as following suit. Thus, in the case of a 10 per cent devaluation, the French Franc would represent only 144 mg of gold, but the Bank of France would continue to sell the dollar at the rate of 5.55ff. To be truly credible this devaluation, with respect to gold, which would incur no shift in exchange rates between currencies, must be accompanied with the promise made by a major group of central banks to provide gold at a 10 per cent premium with respect to its previous price of \$38.5 an ounce.

Barring the U.S. support of the prior exchange rate; the price of gold will have risen without intervention on their part.

Taking into account the fact that the U.S. no longer promises, as the Bretton Woods agreement required, to support their exchange rate, the model herein proposed could be improved in supposing that the dollar would in fact be devalued.

The French would have likely attempted this by suggesting that the nations of the world violate their gentlemen's agreement not to sell official stocks of gold at the market price. By allowing the official gold price to rise, they would devalue their own currencies and force a dollar devaluation in proportion of their parity changes – exactly what Burns had warned Nixon of during the Camp David meeting.

Etats-Unis”; NOTE B –“mesures à prendre en cas de devaluation de la Livre sterling”; and “Sur les modifications susceptibles d’être apportées au statut actuel de dollar dans le système monétaire international (confidential).” B54739/1; Service des Archives économiques et financiers. All documents written in 1966, with no specific dates given.

The Community Attempts a Unified Response

Agreeing To Disagree

Suspending convertibility meant that the American had left the EC with two paths of action. First, the Community could continue to accumulate dollars, which could not be exchanged for gold or other currencies, which meant accepting the presence of the American balance of payments deficit. Or, they could sell the dollars for the best price on the market against their own monies (floating), which would revalue their currencies, cut into their trade surpluses, and affect domestic production and employment.²¹² Because there was no prior consultation on the New Economic Policy, the Europeans felt bullied by the U.S. decision.²¹³ In hindsight, the Nixon team's worries during the 1969 European trip that the French would enact a unilateral devaluation to destroy the system, seem ironic. For all the concern about France and how "drastic unilateral action by any country with major financial responsibilities" might "pose grave dangers for all," the rules were different if the U.S. was taking the action.²¹⁴

When the EEC exchange markets reopened after a day's respite, the commonality of unease over the situation should have been a perfect opportunity to present a strong, united, European response, but instead old differences arose. At meetings convened in the week after suspension, France and Germany tried to come to some consensus. Some of their discussion at this period foreshadowed the agreements that they would obtain from the Americans in December.²¹⁵ Neither side wanted to

²¹² See Lieberman, *The Long Road to a European Monetary Union*, 79; and Kruse, *Monetary Integration in Western Europe*, 92-93.

²¹³ France had actually been preparing for the demise of convertibility at the hands of the U.S. for many years. The finance ministry had expected the U.S. to act during the sterling devaluation of 1966 and while stressing that the Americans would need IMF approval to change its parities, it prepared to form a franc zone in case of devaluation. *Marche des changes 1966, ministere de l'economie et des finances, direction du tresor, affaires internationales note: pour le minister (confidential). Objet: dispositif d'urgence mis en place pour facee à une eventuelle devaluation de la livre sterline our d'une suspension de la convertibilitéen or du dollar des Etats-Unis.*" B54739/1; Service des Archives économiques et financiers.

²¹⁴ Paper; Talking Paper for European Trip, International Monetary System; n/d; folder Trip to Europe February-March 1969, SECRET; Box 443; NSC Trip Files; NPMS.

²¹⁵ Memorandum; Service of Foreign Affairs to the Minister of the Economy; "Elements of a European Position. French-German Meeting." (Paris, 30 August 1971); 30 August 1971; B0054747/2; Service des Archives économiques et financiers.

“give the Americans the impression that this was a permanent arrangement,” but wanted to conclude an agreement on parities as soon as possible in “favorable conditions.” The was the general belief that the dollar was overvalued and that there should be a devaluation vis-à-vis gold of about 5 to 7 per cent, but the Germans did not think that the U.S. would consent to it at that time. French representatives proposed a revaluation of all European currencies in terms of gold, that is their tactic of changing the gold price through joint revaluations to force a dollar devaluation, but Germany seemed not to have considered this an option.

Foremost in the German point of view was protecting the Community currencies against speculation. They discussed doing this by widening the fluctuation bands for Europe in the international system by +/-3 per cent and then narrowing the intra-community margins to +/-1 per cent, with the balances settled in gold, SDRs, or dollars. This was in line with their thinking about the foundations for the new international monetary system where they did “not seek to replace the dollar with another reserve currency of group of currencies but rather create a multilateral system of reserves (like the SDR) with the understanding that such an instrument should compliment the creation of dollars but serve as a substitute.” In addition to this, the Germans did not share France’s love affair with gold and favored revising its role in the international system since they did not think it could be used as a “rational reserve.” Similarly, they were against revaluation in terms of gold as they feared inflation and speculation, but confessed that they did not believe “a strong revaluation was likely.”²¹⁶

In the end, however, neither France nor Germany could agree on one strategy to employ against the Americans and the EC members agreed to disagree and pursued individual policies. For its part, France rejected any appreciation of floating the franc to the dollar. Instead, the French placed the franc on a two-tier system, where the commercial franc, or money used for every day transactions by the general public, which

²¹⁶ Memorandum; Service of Foreign Affairs to the Minister of the Economy; “Elements of a European Position. French-German Meeting.” (Paris, 30 August 1971); 30 August 1971; B0054747/2; Service des Archives économiques et financiers.

preserved the official parity against the dollar, and the financial franc, used for bank transactions was allowed to float to market demand. To curb capital inflows, exchange controls were also employed that reduced the capital inflow and manufacturers were encouraged to sign agreements that limited price increases to 1.5 per cent until March 1972.

The Germans continued to float independently and were highly critical of the two-tier structures their counterparts had assumed, and of their “dirty floats,” that is their market interventions to maintain parity, rather than letting free demand determine exchange rates.²¹⁷ Since May, floating had worked to protect the mark from a flood of capital. The success of the float was aided by an increase in reserve requirements and dollar sales on the free market that soaked up much of the excess DM and dollars. Coupled with government cuts in expenditures, decreased borrowing limits on the Länder and federal governments, and an appreciating mark, the measures helped to cut consumer demand, and kept unemployment and inflation at manageable rates.²¹⁸

Even with the EC’s inability to come to an agreement, the Six still had to confront the U.S. at the September G-10 meeting in London. French and German differences on how to deal with the American payments deficit dominated the discussions. Giscard continued to reject revaluation in favor of more capital controls, and Schiller criticized the French obsession with competitiveness and stated that the franc could easily “bear a three to four per cent revaluation.”²¹⁹ The German Finance Minister, who was now devoted to the benefits of floating, sought to correct the U.S. payments deficit with a depreciation of the dollar, by means of a Community float. As

²¹⁷ Lieberman, *The Long Road to a European Monetary Union*, 79; Simonian, *The Privileged Partnership*, 110-111; and Kruse, *Monetary Integration in Western Europe*, 93-95. Belgium and the Netherlands also adopted the two-tier approach, but with floating. The Benelux countries had suggested a joint EEC float during the ministerial meetings, which would be best to deal with the changes in parity and their effects on the CAP, but in the absence of Community consensus, the Benelux countries floated their currencies against each other and maintained parities through a series of interventions. Because of the non-alignment of European currencies, a complicated system of border taxes and prices had to be applied to maintain the CAP. The independently floating currencies necessitated that this change on a weekly basis.

²¹⁸ See *Ibid.*, 96.

²¹⁹ Simonian, *The Privileged Partnership*, 112.

the independent national economic policies were achieving their means, neither France nor the Federal Republic sought to shift its position.

The EEC did agree on some fundamental goals, which paved the way to a future consensus on the areas of fundamental differences. In London, the Six called for the abolition of the trade and monetary measures, and committed themselves to restoring convertibility, the reduction of the dollar as a reserve asset, a continued obligation to fixed, but adjustable exchange rates in the international monetary system, and to the realignment (with French abstention on this point) of the dollar's parity. And there was the issue of the import surcharge, which Giscard had pointed out, was against GATT and IMF guidelines. The U.S. tactics were bullish and unfair. Connally, whom a British representative described as "a character whose rascality they both admired and loathed," put the U.S. position succinctly – it was time for other countries to share the burdens and they could do this by realigning their currencies to depreciate the dollar, chipping in for defense costs, and accepting more U.S. imports. All of this was supposed to achieve positive trade and payments balances of \$7b and \$2b respectively. Treasury researchers calculated a 7.75 per cent depreciation of the dollar against other currencies to reach its goals.²²⁰ If the delegates were willing to cooperate to achieve these ends, then the surcharge would be lifted.

It was clear to the Europeans that these changes required higher revaluations of their currencies than they had anticipated. Such large movements would significantly damage their own trade and payments balances. France resisted realignment, and strongly suggested that the U.S. devalue the dollar and change the price of gold. This was a continuance of French demands from the de Gaulle era. Finance Minister Schiller had no problems with floating European currencies, and chastised the French for being too concerned about the franc's competitiveness.²²¹

²²⁰ Kunz, *Butter and Guns*, 206; Matusow, *Nixon's Economy*, 169; and Volcker, *Changing Fortunes*, 81-82.

²²¹ Simonian, *The Privileged Partnership*, 112.

The U.S. assertion that other nations shared responsibility for its payments deficit was also a source of contention. The French concluded that only Germany, Canada, and Japan had contributed to the American deficit, while the Netherlands, the UK, France and Switzerland had been plagued by trade deficits. Besides this fact, the officials noted that the European anti-inflationary measures could not have been a primary determinant of the U.S. problems – “Indeed the speculative flow of capital cannot be separated from capital flows linked to differences in interest rates while we may wonder why the U.S. with its monetary laxism and their relative indifference of a widening gap between U.S. and European interest rates.”²²² These discussions most certainly represent the French view of the situation and perhaps were the same arguments that their delegates presented to the EEC and the IMF. The problem, for the French, was that the EEC did not take the same view.

Negotiation – Texas Style

Influence and Power in the Nixon Administration and Forming an International Agenda

Connally rejected the French demand for altering the gold price and stood firm about the administration’s refusal to consider dollar devaluation through any other method than the realignment of foreign currencies. The rationale for this repudiation was more political than economic. If the U.S. forced other nations to revalue upward, the Americans would maintain their prestige in the international monetary system and reduce the role of gold. Connally’s steadfast stance on the gold issue with the import charge backing him, also helped to communicate U.S. resolve to force a decision to its advantage. It was a shrewd tactic that suited Connally’s style, for he believed that the longer the negotiations went, the better his position. However, there were domestic considerations for resisting devaluation. Devaluing the dollar required an act of Congress, which at this point was dominated by the Democratic Party, and Nixon was

²²² Memorandums; Re: Refutation of the argument: The United States alone has the possibility to undertake a modification in the price of gold”; and “Refutation of the argument that all of the countries have their part of responsibility for the U.S. balance of payments deficit.”; n/d; B0062104; Service des Archives économiques et financiers. Translated from French by Mr. Preston Perluss and verified by Michelle Frasher Rae.

sure that the Democrats would use a legislative debate as a forum to damage his reputation on the Hill and with the American public.²²³

The President was eager to keep the positive mood of the NEP's measures for as long as possible, which lasted for about a month. By October, critics of the NEP's domestic provisions began to voice their doubts about the effectiveness of the price controls, and many economists, politicians, and academics wondered if the administration's determination to create a favorable trade and payments balance was not unduly damaging foreign relations. Milton Friedman, father of monetarism and sometime economic advisor to the president, commented that the real issue of the gold price was not actually economic, but political. He wrote, "What conceivable difference can it make to the United States, or to other countries, if we don't sell gold to foreign governments at \$35 an ounce or if we don't sell gold to them at \$38 an ounce?"²²⁴

Barely a month into the international provisions of the NEP, divisions within the economics advisers were beginning to show – some privately and some not so privately. One of the loudest critics, and by far the most damaging, was Arthur Burns, who publicly blasted the administration's "time is on our side attitude" towards parity negotiations. He had still not shaken his reservations about closing the gold window and now was calling for dollar devaluation through changing the gold price. Burns feared that Connally would start a trade war that would lead to global recession, and testified before Congress to that effect.²²⁵ The Fed chair's actions put him back in the disfavor of

²²³ Matusow, *Nixon's Economy*, 170-171.

²²⁴ Quoted in *Ibid*, 170, and *Newsweek*, 20 December 1971, 83. On this point see the dissenting view of John Williamson, *The Failure of World Monetary Reform, 1971-1974*. (New York, 1977), 58-59. He illustrates that "two important economic questions were involved." One was the value of the SDR. Dollar devaluation meant that there would be an "appreciation of the monetary price of gold," which translated into to an appreciation of the SDR in terms of the dollar. Central banks liked the SDR because they could put part of their dollars into an asset that would not depreciate in the event of dollar devaluation. This made SDRs an attractive investment despite their low interest rates. Secondly, he mentions the belief that all nations pegged their parities to the dollar and would just devalue their own currencies proportionately to any dollar devaluation. Williamson says that Fund Article IV. I(a) "referred to a dollar *with a given gold content* as an alternative measure in terms of which par values might be expressed to gold itself. A dollar devaluation would therefore have caused a change in the parity of currency A, in terms of the dollar, unless currency A were also devalued to the same extent as the dollar."

²²⁵ See Henry Kissinger, *White House Years*. (Boston, 1978).

the president, who labeled him “unbearable” for breaking ranks with the administration and going back on his promise of full support he made at Camp David.²²⁶

However, since the Camp David weekend had not brought upon any consensus of long term reform to the international monetary system, Burns was not alone in offering a dissenting view to Connally’s goals in monetary affairs. As early as mid September 1971, George Shultz, whose influence on economic affairs had been replaced by Connally’s, now tried to influence the Treasury secretary’s shortsighted reform goals. While Burns wanted to save the Bretton Woods structure and found a sympathetic friend in Paul Volcker, Shultz wanted to scrap fixed rates altogether and float currencies. He reasoned that without the troubles of maintaining fixed parities, domestic governments would be freer to pursue their own domestic policies without worrying about the damage of external imbalances.²²⁷ Shultz believed that Connally was looking too narrowly to the “quick fix” and attempted to persuade him towards floating by arranging a private meeting with Milton Friedman and by writing a “Shultz draft” of the speech Connally would give at the annual IMF meeting in late September. The draft never made it, and Connally stuck with his original version. Volcker, a proponent of long term reform, did not agree that introducing the Shultz “bombshell” as a productive addition to the bargaining table. He reasoned that it “would plainly not be negotiable, could only further poison the atmosphere, and was not in any even desirable.” Thus Connally stuck with his original goal, but now offered a token olive branch at the IMF gathering. The U.S. would consider dropping the surcharge if foreign governments would consider a “free float as a transitional device to find a new level for the dollar.”²²⁸

Europe’s Balance of Power in International Monetary Negotiations

French Politics and German Economics

This conciliatory gesture was too little in the view of the Europeans, who regarded the American tactics with disgust. French and German officials still tried to

²²⁶ As quoted in Matusow, *Nixon’s Economy*, 171, from H-Notes, 3 October 1971.

²²⁷ See *Haldeman Diaries*, 23 August 1971; 12 October 1971.

²²⁸ For quote see Volcker, *Changing Fortunes*, 82. Matusow, *Nixon’s Economy*, 171-172.

reach a compromise to bring Europe to a consensus and showed some progress by mid-autumn, but these attempts at rapprochement were littered with diplomatic snubs, Gaullist misgivings regarding *Ostpolitik*, and ever-present monetary differences. In economic and monetary politics, the French felt that Bonn was condescending towards France's economic policies -- that French officials were somehow philistine in their handling of economics and monetary affairs. The unwavering German belief in its *Wirtschaftswunder*, and the dominance of the DM in European and world banking, tended to make the Germans a little paternalistic and condescending in these matters, and the French a bit defensive.²²⁹

By that autumn, as speculation pushed the financial franc far above the commercial tier, it appeared that the benefits of the two-tier arrangement were fading. Despite French insistence that parities would not change, all the talk about revaluation had some effect on the market. Efforts to stem the flow of capital were ineffective and the longer the monetary negotiations went on the worse the situation became.²³⁰ In early September, Chaban-Delmas remarked that the French government would not be eternally dedicated to the two-tier system, which was good news to the Germans, who abhorred the system. The comment seemed to indicate the possibility for some change in the franc's management.

For its part, German cooperation came not from the weaknesses of floating the mark, but in alliance politics. There was some debate within the Brandt cabinet of the future of German policy-- should loyalties remain with the U.S. or to Europe? Finance Minister Schiller continued to argue for mark revaluation contingent on franc revaluation. As this was consistent with American demands, it appeared that for the time being, Brandt was maintaining Germany's position on revaluation and siding with the U.S.. Still, as Haig Simonian points out, France was "less vulnerable to the American import surcharge,"²³¹ since its total exports to the U.S. were considerably less

²²⁹ See *Le Monde* 17-18 October, 1971 and then French Secretary General Michel Jobert, *Mémoires d'avenir*. (Paris, 1976), 210.

²³⁰ Kruse, *Monetary Integration in Western Europe*, 98.

²³¹ Simonian, *The Privileged Partnership*, 115.

than the Federal Republic's. France could afford to be patient in this instance. As Europe prepared for the November G-10 meeting in Rome, there was a slight shift in German opinion. Foreign Minister Scheel continuously challenged Schiller's view that relations with Washington trumped relations with France, and it appeared that he was making a dent in the steadfast German position. Statements released by members of the German cabinet revealed a willingness to work within Europe and make allowances for divergent interests to construct a cohesive European position.²³² Karl Klassen suggested that "allowances would be made for those countries reluctant to devalue."

Both sides had several reasons to cooperate, but there was more at stake for the Germans. Brandt had extended an invitation to Pompidou to discuss monetary matters in early 1972, which was accepted after some time and but actually occurred in December. It was a sincere and necessary attempt to mend Franco-German relations after the Chancellor's summit with Soviet Premier Leonid Brezhnev in early September, of which he had failed to notify Pompidou beforehand.²³³ However, of particular significance to the monetary negotiations were recent German criticisms of the CAP. Since the currency crisis of May, Agricultural Minister Ertl criticized the MCA function of the CAP and suggested that the current incarnation of the EEC's agricultural policy needed an overhaul. He admitted that the French, who were the largest beneficiaries of the program, would not concede a discussion about reforming the CAP at that time, but he had always been critical of the mechanism and even suggested that the provisions made in the Treaty of Rome had been unrealistic.²³⁴ The response was terse – if Germany insisted on floating its currency, then it had to expect these kinds of hindrances.²³⁵ It was an obvious linkage to the current differences in monetary thinking and a demonstration of how the issue had permeated relations between the two countries.

The discord could not last for long if the Europeans hoped to make any kind of stand against U.S. demands at Rome in November. The tensions inherent with the CAP,

²³² See *The Times*, 15 October 1971.

²³³ See Simonian, *The Privileged Partnership*, 117-121.

²³⁴ *Financial Times*, 22 July 1971.

²³⁵ *Le Monde*, 14 October 1971.

the possibility of more monetary and economic damages because of the American position, and Pompidou's (and indeed much of the French government's) apprehension towards German power in the East necessitated a re-commitment to Europe. By mid-November, through meetings between their foreign and finance ministers, more amicable positions emerged, and this time the EEC, with the leadership of its two principal members, called for the restoration of fixed parities, the end of the surcharge, and reinstatement of the gold window. Now the Europeans were willing to revalue their currencies (although the degree of these changes had not been agreed to yet) if the U.S. agreed to devalue the dollar and "that the imbalance in the American payments position not be corrected by an improvement on the trade account alone."²³⁶

The Rome Conference

The U.S. Makes a Gesture

In the weeks leading up to the conference, there had been a considerable shift of opinion within Nixon's staff concerning Connally's strategy. Burns had been very public about his feelings; and now other factors worked against extending the negotiations. The stock market, which experienced a boom with the announcement of the NEP, started a long descent in October and by mid-November columnists and even the head of the New York Stock Exchange saw that the longer Connally dragged on, the worse it would get for Nixon politically. The problem seemed to be that the administration did not have a clear course of action for international reform. In Haldeman's notes of a October 22nd staff meeting, Shultz commented that Connally "just wasn't paying attention" to the international economy. "Volcker [was] screwing it up – on verge of snatching defeat from a great victory. Con[nally] agrees – but tends to discount it. Conn[ally] scorches anyone who writes memo on econ[omy] to P[resident]. Treas[ury] leaks memos to press."²³⁷ Peterson joined Shultz's concerns and had been prodding Volcker to get the Volcker Group together, and pushing for the Quadriad to amass concrete plans for negotiations with the international community. Beyond the

²³⁶ Kruse, *Monetary Integration in Western Europe*, 99.

²³⁷ Notes; 22 October 1971; Box 44; WSHF:SMOF:Haldeman; NPMS.

U.S.'s refusal to change the price of gold or devaluation there really had not been a comprehensive plan for what to do in the international arena. Most of the planning had gone into the domestic measures.²³⁸

²³⁸ See Matusow, *Nixon's Economy*, 173-175. Kissinger, *White House Years*, 950, *Haldeman Diaries*, 11 November 1971. Memorandum; Peter G. Peterson to President Nixon; Re: New Economic Policy – International Negotiating Objectives and Foreign Policy Effects; 9 September 1971; folder Handwriting September 1971; Box 13; WHSF:POF; NPMS. The U.S. prepared for formal negotiations with the international community, but Peter Peterson realized that although the domestic agenda was fairly tight, the international agenda was less so. Peterson had “a growing feeling” that some issues “could elude us.” These included understanding how other nations might respond, “an agreed set of negotiating objectives and plans...,” and lastly “A mechanism for getting the right answers to the questions soon.” Peterson wrote two more memos in late October urging action again. See Memorandum; Peterson to Paul Volcker; 25 October 1971; folder [EX] FI-9; Box 55; WHCF:SU:FI EX FI-9; NPMS; and Memorandum; Peterson to John Connally; Re: Negotiating the New Economic Policy Abroad – Work Group; 26 October 1971; folder [1971-1974]; Box 16; WHSF; WHSF:SU:CF FG-12; NPMS. In the last memo Peterson outlined specific concessions and objectives. These included lifting the surcharge and changing the price of gold. For reactions within the Volcker Group to the international reforms see Memorandum; Deane R. Hinton to Peter Peterson; Re: Volcker Group; 1 September 1971; folder [EX] FG-12; Box 2; WHCF:SU:FG12; NPMS. Deane R. Hinton summarized a Volcker Group meeting described the meeting as “quite inconclusive exchange of views. Paul obviously enjoyed himself playing games with the rest of us.” There were several points on the agenda that the Group wanted to present to the President and Volcker refused these options. Among them were – the role of the dollar as a reserve currency, the future role of gold, rules for exchange rates changes, and convertibility. Another memo [Memorandum; Paul McCracken to President Nixon; Re: Outline of Proposals for Interim International Monetary Arrangements; 13 September 1971; folder Handwriting August 17-Sept 71; Box 13; WHSF:POF: Handwriting; NPMS.] with proposals from David Rockefeller was rebuffed by Nixon – “Paul, George and Connally, I totally disagree with his direction. Tell all hand – He wants to go back to a patched up old system – like all the Int'l bankers. Its right for them and totally ruining for the home front.” From these documents, one can assume that much of the planning was kept between Volcker, Shultz and Connally. For a summary of the economic goals on the domestic front see Memorandum; Jon Huntsman to President Nixon; Re: Economic Objectives; 30 August 1971; Box 13; WHSF:POF: Handwriting; NPMS. The Fed lowered exchange rates on 10 November 1971 from 5 to 4 ¾ per cent and Stein advised the president that this would have only a minor impact on the economy unless it was accompanied by other measures by the Treasury. Nixon sent a copy of the report, with his notations to Connally. Memorandum; Herbert Stein to President Nixon; 10 November 1971; Box 14; WHSF:POF: Handwritin; NPMS. Peterson sent another memo to Nixon on 15 November 1971 which described a Connally press conference where the Treasury secretary believed that the “current monetary uncertainty could continue ‘for an almost indefinite period’, that the U.S. would not suffer if it did and that the U.S. ‘is doing very well’.” Peterson reported that he had received calls (no specific mention from whom) that asked him to get Connally to stop the “saber rattling” and the “don’t give a damn attitude.” It was forwarded to Shultz and Connally with [presumably] Haldeman’s handwritten note – “George and Connally – Your Info. Only. RN- does not endorse any view expand.” Memorandum; Peterson to President Nixon; Re: Status of International Economic Negotiations – Your meeting This Morning with John Connally; folder October 1971-15 November 197; Box 14; WHSF:POF: Handwriting ; NPMS. . However, Shultz and Connally sent Nixon a talking agenda outlining points for the president to endorse at a Quadriad meeting on 1 November 1971 saying, “you continue to feel that it is a mistake to make a change in the price of gold and do not want discussions going on that lead people to think the President might recommend a change. You also will not entertain suggestions for even limited forms of convertibility. You want work to proceed on the assumption of

Also notable was the sudden entrance of Secretary of State Henry Kissinger into the debate. He had previously been uninterested in international monetary affairs because he did not think they had much political or diplomatic impact. However, he was increasingly concerned about the consequences of prolonged international debate and soon sided with Arthur Burns' assessments. All of these factors convinced Nixon that he had to push Connally to make some concessions and decisions in the upcoming Rome G-10 conference.

As far as the allies knew, John Connally had not budged from his earlier refusal to devalue the dollar or change the gold price, and Volcker stood with him, convinced that any change in the gold price could be destabilizing. Yet, by the time they arrived in Rome, Volcker had "reluctantly reconciled" himself to the fact that they needed to give in to some change if the negotiations were to be successful. The new European consensus offered both an opportunity and an ultimatum, but before the opening sessions Volcker had introduced a memorandum offering

an exchange rate change between the dollar and the currencies of the other industrialized countries averaging 11 per cent on a basis weighted for our trade with each of them. Even that, we argued, would be inadequate to obtain the \$13 billion shift in payments we wanted, but it would be enough for us to remove the import surcharge, assuming the Europeans and Japanese entered into good faith negotiations on the issues of trade liberalization and sharing security burdens we had raised.²³⁹

He was careful to add that since the realignment would not cover the deficit, the U.S. still would not reopen the gold window. The deputies vehemently rejected this and were even more irate when Volcker told them that he did not intend to release the memo until after the meeting. He tried to get Connally to rescind it, but found that much of its contents had already been leaked.

these two conditions: no convertibility, no change in the price of gold." Memorandum; George Shultz to President Nixon; 1 November 1971; folder FG-12; Box 16; WHCF:SU: FG-12; NPMS. Volcker, *Changing Fortunes*, 84, says that Connally told him that the pressures of the White House did not lead him to be more amicable in negotiating with the allies. He had merely felt that "time had come for movement."

²³⁹ Ibid, 85.

Later, the deputies got another shock as Volcker, with Connally's permission, offered to discuss "hypothetically" the gold price – assuming a ten per cent rise, how might they react? The bombshell caught many of the delegates by surprise, but after an hour Schiller finally acquiesced to a 10 to 12 per cent dollar devaluation. The rest of the EEC remained divided on realignment (Giscard did not respond to the hypothetical question).²⁴⁰ Although there were no agreements on the actual numbers for realignment, the American offer to consider devaluation and the gold price, and the ability for the Europeans to establish a unified presence at the talks, broke the impasse and opened the way for a possible settlement at the next G-10 meeting arranged for December in Washington.

These developments also made for a much friendlier and productive Franco-German summit on 3-4 December. Brandt and Pompidou devoted the first day entirely to monetary talks, or as Pompidou sarcastically referred to it -- the "U.S. poker game over devaluation."²⁴¹ The French president pushed for a 7 per cent revaluation of the mark vis-à-vis the franc, but Brandt offered 5 per cent, which was the minimum Pompidou was prepared to accept. He knew that Brandt faced some opposition from Finance Minister Schiller on conceding to this figure, and Schiller preferred a more conservative figure of between 3-4 per cent. In the end, Brandt conceded that the figure was up for negotiation. Pompidou took this to mean that the chancellor might agree to 6 per cent. The issue of the franc-mark parity was especially touchy because of France's concerns about competitiveness in the EC, and how the differences in parities would affect the deterioration of the CAP and damage German industry. Most important in

²⁴⁰ Ibid, 86. Volcker also notes that when Connally brought up the subject of trade agreements, the EEC members responded that they could not make such arrangements, as this fell under the auspices of Community matters, not individual countries. None of the Europeans brought their trade representatives to Rome, but Connally noticed that Raymond Barre, the ECC trade commissioner was in attendance, and he asked that the other Council of Ministers gather for an impromptu meeting there in Rome to discuss the trade issues. They refused. The episode can be seen as a sophomoric tactic to stave off American demands, a case of Community solidarity, or a refusal to be bullied by Connally's brash 'Texan' tactics. There's likely some truth in each of these explanations. However, Matusow contends that the Europeans brought up the subject of trade and discussed various ideas with Connally, only to reject them. See Matusow, *Nixon's Economy*, 176, and *Newsweek*, 13 December 1971, 86.

²⁴¹ Brandt, *People and Politics*, 256.

these consultations was creating a strategy to deal with Nixon on their upcoming meetings with the American president. In exchange for relenting on revaluation, Pompidou would get the diplomatic victory making a deal with the Americans, as Haig Simonian put it – “the kudos of appearing as Europe’s spokesman vis-à-vis the Americans.”²⁴²

Whereas they could agree on currency, they agreed to disagree on trade. Since the American military presence and imports from the U.S. varied so widely between the two nations,²⁴³ Pompidou could afford to resist American pressures “to finance America’s military, political and economic activities out of its own deficits.”²⁴⁴ The situation for Brandt was different, though. The Federal Republic depended on the U.S. military presence for its security and a high volume of imports for its economic well-being, and it was imperative to come to an agreement with the Americans and get the surcharge lifted as soon as possible.

By offering to talk about the gold price in Rome, Connally had put Nixon in a precarious political position. According to notes of a staff meeting on 12 December 1971, when the president heard about the concession on gold, which he evidently had not authorized Connally to offer, and he was less than happy. Although gold did not matter now that convertibility had been suspended, Nixon was sure that Congress would chastise him about devaluation. Now that the issue was out, the problem now became how to spin the issue to the administration’s advantage.²⁴⁵ Whatever Connally’s motivation for offering the gold concession, it was necessary to move the negotiations along. This was because France, which had insisted on altering the gold price,²⁴⁶ was a

²⁴² Simonian, *The Privileged Partnership*, 122.

²⁴³ France was still technically a member of NATO, but had pulled its ground troops out of the organization in 1966, and did not contribute as much to U.S. defense in the regions as it had beforehand.

²⁴⁴ Brandt, *People and Politics*, 257.

²⁴⁵ See Matusow, *Nixon’s Economy*, 176, and his cited Handwritten Notes of H.R. Haldeman, 12 December, 1971.

²⁴⁶ Memorandum, McCracken to President Nixon; 8 December 1971; folder Memos for the President; Box 43; WHCF:SMOF: McCracken; NPMS. The administration heavily played upon Pompidou’s fears of German dominance and the image of France in European and world politics. Kissinger and Nixon catered to Pompidou’s desire to be “accorded special and preferential treatment, rather than participate in a Western summit. . . . You will want to not that the best way to contain German dynamism toward the East is

prime component of the European team in the negotiations process. The French held the most political clout among the Europeans, which overshadowed its economic weaknesses, but the U.S. needed to come to an accord with France in order for the EC agree to any international settlement. An agreement with the French was pivotal if any progress was to be made in the upcoming G-10 meeting, and without it, Franco-American relations would surely be strained. However, it is also true that the 10 per cent surcharge affected the French economy the least, and its use as a bargaining chip to induce European concessions was limited. The French could bide their time and wait for better offers. Therefore, U.S. relations with the French had to take another route. That route involved gold.

The Azores

The U.S. and France Make a Deal

Nixon's team prepared for the inevitable demands on the gold price and dollar devaluation that Pompidou would make at their meeting in the Azores on 13-14 December 1971. The Azores meeting produced settlements that went beyond the French and the U.S. disagreements. The administration outlined its entire strategy for the shape of the international system that would be discussed at the G-10 in Washington the next week, and checked it against the French vision. By the time the G-10 met, Nixon and Pompidou had coordinated many of their proposals for the conference. The U.S. was looking for realignments of the major European currencies and the yen. The franc would be devalued vis-à-vis the dollar, the mark revalued from 4 to 5 per cent above the franc and the yen revalued against the mark.²⁴⁷ The U.S. would not return to convertibility.

for the U.S. and France to stay close in harmony... They have no intention of permitting the Germans to gain an advantage in maneuvering over the monetary crisis with the U.S.. Apparently, Pompidou achieved an agreement with Brandt in their meetings that Germany and France would act in coordination in dealing with the U.S. on economic issues." Memorandum; HAK to President Nixon; Re: Your Azores Meetings with President Pompidou; 10 December 1971; folder Azores Visit/ Meeting with President Pompidou 13-14 December 1971; Box 473; NSC Trip Files; NPMS. Underlined portions are Nixon's own.

²⁴⁷ Nixon's team was aware of the concerns about mark-franc parity. "The Germans are primarily concerned about the parity of the DM versus the French franc. Their trade with France is greater than that with the United States. They have had long and serious negotiations with the French, who are stubborn. They cannot move the mark from 8 to 10 per cent unless the French go at least half the distance. And the only way they conceive of this possibility is for the dollar to devalue by a token amount, say 5 per cent."

Connally slipped in demands for trade talks in return for any agreement on the gold price. The EC Commission had already submitted a mandate for trade negotiations with the U.S. a few days prior to the Azores meeting, and part of the talks that weekend would insure that the French would not block it.²⁴⁸ There were also briefings on wider margins for parity fluctuations of about 3 to 4 per cent. This was small enough, the U.S. felt, to maintain a fixed system, but large enough to allow for minor adjustments.

On the first day of the Azores meetings, both sides presented a general outline of their views. They found that the other side was willing to go much further than anticipated, which paved the way for more comprehensive agreements. These in turn, set the agenda for the IMF meeting in Washington the following week. Kissinger held a preliminary meeting with Pompidou and briefed him on Nixon's positions regarding monetary affairs, and informed Pompidou that the president was willing to drop the surcharge and negotiate a new price for gold.²⁴⁹ At the meeting later that day, Kissinger and Nixon presented the situation in both political and economic terms. Kissinger discussed the issues in technical monetary terms to compensate for Nixon's lack of expertise on the subject. The president freely admitted that Pompidou had far more experience in monetary matters. Both stressed the value of the special relationship between France and Germany. Kissinger played to France's concerns over the balance of power in Europe stating, "We also believe that divergences or a confrontation between France and the United States would leave Germany free to pursue a nationalist

Letter; A. Robert Abboud (Senior Vice President of the First National Bank of Chicago) to Richard V. Allen (Deputy Assistant to the President for International Economic Affairs); 2 November 1971; folder CO 53 [Gen]; Box 33; WHCF:SU: CO 53 [Gen]; NPMS.

²⁴⁸ "Framework for Monetary and Trade Settlement." 10 December 1971; Box 13; WHSF:POF: Handwriting Files; NPMS. See Connally's fully unclassified briefing paper – Memorandum; Connally to President Nixon: "Monetary and Trade Issues Aiming at the Azores Meeting." 10 December 1971; Box 77-353C; Connally Treasury Papers; LBJL. For the trade negotiations see Memorandum; Peter G. Peterson to President Nixon; Re: Progress Report – Trade Negotiations in Conjunction with Monetary Talks; 10 December 1971; Box 15; WHSF:POF: Handwriting Files; NPMS.

²⁴⁹ Many of the briefing papers that Nixon seems to have read were from the NSC and Treasury. The State Department papers were marked as 'seen' but the president made no notations. See accounts of this meeting in Volcker, *Changing Fortunes*, 88, and Kissinger, *White House Years*, op cit. I take my account from several memorandums of conversation. See Memorandums for President Nixon; Beginning 12 December 1971; Box 87; NP, POF; NPMS.

policy and other countries might try and play upon such a rivalry.” Nixon echoed this feeling saying that, “Fundamentally, Chancellor Brandt and Germany needed a France not too concerned by their *Ostpolitik*. They needed her blessing. Everyone in Europe was counting on France to defend certain commercial and financial interests with the United States. It is a comfortable situation for them. In case of any difficulty they can say, ‘Well, it’s the French.’”

Pompidou, a former banker, dominated much of the conversation on monetary affairs. From the transcripts, he seems not to have responded, verbally or otherwise, to Nixon’s pandering on French perceptions on the balance of power in Europe. He agreed that France’s role was paramount to any agreements in the international negotiations, and presented the French view on both an international tier in relation to the dollar and then on a European tier with the franc’s association to the DM and European integration. First, Pompidou clarified the French position on gold, and denied that the Rueff’s demands for doubling the price of gold were the official position of the government. The men hardly mentioned the gold price during these first meetings, apart from Nixon restating his initial offer. When the topic did come up in conversation, Nixon and Kissinger always refuted Pompidou’s request to raise the gold price. Pompidou wanted fixed parities, a small devaluation of the dollar in relation to gold, and the promise that the U.S. would defend the new parities, with the dollar returning to convertibility. Nixon and Kissinger consistently rejected dollar convertibility, reasoning that it would destroy the U.S. balance of payments and return the dollar to the same burdens from which it had recently been freed. Pompidou suggested that there needed to be a long-term commitment to convertibility as a goal, and explained in detail how this might be done. Nixon and Kissinger listened politely and then attempted to turn the conversation back to their initial concessions of lifting the surcharge and the price of gold, hoping that Pompidou would see convertibility as something for negotiation in the context of reforming the entire system. Pompidou was insistent that the dollar return to convertibility among other currencies, making it clear that the only option for the dollar’s defense after this point would be to “buy dollars with other currencies.”

Kissinger confirmed this observation and restated the U.S. position that gold/dollar convertibility was out of the question. Pompidou understood.

On the question of currency realignment, which involved the second European tier of the French position, Pompidou mentioned a “moderate” dollar devaluation, and Kissinger offered between 5 and 10 per cent. They agreed that this was negotiable, but Pompidou opposed going as high as 10 per cent, because of the effect on European parities. He believed that the franc, lira, and pound had to stay tightly together in parities, and would adjust in relation to the dollar, and that the mark should revalue vis-à-vis the franc. Pompidou also reasoned that the new fixed parities should have moderate margins, that is, that they should enjoy a little flexibility to allow for some minor adjustments, but to prohibit huge divergences among currencies. Huge differences in parities would promote a lack of economic discipline and “would be a drain of all currencies towards the strongest. This is now the Deutsche mark. Just as a dollar standard did not suit him, neither did a mark standard.”²⁵⁰

The second day of negotiations, Kissinger and Pompidou began with a breakfast meeting where they discussed the definitions of dollar defending, devaluation, and reform.²⁵¹ Pompidou had spoken to Connally, who “had the firm purpose of defending the dollar after a deal had been made but not the means and did not seem disposed [to] such means as it had.” Kissinger replied that he understood his point and that President Nixon had shared this feeling, believing that the U.S. would defend the dollar in the context of a new monetary system. This meant that after realignments and reforms, the U.S. would be willing to defend its new parity, but had no interest in doing so in the event of a temporary fix. The U.S. was under the impression that Pompidou had other ideas, and he affirmed this by describing what he believed to be a viable action for the dollar:

²⁵⁰ Memorandum of Conversation; Re: Meeting at Junta Geral, Angra do Heroismo, Terceira, Azores. 13 December 1971; 4 pm; folder Memorandum for President; Box 87; POF: Memorandum for President; NPMS.

²⁵¹ See Memorandum of Conversation; Re: Meeting between Mr. Pompidou and Dr. Kissinger, Azores. 14 December 1971; 0830; Box 87; POF: Memorandum for President; NPMS.

He drew on his experience with the French Franc. When the franc lost value, no one in the world, no central bank kept francs and the French had to give hard currency to bolster it (dollars). When the French found that they had exhausted their special drawing rights at the International Monetary Fund, their reserves and loans, all of which were insufficient, then they devalued. Afterwards, with the French franc at a correct level Central Banks still did not keep French Francs and if there were too many and we had a negative balance of payments the French had to give foreign currencies. This applied to the U.K. as well as to France. This is the process which he thought would be applied to the devaluation of the dollar. He understood that present dollar balances would not be included as they were too big. The President apparently felt we were thinking of something else.

Kissinger responded:

...after talking to Secretary Connally...the Secretary feels if the exchange alignment is correct then we will be prepared to operate the system, if what we had already talked about was not enough. Secretary Connolly preferred to delay the final commitment until the final settlement of the new international system.

Kissinger then offered Pompidou an outline of the agreements that could be achieved at these meetings, which he hoped could be released in a joint statement. He believed that Nixon and he could come to terms on a percentage for dollar devaluation and support long-term reform the IMF. Pompidou would not agree to definite terms for an interim or new system at that time, and that there was obviously a difference between his and Connally's understanding of defending the dollar.²⁵² Returning to the subject of devaluation, Pompidou suggested that they should present the dollar's devaluation to the public in terms of raising the gold price to \$38 an ounce. When Kissinger replied that this really amounted to a percentage, Pompidou reiterated the \$38 price. Kissinger remained noncommittal and commented that it had been Connally's opinion that the

²⁵² The resulting public statement included references to dollar devaluation and "revaluation of some other currencies," and broader permissible margins of fluctuations around the newly established exchange rates." Connally's wish to include trade in the negotiations was accommodated by mentioning the EC's mandate to settle trade issues. See "Text of a Joint Statement by President Richard Nixon and President George Pompidou Following Meeting in Angra, The Azores." 14 December 1971; Box 87; POF: Memorandum for President; NPMS.

U.S. should not accept anything lower than 10 or 9 per cent devaluation, but that he would cede to Nixon and Pompidou's wishes. He could also not commit to any statement that did not mention fixed parities, and stated that 1 per cent was too small and 3 per cent too large. He reaffirmed his demands for a 6 per cent mark revaluation over the franc and would accept no more and no less, no matter what Schiller's demands might be.

The following day, Nixon, Pompidou and Kissinger met again to talk about the proposals that Connally and Giscard discussed at the finance minister's meeting.²⁵³ The first issue was hammering out a firm number for the devaluation of the dollar. The U.S. had pressed for a 10-12 per cent devaluation, and agreed to propose this to Congress in terms of gold, but Pompidou held strongly to his aversion to these percentages and stuck to his \$38 and ounce figure, which amounted to 8.6 per cent devaluation.²⁵⁴ He contended that if the parity change was any higher, the pound and the lira would have to be devalued, wrecking the parity between them and the franc.

To change the parity between the franc and the pound and lira would represent an immediate financial loss for the Bank of France on the order of \$300 million if the dollar were devalued and the price of gold were not changed since the French franc would not move in relation to Gold. The Bank of France would lose 300 million dollars in 24 hours.

Nixon agreed to 8.6 per cent, seeing that anything higher would meet the opposition of at least three European Community members.

The second issue – arranging for the revaluation of the mark and the other European currencies – required some diplomatic maneuvering. Brandt had indicated

²⁵³ The texts of the finance minister conversations are not yet declassified from John Connally's papers at the LBJ library. For the source of the Nixon, Kissinger, Pompidou meeting see Memorandum of Conversation; Re: Meeting at Junta Geral, Angra do Heroismo, Terceira, Azores. 15 December 1971; 0900; Box 87; POF: Memorandum for President; NPMS .

²⁵⁴ Tew, *Evolution of the International Monetary System*, 155, notes that the change in gold price did not really matter in banking operations, since the dollar could no longer be converted into gold, but the change in gold price rather than saying it was a dollar devaluation "enabled the change in pegged rates to be represented as more in the nature of a depreciation of the gold value of the dollar[,] than an appreciation of the dollar value of other currencies." This meant that European banks could "maintain the local currency value [say for example Germany – the mark] of their reserve assets."

that he was willing to go to 5 or maybe 6 per cent against the franc, and so the German negotiations had been all but concluded. Pompidou said that in order to obtain the rates for Europe that they agreed to here, he would have to “give indications” to “their partners in the Community” without the impression that the rates had already been formally decided upon. “The French would say to the U.K. that in margin to their discussion with us on the rate of the dollar they believed that there was a maximum figure beyond which they would not go. If the British devalued, then the French would too.”

The matter of fixed exchange rates and new margins brought the future of European integration and international reform into discussion. Pompidou stated that France could accept 2 per cent margins, while Connally had pushed for 3. The French president informed them that broadening the margins held consequences for European monetary integration and that France would request that the EC restrict itself to smaller margins if the IMF agreed to extend them. Nixon and Kissinger took the issue out of a divided European and IMF stance and placed fixing margins in the context of international reform and a stable monetary system. Pompidou explained that margins were more of a political issue than a monetary one, and that for one currency to bear the weight of the system as the dollar had done for years was unhealthy. Although some had thought the Europeans were trying to supplant the role of the dollar, he did not think this was the case and “believed it was much more normal to seek an international forum such as the IMF with a notion of reserve and liquidity rather than to try and recast the dollar and create a European currency. This would waste time and create a monetary war.”

Turning from monetary issues to trade, Nixon used Congress as a bargaining chip. He said that if the administration could show some European movement on trade issues, he could guarantee a favorable vote for changing the gold price. Even with the Democrats holding majorities in both Houses, he was sure that “a coalition of responsible Democrats and Republicans would support this policy.” Pompidou did not think that securing passage of the trade mandate would be difficult and he and Nixon

agreed that after Congress voted on gold, trade would be added to the EC package.²⁵⁵ They both pledged to begin the negotiation process within the European Commission and in Congressional committees. Nixon ended the conversation with an observation: “reevaluation was unfortunately more important than trade. Congress did not understand monetary matters.” Pompidou responded that, “he had a Parliament that did not give a damn about monetary matters.”²⁵⁶

Later that afternoon, the presidents met again with their finance and foreign policy advisers to finalize the agreements.²⁵⁷ They constructed a “Frame Work for Monetary and Trade Settlement” that would serve as a guideline for the coordination of their policies and procedures to be suggested at the Washington in a few days.²⁵⁸ In the nine points, they reiterated their commitments to the removal of the 10 per cent surcharge, the change in the gold price to \$38 an ounce, the maintenance of the franc to the present gold parity, the revaluation of the mark by 5 or 6 per cent, and widening exchange rate bands to 2.25 per cent margins. There was no mention of convertibility but Pompidou did get a vague pledge from the administration to defend the new parities. Point number five that stated: “The United States intends to assist in the stability of the system and the defense of the newly fixed structure of exchange rates in particular by vigorous implementation of its efforts to restore domestic price stability and

²⁵⁵ Nixon would also meet unofficially with Brandt in Key Biscayne, FL at the close of December and talk briefly about the importance of trade negotiations especially about grain. He told the Chancellor that he would need these concessions in order to pass the gold bill through Congress. See Memorandums; folder Brandt Visit Dec 1971; Box 918; NSC Files, VIP Visits; NPMS.

²⁵⁶ Nixon’s use of Congress was really a bluff since it was the executive office that had pressed for the trade concessions. Although Congress would undoubtedly be pleased with the demands, the president did not need the trade mandate to pass the par value bill since most members of Congress thought that the dollar was undervalued and that parity changes were needed to restore confidence in the dollar. Nixon asked Congressmen not to act on the issue until after Congress went back into session, because action now might take away his bargaining chip with the French. See Memorandum of Conversation; Box 87; Azores; POF; NPMS.

²⁵⁷ Memorandum; Re: Meeting at Junta Geral, Angra do Heroismo, Terceira, Azores. 15 December 1971; 2 pm; folder Memorandum for President; POF; Box 87; NPMS.

²⁵⁸ NP, POF: Memorandum for President. Box 87. “Frame Work for Monetary and Trade Settlement.” (Signed by Richard Nixon and Georges Pompidou) Nixon’s notes show his political line of thinking – “It is more competition, more prosperous – Let us make it a more peaceful world. Deal must be good for both – Free world wins.” See NP, Presidential Speech Files, Box 70. Sat. 18 December 1971. Meeting with Finance Minister.

productivity.” Other details such as long-term reform and trade between the U.S. and the EC would be negotiated in other forums.

On this point, Pompidou was especially interested in Nixon’s views toward the Community. He inquired if the U.S. was actually in favor of the EC despite the trade difficulties. Nixon responded, “we shouldn’t be in favor of it but we are.” He had supported integration as Vice President and continued to do so now, but he saw it as a political rather than economic matter even though it would damage some U.S. economic interests. However, “united economies of the European countries would create a strong free world force that would be beneficial to us in the long run and would be helpful in moving towards a world of peace.” In an obvious reference to Brandt’s *Ostpolitik*, the French president replied that integration was necessary for the balance of power in Europe. He reasoned that individual states might race to establish relations with the Soviet Union, which would damage relations on the continent and with the U.S.. “The Soviets hope détente will lead to an early departure of the U.S. from Europe.”²⁵⁹

The Smithsonian Agreement

Birth of a New System or Just Re-wrapping the Old?

With French objections resolved, the next step was to prepare for the G-10²⁶⁰ conference at the historic Smithsonian Institution in Washington on 19 December. The final agreement was a compromise for everyone and followed the course that Pompidou and Nixon had set days before. As the U.S. had already agreed to raise the gold price to \$38 an ounce and lift the surcharge, the Washington meeting consisted mainly of negotiations to determine how much the other nations would revalue. In terms of the dollar, the French franc rose 8.57 per cent, retaining its parity with gold, and the German mark settled on a hefty 13.58 per cent rise, which matched the 6 per cent against the

²⁵⁹ Memorandum of Conversation; Re: Meeting at Junta Geral, Angra do Heroismo, Terceira, Azores. 15 December 1971 2 pm; folder Memorandum for President; Box 87; POF; NPMS.

²⁶⁰ Kenneth Dam, *The Rules of the Game*, 190-912, notes that the negotiations were conducted among the G-10, which comprised the industrial nations, and no representation from the 3rd world. The only IMF member present was the Managing Director shows the minor role the Fund played in the process. He also says that the U.S. did not want to “accept its convertibility obligation under Article VIII, Section 4.” For his analysis of the legality of the U.S. decision to change the gold price and the problems it caused for the Fund.

franc that Pompidou had promised to fight for at the Azores.²⁶¹ The delegates agreed to return to fixed, but now more flexible parities, by enlarging the previous band of fluctuation of 1 per cent above or below the dollar to +/- 4.25 per cent.

The reactions of the international press and governments regarding the Smithsonian Agreements were generally positive. Nixon put a domestic spin on the story by explaining the gold price change in terms of new jobs and American economists were pleased with the move, calling it “promising,” “will have a buoyant effect on the economy,” and praised Nixon and Connally for their “skill” in their dealings. The administration did note that Milton Friedman downgraded the price of gold but “did find beneficial the agreement on a wider margin of fluctuation of exchange rates. But...says the decision on a new price for gold will eventually lead to a binding commitment for the dollar and thus future crises.” The international reaction was positive with Foreign Minister Schell proclaimed that it “brings relief to W. [sic] Germany’s sagging monetary system,” and “equitable and realistic” by the British papers. The Soviet Union retorted with typical venom, calling the agreement “a blow to U.S. prestige and reflected a deep crisis in the U.S. economy.”²⁶²

Conclusions

The Death of Bretton Woods or Simply Life Support?

The New Economic Policy and the Smithsonian Agreement signified a monetary and political victory for the Americans. Turning to a more flexible system, Nixon now had more freedom to conduct economic policies as he liked, and could claim that managing the U.S. economy was sufficient for managing the dollar’s position in international system. This was more beneficial to him in the coming years, as successive market ups and downs introduced more flexibility was into the system. Therefore, the agreements marked the first steps relieving the dollar from its overvalued obligation. By suspending convertibility, the U.S. had a bargaining position in reform discussions

²⁶¹ Strange, *International Economic Relations*, 343, and Kruse, *Monetary Integration in Western Europe*, 101.

²⁶² Annotated New Summaries; “Weekend News Review” 20 December 1971; Box 37; WHSF: POF; NPMS.

because national banks had excess dollars and were ready to negotiate to return some stability to the system and secure their reserve assets in a unit that carried investor confidence. Acting unilaterally and quickly meant that the banks were stuck with these dollars until the U.S. agreed to continue convertibility on their own terms: European parity realignments and concessions on trade. However, to get promises from France on trade in exchange for revaluations, Connally had given up the 10 per cent import surcharge that threatened European trade, in exchange for revaluations of EC currencies that scarcely dented U.S. trade or balance of payments deficits. With the threat of the import tax gone, the promises of productive trade arrangements to correct the “unfair” advantages foreign governments held over the U.S., were lost.²⁶³

The May float of the DM and the August 1971 decisions should have signaled a change in thinking for the long-term reform of the system. By clinging to a slightly flexible version of fixed rates, nations were staving off the inevitable move to floating that had thus far proved, on a smaller scale with the European floats, that it was a safe and effective means of managing currencies. The fact that the U.S. had refused to reopen the gold window, and afterwards put a temporary hold on swap arrangements with central banks, moved international monetary affairs closer to adjustable parities.²⁶⁴ Central banks would no longer support a weak dollar or the American external balances through currency reserve or gold exchanges. The balance now relied on the U.S. keeping its balances through fixed exchange rates and other countries appreciating their currencies in proportionate amounts, which meant that parity alterations could become more frequent and subject to market conditions.²⁶⁵ In the event of world crises that

²⁶³ Volcker, *Changing Fortunes*, 90, says that except for a few agreements made in regards to citrus, nothing could be done to help the trade deficit without the threat of the import surcharge. For archival sources on the trade negotiations see Peter Peterson and John Flanigan’s files at the Nixon archives. A brief overview of the start of these talks can be found in an early memo. Memorandum; Peter Peterson to President Nixon; Re: Status of Trade Negotiations and Gold Price Legislation; 1 February 1972; folder January 1972-March 1972; Box 16; WHSF:POF: Handwriting Files; NPMS.

²⁶⁴ Tew, *The Evolution of the International Monetary System*, 155-156. The swaps were put on hold until July 1972 and then sparingly used until the next year.

²⁶⁵ Kruse, *Monetary Integration in Western Europe*, 101.

pushed the fixed limits to the boundaries, the nations would be forced to abandon their restrictive parities. This is exactly what would happen during the oil crisis in 1973.

However, it is also true that Bretton Woods had been altered in so many ways before the decisions in Washington, that by this time it barely resembled the regime that its planners had envisioned decades before. The changes were grossly overdue. Nixon's NEP sped the slow decay of the system and forced its participants to take some steps to break from their reliance to the dollar. It certainly was not the end of U.S. influence in Europe, but the crisis had renewed Europe's interest in itself.

As far as Nixon was concerned, he was finished with the issue. He praised the Smithsonian Agreements as "the greatest monetary agreement in the history of the world" and he had helped create it. Never interested in the complexities of monetary affairs or mechanisms, he dealt with the subject only because it threatened the wealth of the nation and the health of his presidency. He had freed the dollar from the scourge of speculators and the weight of gold, and with an eye to the 1972 elections, he sold devaluation to the American people in terms of something they could understand – jobs. As D.C. Kruse summarized Nixon's strategy, "Devaluation has to be defined in terms of American goods being more competitive, so therefore there are more jobs in the United States."²⁶⁶ To Nixon, monetary policy was a mill worker's vote somewhere in Ohio.

²⁶⁶ Matusow, *Nixon's Economy*, 178. Connally quote from Haldeman, *Haldeman Diaries*, 15 December 1971. Nixon had not been entirely truthful during the discussions with the French on trade and monetary policy. As shown above, Peterson and Connally were behind the initial push for trade not the congressional consensus. Nixon also met with congressional leaders after the Azores where he outlined the plan and asked them to hold off on action until after the Washington meeting so that they could use Congress as a bargaining lever. Connally's suspicions towards the EC were adequately summed up "We trust us more than we trust them. Each of them hides behind their commitment to the Common Market." For the complete transcript see Memorandum; Re: Bi-Partisan Leadership Meeting December 15, 1971 12 noon; folder Memorandum for President; Box 87; POF; NPMS.

CHAPTER V

SNAKES, TUNNELS & FLOATING: JANUARY 1972-SEPTEMBER 1973

After the chaos of Nixon's decision and the ensuing international negotiations that led to the Smithsonian Agreements, the monetary community would spend the next year trying to redefine its limits. It would prove to be a transitory period for monetary relations. The U.S. would gradually become more a vocal proponent for greater flexibility, and Europeans would be forced to make adjustments to their own monetary futures because of these American wishes.

United States policy makers hoped that the Smithsonian adjustments would release them from the encumbered responsibilities of Bretton Woods, but there were doubts that these new rates would hold. Nixon called it a landmark agreement, but Volcker offhandedly remarked during the signing of the agreement, "I hope it lasts three months."²⁶⁷ Volcker's expectations were not out of line, as they reflected what the administration and the markets knew – that the dollar devaluation had not gone far enough. Publicly, however, the Treasury supported the new rates in the hopes that they would stick and now focused on long-term reform that targeted the surplus countries around the world that the U.S. felt had contributed to the payments disequilibrium and the American deficit.²⁶⁸ The Europeans joined the reform efforts, hoping to return to fixed rates and convertibility with the SDR, instead of the dollar, as the anchor for the system. Both sides of the Atlantic had very different ideas as to the structure and

²⁶⁷ Volcker, *Changing Fortunes*, 90. Paper; Connally to President Nixon; "Draft of the Par Value Modification Bill S. 3160."; Box 77-363A; Connally Papers; LBJL. S. 3160 became Public Law 92-238 when it was approved by Congress on 31 March 1972 and the parity of the dollar to gold changed from one thirty-fifth a fine troy ounce of gold to one thirty-eighth of a fine troy ounce of gold at noon 8 May 1972. Letter; John Connally to Pierre-Paul Schweitzer (IMF Managing Director); 5 May 1972; folder May 1972; Box 77-363B; John Connally Papers; JBC Official Chronology; LBJL. .

²⁶⁸ The reforms were now debated by the C-20 instead of the G-10. Now, the G-10 members felt that the discussions should include the developing countries. For a discussion of the various plans for reform, see Williamson, *The Failure of World Monetary Reform*, Chapters 3, 4, 5, and 6.

function of any future system, but key to the European strategy was to disengage the dollar from its central role.

Europe's monetary fate had always been dependent on the interests of France and Germany, and the smooth transition from Bretton Woods to Smithsonian rates relied on their cooperation. France had long sought to lessen the dollar's influence in monetary affairs, and the reform negotiations offered Europe an opportunity to shape the system to their liking. The realignments did have an influence on promoting an EC monetary identity as Pompidou would fulfill his promise to Nixon in the Azores and narrow the Smithsonian bands for European currencies that built a more independent mechanism of currency management. Therefore, the consensus that had brought France and Germany together during the international negotiations was now bringing the European Monetary Union closer to fruition. It could be the start of monetary independence from the dollar, but with a distinct European vision. Bonn and Paris would have to lead for a success, but they would have to overcome both national and international differences.

Pompidou's Serpent

European Monetary Union gets an Unexpected Boost

As a precursor to the upcoming Community finance minister meeting in March, Pompidou and Schmidt met in February 1972 to discuss the particulars of a renewed agenda in uniting Europe. The Smithsonian rates had enlarged the currency band and now European rates could fluctuate up to a 9 per cent difference between the EC members. The rates may have been a triumph for dollar diplomacy and Nixon's domestic agenda, but they were a serious threat to the development of the Community. As he had told Nixon during their Azores meeting, Pompidou suggested to Brandt and the EC that they narrowed the margins that the Community currencies would fluctuate within the Smithsonian bands. The French President's initiatives were not only linked to the domestic benefits of stable currencies, such as increased inter-European trade and more industrial development for France, Pompidou closely linked EMU as a means of establishing a distinctly European identity in EC/U.S. relations. Creating a monetary

union with smaller bands could fix a distinct and powerful European voice in monetary and political affairs, and offer a measure of independence from the Americans.²⁶⁹

Brandt was not as concerned with using Europe as a challenge to U.S. influence, as the Chancellor was still balancing his influence within the Western alliance to maintain support for *Ostpolitik*, but close alignment with France would help ameliorate domestic criticism of rapprochement with the East.²⁷⁰ Primary on Brandt's European agenda was a cohesive plan to combat inflation, which meant a certain amount of national economic policy coordination and Community institutions to achieve this planning. The French opposed transferring any national sovereignty to the Community level, and the distinction between the German love of federalization and the French comfort with confederation would be well illustrated in the year to come. As the immediate threat of currency misalignment grew heavier on their minds, Brandt acquiesced to some capital controls, which contrasted with Finance Minister Schiller's earlier refusals to do so,²⁷¹ and agreed to narrow the Smithsonian rates for European currencies. In return, Pompidou approved the creation of an EEC committee to plan for economic policy coordination among states, and dropped much of his rancor towards a body to promote the same in political relations.²⁷²

Since the members still clung to the hope of creating EMU by the 1980 target date set by the Werner Plan of 1970, the Community reacted quickly to the exchange fluctuations and imposed parity restrictions. The Plan had outlined some provisions to manage European exchange rates at the first stage (from January 1971), where central banks were allowed to intervene on an "experimental basis" to limit their currencies within "narrower bands than those resulting from the application of the margins in force

²⁶⁹ Simonian, *The Privileged Partnership*, 127.

²⁷⁰ Ibid, 126. Ratification of the *Ostpolitik* treaties would take place later that year and there was a possibility that they would be rejected by the legislature.

²⁷¹ The shift in thinking was already apparent in December 1971 when the Bundestag *temporarily* amended the Foreign Trade and Payments Law on 10 December 1971 (interestingly before the Smithsonian Agreement) that "empowered the Bundesbank to impose a special cash deposit (Bardepot) requirement on foreign borrowing except for trade credits and to authorize the federal government to take administrative action to stop other forms of capital inflows." Kruse, *Monetary Integration in Western Europe*, 105.

²⁷² Simonian, *The Privileged Partnership*, 125-127.

in relation to the dollar.”²⁷³ However, there was no clear guideline or target band for the banks to attain. By dropping its commitments to Bretton Woods and initiating the Smithsonian Agreement, the U.S. had now made the European monetary union a necessity that motivated European policy-makers to make changes. These issues also forced Pompidou and Brandt to discuss more substantive plans in other stages of union that could not be disconnected from monetary issues, such as political and economic coordination. Again, the Werner Plan had provided for this inevitability, but because of the lack of consensus in the EEC, leaders had only accepted a vague sketch of action that was to commence in 1974. This phase was supposed to enact “progressive” narrowing of the currency bands, where national economic coordination would make national intervention unnecessary. Now because of the new exchange rates, the current monetary conditions demanded that they make concrete efforts and move EMU’s schedule ahead.

Following the Pompidou/Brandt summit of February, the Finance Ministers of Germany and France met in Bonn at the beginning of March to create the details of the new exchange rate band to present them to the Community later that month -- much to the chagrin of the other members.²⁷⁴ Narrowing the bands was desirable, but choosing which currency central banks would use to intervene to maintain the bands or how the exchange accounts would be settled, was a different matter. Germany, as a creditor and surplus nation, favored settlements in low-risk convertible assets like gold or SDRs. France, interestingly, argued in favor of settling accounts with dollars. As to an intervention currency, both argued for a variety of Community monies. Ultimately, at the Council meeting on 21 March, they came to an agreement with intervention by means of Community currencies and reserving dollar use to special circumstances. At the heart of the March European accords, though, was the parity limit of +/- 2.25 per cent for EC currencies. The Community “snake” would travel through the

²⁷³ Tew, *The Evolution of the International Monetary System*, 157–158.

²⁷⁴ The EC tried to agree on a mechanism for intervention in the first months of 1972 and was unable to agree on its course. Again, bilateral negotiations between France and Germany proved to smooth an agreement, but smaller nations resented being left out of the process.

Smithsonian's "tunnel," and the members vowed to establish their currencies within the band by July.²⁷⁵

The Pound Crisis of 1972

The Sterling Unmasks Underlying Problems for the Dollar and European Unity

In the meantime, Paul Vocker's wry prediction on the longevity of the Smithsonian parities was about to come true, but with regards to the pound sterling, not the dollar. Although the British economy and payments accounts had improved in the preceding years, the nation's fortunes had reversed the first quarter of 1972.²⁷⁶ The current account became a deficit, a miners' strike threatened the trade balance, annual wage increases were pushing prices higher, and the government announced that domestic demand would rise by 2 per cent in the coming year and thereby increase the

²⁷⁵ For discussion on the snake see Rainer Hellmann, *Gold, the Dollar, and the European Currency Systems: The Seven Year Monetary War*. Marianne Grund Freidberg, trans. (New York, 1979); Dennis Swann, *The Economics of Europe: From Common Market to European Union*. 9th ed., (London, 2000); Loukas Tsoukalis, *The New European Economy Revisited*. 3rd ed., (Oxford, 1997); and Horst Ungerer, *A Concise History of European Monetary Integration: From EPU to EMU*. (London, 1997). The Original Six joined the snake in March 1972, and the new members, Great Britain, Denmark and Ireland joined in May. Norway, although not a member, joined the snake at the end of May.

There is a difference between the currency used to intervene in maintaining parities and a "settlement" currency. Tew, *Evolution of the International Monetary System*, 158, best explains the process: "...whenever the 'strongest' EEC currency's percentage premium over its parity plus the 'weakest' currency's discount on its parity reached a predetermined amount (2.25) then someone buys the weakest currency with the strongest. The 'someone' may be either the weak-currency country (debtor intervention) or the strong-currency country (creditor intervention) or both together. With creditor intervention, the intervening country buys the weak currency in the exchange market with its *own* currency, which it can make available as required; hence the only problem with arises is what to do with the weak currency which has been purchased. With debtor intervention, the intervening country has first to borrow from its partner the strong currency needed for purchasing its own weak currency in the market: hence the need for the so-called 'very short-term' credit facility which was incorporated in the EEC scheme.

Whether the intervention is by the creditor or by the debtor country, a settlement arrangement is needed, by which periodically (monthly, in the EEC scheme) the creditor countries can exchange their accumulation of weak currency for a more acceptable reserve asset, and at the same time obtain repayment of their 'very short-term' credits, likewise in terms of an acceptable reserve asset. The snake scheme provided that the monthly settlement should be effected by the transfer by the debtors to the creditors of a mixed bag of reserve assets selected on an agreed formula."

²⁷⁶ All of this despite the confidences of the OECD Working Party Three (Monetary matters) meeting of 28-29 March 1972, where the members proclaimed the currency realignment sound and the fact that the pound actually strengthened in the first quarter with a small balance of payments improvement. See Memorandum; Robert Hormats to HAK; Re: Report on Monetary Situation; 6 April 1972; folder [EX] FI-9; Box 55; WHCF:SU:FI: FI-9; NPMS.

flow of imports. By May, the balance of payments deficit had multiplied and Chancellor of the Exchequer Barber did little to calm investor fears about devaluation when he commented that “it is neither necessary nor desirable to distort domestic economies to an unacceptable extent in order to maintain unrealistic parities.”²⁷⁷

In mid June, with the possibility of a dock strike looming, the markets had had enough bad news and began dumping sterling. In the next week, the speculative frenzy prompted nearly every member of the snake to intervene and attempt to manage the crisis and keep the pound within the band, but it was to no avail. London finally closed its markets and stopped intervening to maintain parities. Barber did not understand why the markets were reacting so harshly to the payments figures and rejected devaluation so soon after the Smithsonian Agreements. However, no matter how the Chancellor of the Exchequer felt about the current financial situation, closing the exchange was a clear signal to speculators that the pound was no longer able to stay within the snake or the tunnel. Given this fact, Barber announced the pound’s leave from the snake through a temporary float starting on 27 June, with Ireland as the only other member joining the float. The Dutch and Italians left the snake shortly thereafter, citing speculative inflows from the float.²⁷⁸

The failure of the pound, kroner, and lira to stay within the confines of the snake was a setback for EMU, and demonstrated the still cosmetic nature of monetary cooperation among the members. Although central banks had intervened to maintain the pound’s parity, but only in the name of the Bank of England, this meant that the end of the month settlements would be the sole responsibility of London in terms of either gold or dollars. Additionally, as Britain would not be a member of the EC until 1 January 1973, it was not eligible for mutual assistance and the individual members did not extend bilateral assistance, nor did they publicly announce their desire to support the pound, despite assurances to the British that they would do so. The mechanisms for the snake

²⁷⁷ Kruse, *Monetary Integration in Western Europe*, 114.

²⁷⁸ *Ibid*, 116. The members amended the regulations to allow the Banca d’Italia to make its settlements in dollars instead of gold or SDRs so it could still participate in the snake. The Dutch were given no such recompense.

had been created and had functioned well, but the members lacked the will to use them in concert for the good of European financial unity, rather than in the national interest. As Kruse stated, “Far from being an instrument of economic and monetary unification...the snake was a gauge of the degree of integration that already existed.”²⁷⁹

From Pound Crisis to Dollar Speculation

The Snake Survives Another Challenge

The White House was unconcerned about the maintenance of the parities, as there appeared to be no crisis situation that threatened the domestic economy. Nixon was interested in the reform and trade negotiations inasmuch as they applied to his domestic program. Unemployment and inflation were the main focus of the President’s agenda, and price and wage freezes under Phase I and II of the New Economic Policy had temporarily subdued inflation and some capital controls were in place to manage investment flows. Still, Nixon worried that a boom would not happen in time for the November elections and promoted massive government spending, but it was hardly necessary, since prosperity was in the near future.²⁸⁰ Arthur Burns started to provide easy money with low interest rates at the end of 1971, and Americans who had been protective of their savings began to spend freely that summer. By July, economic figures predicted the boom, which hit in full force in the months preceding the elections just as Nixon had wanted.

Even though the administration’s agenda fueled the recovery, the current account deficit, which reflected the imports and exports for goods and services and the leading indicator of international payments flows between nations, continued to be in deficit. Investors still believed that the dollar was overvalued, and the Fed’s monetary initiatives were complicating matters and threatened to break the new parities and with it, French-U.S. relations. The attack on the pound had been a prelude to growing speculation on

²⁷⁹ Ibid, 115-116; and Tew, *The Evolution of the International Monetary System*, 159. Tew points out that the float also ended the sterling standard where many of the former Empire’s colonies had pegged their currencies to the pound. About “a dozen” ceased to use the sterling and went to carrying more dollars in their reserves.

²⁸⁰ See Matusow, *Nixon’s Economy*, 186-189. On the effectiveness of wage and price controls see pages 192-198.

the dollar. The float showed investors that there was room for adjustments in the Smithsonian parities and it was widely believed by economists, bankers, and the media that the 1971 negotiations had opted for the least, rather than the necessary, percentages of devaluations and revaluations.²⁸¹ Early in January 1972, Robert Hormats and Helmut Sonnenfeldt warned Kissinger that the low U.S. interest rates were flooding Europe with dollars and causing pressure on the French-U.S. relations because they jeopardized the parity agreements made at the Azores. The French were suspicious of Connally “and others who believe that the realignment agreed upon in Washington was not large enough” and believed that they “are now attempting to force a greater realignment by maintaining low interest rates and thereby forcing out dollars in an attempt to force the dollar to drift lower on world monetary markets.” Since loose money was necessary for domestic growth and Arthur Burns was unlikely to tighten credit, there was no option to reassure the French by raising interest rates. However, there “is some talk in Congress” that the dollar devaluation was not enough, and the men reminded that French support was critical in trade negotiations. They suggested that Kissinger restore French confidence by assuring them that Congress would not raise the price of gold above \$38 an ounce “pending desired trade concessions.” Kissinger, who was now more involved in international monetary diplomacy, understood the importance of the Azores to Pompidou’s view of French leadership in monetary affairs and that keeping relations friendly would enable the U.S. to “profit from France’s growing stature in world affairs, particularly in Europe.”²⁸²

²⁸¹ *New York Times*, 23 February 1972.

²⁸² Memorandum; Robert Hormats and Helmut Sonnenfeldt to HAK; Re: French Concerns about the Strength of the Dollar; 24 January 1972; and Memorandum; Theodore L. Eliot, Jr. (State Department) to HAK; Re: Georges Pompidou and France’s Role in World Affairs; 18 January 1972; folder France vol. VIII; Box 678; NSC Country Files Europe; NPMS. There is a lengthy paper trail on the interest rate dollar problem, which starts immediately after the Smithsonian Agreement. Shultz seems to have initiated Nixon’s concerns over money supply with a 18 December 1971 memo where he expressed deep reservations about the “lack of growth in money supply.” Attached was a letter to Shultz from Milton Friedman with a copy of Friedman’s correspondence to Burns, that chastised the Fed’s policies. “What in God’s name is happening? Despite your repeated assurances that the recent cessation of monetary growth is a temporary departure from a longer-run of moderate growth, the figures show no sign of a return to such a path. There was some justification for offsetting the earlier unduly rapid growth. But this has by now been carried too far too long.” (Nixon’s emphasis.) Friedman went on to describe the conditions of

The heavy dollar dumping reached crisis proportions for the Europeans soon after Britain floated the pound. Speculation against the dollar carried weightier consequences for the remaining members of the snake. Whereas floating the sterling affected the members of the snake equally, dollar speculation affected each nation disproportionately. Because parities were set to the dollar and it was a reserve currency, and each country received a disproportionate amount of dollars, they might have to implement individual controls that would affect parities in the snake. Germany and Switzerland, representing the strongest European currencies, took in the largest amounts and were forced to close their markets.

The inundation of dollars was another challenge to the Federal Republic's resolve over the use of capital controls. The Bundesbank had already implemented limited controls in December, and managed to slow loans to foreign borrowers, but these measures were inadequate to halt purchases of bonds and money market paper.²⁸³ Thus, the Germans had two options— floating as a means to revaluation, or applying more

the recession of 1960 and likened them to the present time. Nixon instructed Shultz and Connally to meet with Burns. Memorandum; George Shultz to President Nixon with Friedman Letter; 18 December 1971; Box 15; WHSF:POF: Handwriting Files; NPMS. Nixon did write personally to Burns about the money supply and the problems within the Fed. Burns' handwritten notes on the last page reflect the relationship between he and the president – “...what nonsense! No answer to be made to this letter. It's outrageous.” Letter; President Nixon to Arthur Burns; 28 January 1972; folder Nixon, Richard- Incoming 1968-1980; Box N1; Burns Papers; GRFL. Later, CEA Chair Herbert Stein alerted Schultz, who was by then Secretary of the Treasury, to high dollar trading in the spring of 1972, and believed that this was an indication of the lack of confidence in the present dollar parity. See Memorandum; Herbert Stein to President Nixon; 22 June 1972; folder FI-9; Box 55; WHCF: FI-9, NPMS; and Memorandum; Herbert Stein to Shultz, Weinberger, and Flanigan; 5 July 1972; Box 44; WHCF: SMOF: Stein; NPMS.

²⁸³ See footnote 5 on the legality of using capital controls in the Federal Republic. For the rise in foreign short-term capital see the Bundesbank's *Monatsberichte*, June 1972, 5-7 and *Jahreswirtschaftsbericht 1972 der Bundesregierung*, 9-11. The U.S. was also keeping track of the German movement to the usage of capital controls. See David Rockefeller's telephone conversation with John Ehrlichman about French and German attitudes about U.S. policy. “...European finance ministers and central bankers are now to the point of disenchantment which will probably lead to the imposition of capital controls in the short run.” Memorandum; John Ehrlichman to Peter Flanigan; 7 April 1972; folder FO-4; Box 32; WHCF:SF:FO-4; NPMS. .

According to Fitch, *Dictionary of Banking Terms*, the money market is an “informal network of dealers and institutional investors” that works outside of the established markets like the NYSE. As an example, banks that sell certificate of deposits (investors put money into banks for a fixed or not fixed rate for a certain period of time) engage in these market transactions. The market primarily deals in short-term investments of usually up to 90 days.

controls. Floating held dangers on both the Community and international exchange levels. First, the remaining members of the snake would have to agree to a joint float in order for parities to remain in the band. France did not take in the same amount of dollars as the Germans because the Bank of France kept interest rates low to discourage foreign investments and had preserved the split market system that insulated the financial franc. Pompidou also rejected a float that would appreciate the franc. They did not want to negatively affect industry and make exports more expensive or add to inflationary pressures. The Federal Republic shared these same concerns as the appreciation of the mark in the last 3 years had made German exports steadily more expensive vis-à-vis its trading partners.²⁸⁴ The Bundesbank also believed that the surplus account was due to short-term inflows and not a fundamental disequilibrium in the German payments position.²⁸⁵

However, excluding the negative impact that floating would have on national economies, revaluation was disadvantageous on the international monetary level. Floating would undercut the already deteriorating market confidence in the Smithsonian rates that were barely seven months old. Despite the problems with the pound, it was still too soon to determine whether these parities were suitable to fix the external disequilibrium created in the last 30 years. The market activity seemed to be targeting what it believed to be an undervalued dollar, rather than an overvalued mark. Here, the mark's reputation for safe investment, worked against the Germans, and to some extent the EC, as it was among the strongest currencies with the largest market in Europe and it always attracted large amounts of capital when the markets attacked the dollar. The mark's strength was a demonstration of the economic power of the Federal Republic, and whether Brandt's team decided to float or not, determined how the Europeans would respond as a whole to the crisis. Clearly, national interests still played a large part in Community decision-making, in spite of the promises of the snake or EMU by 1980.

²⁸⁴ Kruse, *Monetary Integration in Western Europe*, 119.

²⁸⁵ *Monatsberichte*, July 1972, 7.

Since floating held disadvantages for the Germans internationally and domestically, they decided against revaluation in favor of capital controls. Non-residents now required Bundesbank authorization to participate in the domestic bond markets, reserve requirements were increased on non-resident and even resident deposits, and German companies were under certain restrictions in their foreign borrowing.²⁸⁶ The choice fared better for the survival of the snake and the Smithsonian parities, and it was a real sign of commitment to the rates as the extension of the controls demonstrated a real turn-around in German policy. Whereas intervening in the markets to such this degree would have met with stern resistance from Minister Schiller less than a year ago, the new Finance Minister Helmut Schmidt did not hold the same unwavering beliefs in the wisdom of the free market. Still, even these precautions did not calm the markets when they reopened on 28 June. Speculation on the dollar continued and the European banks intervened to keep their established parities, until 17 July when the EC finance ministers formally committed themselves to the Smithsonian rates. The markets got the message and the currency trading frenzy dwindled.

The good relations in Paris were also due to Helmut Schmidt taking over the finance minister post from Karl Schiller in the midst of the float/controls debate. Schmidt forged a good rapport with his French counterpart, Valéry Giscard d'Estaing, which was a stark contrast to Schiller, who had been the deal breaker during many negotiations with the French, scolding them for what he viewed as France's irresponsible policies that relied on near constant intervention in the exchange markets. In the past, Schiller had the strong support of the Chancellor, but the power paradigm in the Cabinet shifted after the British floated the pound. Schmidt, who was Defense Minister at this time, led a group within the Cabinet, which included Karl Klassen of the Bundesbank, which now supported limited capital controls in order to uphold the Smithsonian parities and minimize political difficulties. Schiller, who was becoming increasingly frustrated with the government's acceptance of controls since December 1971, argued against controls and in favor of floating all the EC currencies against the dollar. Realizing that

²⁸⁶ Kruse, *Monetary Integration in Western Europe*, 119.

he no longer had the support of the Chancellor or the Cabinet, he announced his resignation on 6 July.²⁸⁷

Accepting capital limitations, even temporarily, helped Germany's relationship with France, and seemed to make good on Brandt's promises to Pompidou at their February meeting. The controls also demonstrated the Federal Republic's resolve to maintain parities within the snake, and similarly Brandt's desires not to look like he was turning his back on Western Europe. And for whatever the reasons, the snake had survived two challenges to its existence in the first four months of its life. The appearance of cooperation during speculative pressures on the dollar was also important since there had been no resolutions regarding the institutional organization of the EC – France still vehemently rejected a supranational structure. Independent national actions had to save the snake, not Community actions. However, the gesture was not enough to remedy the residue of discord that still surrounded the pound crisis. When the two leaders met again in Paris at the end of July, Pompidou made clear that Great Britain's float was unacceptable and made the pound's return to fixed rates a precondition for the next EC summit. He likened London's refusal to return to the snake as evidence of its special relationship with the United States, and suspected that it would lead to a monetary division between the Americans and Europeans.²⁸⁸

Reaction to the Pound Crisis

The Nixon Team Gives Meaning to Current U.S. Policy and the Lack of It

The Europeans and Americans did have great differences on the function of the current monetary arrangement and internal memoranda shows that the U.S. had other ideas about defending the new parities. This was very much in tune with the discussion between Pompidou and Kissinger at the Azores on how the U.S. would defend the

²⁸⁷ Simonian, *The Privileged Partnership*, 135. Schiller actually held two posts in the German cabinet – Minister of Economic Affairs and Minister of Finance. He assumed the earlier position when Alex Möller resigned in 1971. Brandt described Schiller as “egocentric” and regarded “his grounds for resigning – a limited measure of control over foreign currency movements – were trivial.” Schmidt held the Defense, Finance, and Economic positions until the elections later that year. See Brandt, *People and Politics*, 438, and Letter; Arthur Burns to President Nixon; 8 July 1972; folder [EX] FI-9; Box 55; WHCF:SU:FI [EX FI-9]; NPMS.

²⁸⁸ Brandt, *People and Politics*, 260.

Smithsonian rates. In December, Connally had been reluctant to obligate to traditional market intervention and instead linked the defense of the dollar to domestic initiatives for growth and inflation control. Therefore, committing the U.S. to defend parities depended on the shape of the IMF reforms. At the start of sterling's troubles, Peterson wrote a memorandum to Nixon reasoning that the monetary turbulence in Europe "shows the wisdom of the U.S. refusal to consider convertibility until a new and stable monetary system is in place" and he blamed the rush of short-term funds to Europe's inability to devise "no mechanisms to give economic validity to the new parities."²⁸⁹ Members of the CEA advised Shultz that they did not feel that it was in the interest of the administration to intervene.

It has been the policy of the U.S. Government so far to reserve all its options with regard to our position on international reform. But support of the pound and/or lira in an effort to prevent or mitigate their float would telegraph some very clear signals regarding our views of the new system. It would suggest a distaste for greater flexibility and a commitment to the old notion of defense of existing parities except in the face of clear evidence of "fundamental disequilibrium." Such support operations would be a departure from our usual practice under the old system, and would thus set a precedent which might move us away from rather than toward an optimal new system.²⁹⁰

Unfortunately, sticking to this policy seemed like an extension of benign neglect to the Europeans, who steadfastly believed in fixed exchange rates and expected the U.S. to do its part to maintain them. Pompidou was also correct in his belief that a British or EC floating would cause a division in U.S.-EC relations, and there was some disagreement within the Nixon team about the choice of controls or floating. Arthur Burns praised the decision to impose controls, saying that Klassen had chosen "international monetary stability." However, floating any of the EC currencies held great benefits for the dollar. It encouraged more exchange rate flexibility, which was consistent with the

²⁸⁹ Memorandum; Peter Flanigan to President Nixon; Re: Floating the English Pound; 23 June 1972; folder [EX] FI-9; Box 55; WHCF:SU:FI [EX FI-9]; NPMS. Arthur Burns also expressed concern that speculation on the lira would soon follow.

²⁹⁰ Memorandum; Herbert Stein, Marina Whitman and Ezra Solomon to Shultz; 26 June 1972; Box 12; WHCF:SMOF:Ezra Solomon; NPMS.

administration's long-term reform goals, and revaluations would improve the U.S. balance of payments position. Herbert Stein thought that,

In my opinion what has happened can be described at most as making the best of a bad situation. The weak currency, the pound, has been devalued relative to the dollar. The net is that some of the trade advantage gained by last years' currency realignment – which we thought was too small at the time – has been lost. At the same time we are acquiescing in the imposition of controls on capital movements, which we don't like in principle and which weaken our case for trade concessions to bring our balance of payments into equilibrium. And we have lost Schiller, who was, I think, a force for the kind of monetary reform we want.²⁹¹

Although the U.S. had not unveiled its outline for reforms during the pound's difficulties, the administration's thinking was certainly moving towards floating, and there was one staff member who saw how the lack of a U.S. plan was exacerbating monetary difficulties, rather than helping the stability of the Smithsonian parities. Robert Hormats of the NSC reported to Kissinger on the seriousness of the crisis and how it might affect the lira. In order to maintain the boundaries of the snake within the Smithsonian rates, the EC had to make a deal with Italy so that it would not float the lira and drop out of the snake. They agreed to support the lira by intervening with dollars, that is to buy lira with dollars and keep it within the band. This was a compromise since under the EC rules made only a few months earlier, the members would have had to “intervene in their currencies to support the lira, and Italy would have been obliged to buy back the lira with other hard currencies and gold.” This was an important distinction since if speculation on the lira or dollar continued, the EC countries would have to purchase more dollars to support their rates or Italy's dollar reserves would be depleted.

Hormats believed that there was a high probability of more speculation against the dollar and lira because the markets lacked confidence in the new rates. He reasoned

²⁹¹ Letter; Arthur Burns to President Nixon; 8 July 1972; Memorandum; Herbert Stein to President Nixon; 11 July 1972; and Memorandum; Richard Erb to Peter Flanigan; 7 July 1972; folder [EX] FI-9; Box 55: WHCF:SU:FI [EX FI-9]; NPMS.

that without the industrial nations showing signs of support for the Smithsonian parities through intervention, they would most likely falter. The U.S. refusal to intervene in the markets and “the fact that we have dragged our heels with regard to reform” weakened the U.S. bargaining position on ways that the Europeans might manage future currency crises. “We should begin to move more rapidly toward reform...”²⁹²

United States Approaches for Reform are Finally Defined

George Shultz and the Cult of Floating

The pound and dollar crises had demonstrated the weaknesses of the snake, but the mechanism still survived. Europeans still advocated fixed parities with convertibility, and worked to institutionalize the snake to strengthen it with these criteria in mind. However, changes in American monetary leadership were already altering the dynamics of the international monetary system and U.S.-EC relations. Arthur Burns had not made a secret of his wishes for the U.S. to restore convertibility and maintain fixed parities, and when he made a speech at the International Monetary Conference for commercial bankers in Montreal in May 1972, with these recommendations, the differences within the administration came to public attention. Volcker, who attended the conference read the speech beforehand and felt that it did not say anything new, but blamed the press for seizing on Burns’ opinions and interpreting them as current policy, which Volcker refuted at a press conference. In truth, there was no official reform position. Connally thought that international monetary and political conditions were not right to establish the U.S.’s position on monetary matters.²⁹³

²⁹² Memorandum; Robert Hormats to HAK; Re: Report on Monetary Situation; 27 June 1972; folder European Community Market; Box 322; NSC Subject Files: European Community Market; NPMS. As this memo was written before the Germans made their decisions on capital controls, Hormats also correctly predicted how the Germans would respond to the crisis. He believed that the Germans would reject floating and impose capital controls for fear of alienating the French and halting EMU. He advised that the Treasury should not take a hard line against such steps for fear of angering the Europeans and “provoke a European reaction with would lead to measures more inimical to our interests.”

²⁹³ Volcker, *Changing Fortunes*, 117.

George Shultz replaced Connally as Secretary of the Treasury in May 1972,²⁹⁴ and moved to formulate U.S. reform position. Shultz believed in the benefits of free-market floating, and within the administration, he had made his opinions clear that fixed exchange rates were no longer desirable, or indeed attainable. He met regularly with his economic team, which included Stein, Kissinger, Flanigan, Volcker, and Burns. Peter Flanigan's viewpoints, who became chair of the CIEP in 1972, complimented Shultz's principles, believing that the pound float was proof that the U.S. had correctly refused to return to convertibility until lasting reforms had been negotiated.²⁹⁵ Arthur Burns advocated fixed exchange rates and was worried about the impact of the European floats, especially if the lira should fall again.

Negotiating Long-Term Reform in Rome

European and U.S. Differences

The Treasury decided to unveil its plan at the September IMF meeting in Rome was as Volcker described it, a “conceptually simple but operationally difficult system,” but it did reflect their desires for more flexibility.²⁹⁶ The U.S. proposal aimed at relieving deficit countries of external payments pressures. Naturally, this was

²⁹⁴ Nixon tried to give Connally a post as the chief of international economics, but Connally refused. There was wide speculation that Nixon would make Connally his running mate in the upcoming elections. The president admired Connally's take-charge nature and had a high regard for his opinion in not only matters that related to his post in the Treasury, he also instructed Kissinger to give Connally twice weekly briefings on the war in Vietnam – and brief Vice-president Spiro Agnew only once a week, “so he is able to speak with some authority on this.” See Memorandum; H.R. Haldeman to HAK; 10 April 1972; folder John Connally; Box 811; NSC Name Files; NPMS. See also Matusow, *Nixon's Economy*, 198-201.

²⁹⁵ Kunz, *Butter and Guns*, 213. Peter Flanigan also took a visit to the EC members in mid 1972 (during the capital crisis) to gauge their attitudes towards reform. He was interested in how the European monetary initiatives would impact the U.S. and the international negotiations and asked leaders how they felt about introducing flexibility in the system. See for example Memorandum; Robert J. Morris to Peter Flanigan; Re: Suggested Talking Points; 26 May 1972; Memorandum; Peter Flanigan to President Nixon; Re: Requested Follow-up on European Trip; 12 July 1972; and Memorandum with *New York Times* article; Peter Flanigan to President Nixon; Re: European Attitudes in the IMF Talks; 18 September 1972; folder Confidential FI-9; Box 55; WHSF:WHCF:SU:CF:FI-9; NPMS.

²⁹⁶ See Memorandum; “U.S. Objectives for Trade Negotiations and Monetary Reform; and Memorandum; George P. Shultz “Needed: A New Balance in International Economic Affairs.”; 26 September 1972; folder CO 1-5 Europe; Box 6; WHCF:SF: CO 1-5: Europe; NPMS. See also Briefing Book; “U.S.-European Relations Economic Objectives.”; Box 5; WHCF:SF:CO1-5: Europe; NPMS. For an over view of Shultz's statements on capital controls see Handwritten notes and report starting at “suggested Breakfast Agenda.”; n/d; folder Foreign Direct Investment; Box 167; WHCF: SMOF: Stein. Subject Files; NPMS.

advantageous to the U.S. as the largest deficit payments nation, where the Bretton Woods system had applied the most pressure. The system was based on an agreed upon amount of acceptable reserves for each country, and when a nation experienced gains or losses in their reserves that offset that norm, it would have to adjust its parity or policies. The enforcer rule stated that if a surplus country refused to adjust its rates according to the reserve standard, then it would be barred from converting its currency into gold or SDRs.²⁹⁷ Deficit nations had more options for currency regulation than under the Bretton Woods arrangement, by borrowing or employing monetary or fiscal policies, and as a last resort imposing capital controls.

The last option, Shultz considered the most undesirable action of the lot, as capital controls went directly against his vision of an ideal free market currency system, and this is where the Secretary of Treasury was trying to lead the international community. Fundamentally, by giving the new system the traditional option of using domestic policy to manage currencies *and* adding the possibility of devaluation or revaluation through floating, the U.S., as Volcker said,

...sharpened the basic question of whether really meaningful elements of exchange rate flexibility can be introduced into a par value system without that system's shaking apart sooner or later. The very purpose of making exchange rates more flexible is to minimize the need for controls and reduce potential conflict between monetary policies that seem appropriate for domestic needs and the need to defend a currency in the exchange markets. But at the same time, the mere expectation that exchange rates might change sends huge sums of liquid capital rattling through international markets seeking speculative gains, in the process making it impossible either to maintain par values or to avoid mobilizing monetary policy to stabilize the currency.²⁹⁸

The provisions of the U.S. plan could not have been farther from the European vision. Although the global markets experiences with floating had been tempered a bit with the mark's floating, and the still floating pound, it was a policy that was out of the

²⁹⁷ Volcker, *Changing Fortunes*, 199-120, points out that this plan was remarkably similar to the Keynes Plan proposed during the Bretton Woods debates. At that time, the U.S. rejected the suggestion because it was a surplus nation, while the British supported it as a deficit nation.

²⁹⁸ *Ibid*, 123.

normal functioning of the system – something used as a last resort in crisis. The European Community would not endorse it, and its preparations for EMU, based on pegged rates within the snake, reflected this feeling. Europe was still in the mindset that convertibility had to be restored and that floating was an irresponsible way to manage money. By resorting to capital controls to manage the latest currency crisis the EC stepped further away from the U.S. vision. While French dissatisfaction with American policy and the role of the dollar was nothing new to U.S. officials, now the Germans seemed to be moving farther away from close relations with the U.S. in monetary affairs and tuning into the European rhythm. Giscard and Schmidt's contrasting commentaries to Shultz's IMF speech made this more obvious. Instead of more flexibility, Schmidt advocated "a careful look at the present intervention system" and Giscard stuck to his demands of "stable but adaptable par values." On what should serve as the international reserve unit, Giscard kept the French position open between the SDR and gold and suggested in his discussions with U.S. officials that Shultz's plan was "perhaps too open-ended with respect to what could be held as reserve assets." The largest differences came in the discussions of how to restore the balance of payments among nations. Schmidt made a veiled commentary on U.S. domestic policy saying "no country can subordinate domestic stability or full employment to its balance of payments." Giscard echoed this feeling saying, "changes in par value should not be conceived as a substitute for internal policies designed to restore external equilibrium."²⁹⁹

The October EC Summit in Paris

Deepening Europe

French preoccupation with its own relations vis-à-vis the U.S. were not new. De Gaulle strived to make France the alternative power to the Cold War bilateralism of the U.S. and the Soviet Union. Now, Pompidou added another dimension to the equation – that of Europe. The instability of the Smithsonian parities, the speculation against the dollar in the summer of 1972, and conflicting opinions on monetary reforms, convinced

²⁹⁹ Memorandum; Richard Erb to Peter Flanigan; 4 October 1972; folder FO-4 Financial Relations; Box 32; WHCF:SF:FO-4 Financial Relations; NPMS.

Pompidou that France should strengthen Europe monetarily and place France in the center of that power.³⁰⁰ This was also another reason to press forward and establish better relations with the Germans and strengthen the EC. Thus, for France, EMU held a European, national, and international agenda, and this was an important element of French objectives when they hosted the EC summit in Paris October 1972.

Although, Brandt shared Pompidou's goal of establishing a strong EMU, he did not view the U.S./European relationship quite as adversarial. He strongly suggested (without the prodding of the U.S.) that the EC consider some kind of formal or institutionalized communication with its primary trading partners -- especially the U.S. and Canada, and rejected the isolationism of the French to the U.S. in EC affairs.

I thought it unwarrantable and improper that the French draft for a final communiqué should make no mention whatever of our relations with the United States and Canada. This led to an open dispute at the conference table. I could only construe the absence of any allusion to America as a snub, and ostentatiously declined to suggest any amendments. My point was taken, and the joint communiqué finally assumed a form acceptable to me in that it spoke of a 'constructive dialogue.'³⁰¹

The variation in opinion was also a matter of priorities. The Germans were more concerned with rising inflation than the position of the EC in international politics. Brandt emphasized consensus on the coordination of national economic policies in order to create a "Community of stability." In return for assurances that the members would move in this direction, it was easier for the chancellor to give support to a European Monetary Cooperation Fund (EMCF), to be created in April 1973, that would intervene in foreign exchange markets and support EC currencies on request. The EMCF was a politically sensitive subject in the Federal Republic, since Brandt's critics were wary of him "giving away good German money."³⁰²

³⁰⁰ Simonian, *The Privileged Partnership*, 142.

³⁰¹ Brandt, *People and Politics*, 266.

³⁰² Ibid. For details about the Paris summit, see Simonian, *The Privileged Partnership*, Chapter 6; and Kruse, *Monetary Integration in Western Europe*, 122- 125.

The success of the October EC summit was also smoothed by Helmut Schmidt's new position as German finance minister, which occurred in the midst of the summer run on the dollar, and during the tedious negotiations between France and the Federal Republic on the agenda of the summit. Schmidt's willingness to impose capital controls instead of a float and his friendly relationship with Giscard, were important factors that allowed the Paris meeting to go forward despite the severe differences on the political organization of the EC. While the ministers could now assemble the details of the ECMF, a common trade position in the upcoming negotiations with the U.S., and a cohesive anti-inflation program for the EC, the cordial relations between Schmidt and Giscard did not mean that their nations' objectives in all these areas were harmonious. The post-summit dialogue still revealed the divergent views of the function of the EC. The Germans concentrated on anti-inflation and get an agreement to restrict government spending and the flow of easy money and foreign capital. France, on the other hand, continued to use the Community as an extension of its foreign policy goals, which was demonstrated by their opposition to any reductions in the EC external tariff or trade quotas that might look like concessions to the Americans.³⁰³ Despite these conflicts, the Paris summit had shown not just a renewed commitment to EMU, but a deepening of its institutions and agreements, although somewhat flawed in their application.

The NSC was quick to notice the changes in the EC resulting from the Paris summit and advised Kissinger how the U.S. could capitalize on them. NSC staff members Sonnenfeldt and Hormats concluded that, "The Community is more than a mercantilist arrangement; it shows signs of becoming the embodiment of a collective political will." They remarked that the Europeans had "signaled their determination that economic tensions with us [The United States] should not get out of hand and affect the political relationship." Although the members were "determined to work together to achieve their economic objectives within the EC framework," the Community acknowledged that their internal economic policies carried international implications

³⁰³ Simonian, *The Privileged Partnership*, 139, 150-152; and Loukas Tsoukalis, *The Politics and Economics of European Monetary Integration*. (Oxford, 1977), 124.

while recognizing that trade and monetary issues were linked. This was important consideration for the Americans because of its heavy emphasis on trade negotiations to offset the U.S. trade deficit. The NSC felt that the U.S. could take advantage of the more frequent EC foreign minister meetings which were now scheduled to meet four times a year because it “provide[d] a forum other than the Commission for policy-making on the EC’s external relations.” However, though the summit clearly signaled that “Europe is not being built on anti-Americanism,” the memorandum did note one substantial shortcoming. The final communiqué only specifically mentioned the U.S. once, referring vaguely to the formalities of the EC-U.S. relationship, which reflected the French and German differences on the subject. The Community determined to “maintain a constructive dialogue with the U.S. ‘using the most appropriate methods.’” Interestingly, the NSC noted Pompidou and Brandt’s differences on the subject, saying that the Germans wished for an “institutionalized dialogue” with the U.S., and commented, “We are not too enthusiastic about institutionalization.” Sonnenfeldt and Hormats did not give a hint to what kind of dialogue they did endorse.³⁰⁴

Another Weak Link in the Smithsonian Agreement

Volcker’s Shuttle Diplomacy – How to Re-arrange the World Monetary Order in 48 Hours

In spite of the ongoing negotiations on reform, monetary and economic conditions soon forced the break down the Smithsonian Agreements. The changes happened so quickly that they escaped formal discussions and created a new international system virtually over night and to the benefit of U.S. ideals. There were several factors at work to create the atmosphere for speculation against the dollar and with it a dollar devaluation. First, the U.S. economy experienced strong growth in the second half of 1972. Arthur Burns had been under pressure to keep money loose to fuel Nixon’s boom, although the Fed Chair denied that pressures from the White House motivated lowering interest rates. Consumerism energized the GNP and was

³⁰⁴ Memorandum; Helmut Sonnenfeldt and Robert Hormats; Re: EC Summit Conference, October 19-20, 1972; 27 October 1972; Box 322; NSC Subject Files: European Common Market; NPMS.

complemented by corporate spending. Second, the price and wage freezes implemented as phase II of the NEP, were suddenly lifted in the first months of 1973.³⁰⁵ This part of the August 1971 economic package had never been popular with Stein or Shultz, and Connally, who had been its biggest advocate was no longer in control of economic policy. The flow of money and relaxation of the price controls contributed to rampant inflation that emerged soon after. Third, keeping with the dominant ideology of free marketers in the administration, the Treasury pushed for the relaxation of international capital controls. Lastly, there was no improvement of the trade deficit as a result of the Smithsonian realignment. In fact, it had decayed from \$2.7b in 1971 to \$6.9b in 1972.³⁰⁶ The strong economy and devaluation had actually contributed to the deficit. Domestic demand had increased imports, and since the devaluation had raised the price of foreign goods, the deficit grew. Imports also had a damning effect on domestic inflation. A world agriculture shortage put a heavy strain on U.S. food stocks, as the lower prices sent much of America's farm production elsewhere. Prices at home skyrocketed as a result.³⁰⁷ All of these factors combined to create a volatile market that could force another dollar devaluation.³⁰⁸

The Italian lira was easily the weakest currency of the EC, which might have not been a concern for the dollar except for the current condition of the U.S. economy and the belief that the dollar was still undervalued.³⁰⁹ The weak link in the Community broke again on 22 January 1973, when the Italian bank introduced a split market for the lira and allowed the financial lira to float. Investors rushed to exchange lira for the Swiss franc, which also started to float in response to the influx. The appreciation of the

³⁰⁵ For details about the price and wage freezes see Matusow, *Nixon's Economy*, Chapter 8 The Great Inflation.

³⁰⁶ As quoted in Matusow, *Nixon's Economy*, 234, from Gottfried Haberler, "International Aspects of Inflation," in Philip Cagan et. al., *A New Look at Inflation*. (New York, 1973), 79-105.

³⁰⁷ See Matusow, *Nixon's Economy*, Chapter 8, for a good description of how Nixon's agricultural price freeze policies contributed to inflation. He would impose restrictions on the meat and poultry industries in June 1973, which was ineffective. The Price Board was phased out in April 1974.

³⁰⁸ Odell, *U.S. International Monetary Policy*, 307-312.

³⁰⁹ The pound had another crisis in October 1972, which did not negatively affect the dollar. Memorandum; Robert Hormats to HAK; Re: International Monetary Problems; 30 October 1972; Box 5; WHCF:SF:CO 1-5 Europe; NPMS.

franc to the dollar exposed the weaknesses of the Smithsonian parities, and investors began to exchange dollars for marks in anticipation of an all EC float. However, the initial EC response was not to float, but for each member to combat the inflows according to need. Germany, as always, was the primary stronghold of speculators, and in the first few weeks of February, the Bundesbank took in \$6 billion. Foreign borrowing and the transfers of German subsidiaries into the Federal Republic of more than \$50,000 required government approval, and the legislature raised the Bardepot to 100 per cent. France, which did not experience the same pressures, responded with a barrage of restraints on foreign investments. Non-resident's accounts could not collect interest with maturities of less than 180 days, and bank reserves had to cover all new deposits.³¹⁰

Publicly, the members denied that the dollar was undervalued, but they also realized that they could not continue to defend the parities as the unprecedented amount of money making its way to the continent's banks could lead to a boom in credit and exacerbate the inflation problems that the members were trying to contain. Floating, although favored by the U.S., was equally undesirable. Germany refused to float the mark alone for fear that it would rise above the limits set by the snake and ruin its pro-EMU position within the Community. Also, floating all the EC currencies together would devastate the anti-inflation agenda and domestic economies, as well as pulling all the currencies up towards the strongest, which was the mark. The French worried about creating a D-mark zone and feared that it would decrease its competitiveness vis-à-vis Germany.³¹¹

This time, contrasting to the benign neglect of 1971, the flurry of dollar dumping brought the administration to consider devaluation through consultation with the allies. As usual, Shultz, Stein and Flanigan advocated floating the dollar, while Burns opposed

³¹⁰ Memorandum; "Weekly Report on International Finance." 10 February 1973; folder Presidential Memoranda; Box 47A; WHCF:SMOF:Stein:Presidential Memoranda; NPMS. Stein reported that the Federal Reserve Bank of NY sold \$300 million in foreign currencies "to hold down exchange rate fluctuations in the New York market." Japan accumulate \$1.1b, the Netherlands \$400m, Belgium \$250m. France was still maintaining a split exchange at this time. Anonymous

³¹¹ Kruse, *Monetary Integration in Western Europe*, 127-128.

it. Volcker offered another option.³¹² He urged quick action through devaluation believing that the way to a diplomatic solution had been cleared by the first realignment -- “Because we had already established the precedent of changing the gold price, I felt it would be useless to resist doing so again.” He proposed convincing the Japanese to revalue the yen by 10 per cent against gold in return for a 10 per cent dollar devaluation against gold, thus appreciating the yen 20 per cent. To obtain the 10 per cent dollar depreciation that Volcker warranted would settle the markets, he would have to convince the Europeans to maintain their current parities. As the imbalances caused by Japan’s trade surpluses were also a concern for the EC, the members would likely agree to the provisions with the yen’s revaluation. Shultz agreed and sent him on a secret tour of the major monetary capitals to negotiate realignment.³¹³

Volcker could not persuade Finance Minister Kiichi Aichi to agree to a fixed appreciation of the yen, but Aichi consented to a float, which Volcker assumed would lead to the appropriate parities. After he arrived in Bonn, Volcker discovered that Schmidt had already left to consult with Giscard in Paris. This was something that concerned him because he felt that he could count on support from the Germans, since Bundesbank President Otto Emminger had sent Volcker a telegram urging negotiations with the allies on devaluation, and was eager get the German finance minister’s corroboration before presenting the plan to Giscard. When he did talk with Schmidt, the finance minister was “cautious” and made it clear that any decisions would have to be made by the Community. On February 9, at Giscard’s invitation and to the consternation of the smaller members of the Community, Volcker met with Schmidt, Giscard and Anthony Barber in Paris to discuss the options.³¹⁴ According to Volcker’s

³¹² The following recount of the negotiations for the February 1973 dollar devaluation are taken from Volcker, *Changing Fortunes*, 106-111. See also Odell, *U.S. International Monetary Policy*, 313-317. Odell gives a slightly different account of Volcker’s trip, but this was written before Volcker published his memoirs.

³¹³ In an interview for Odell, *U.S. International Monetary Policy*, 313, Shultz gave a harsher view, “We put out two propositions. Either change the exchange rates in the form of a second devaluation, or have an open float – take your choice.”

³¹⁴ When the Italians found out about the meeting they complained and Giscard invited the Italian Minister to the Treasury G. Malagodi to attend.

impressions, the European intrepidation about floating against the dollar was due to their belief that it would “in effect constitute a declaration of monetary independence from the United States,” for which he “... felt they doubted they had either the political cohesion or the technical ability to manage it successfully.” The observation was probably bound in truth. The snake mechanism had shown that the Community had weak coordination in monetary and economic policies and was not yet ready to take this kind of leadership role. The undersecretary apparently did not consider that although the French and Germans were warmer to floating in this case, the primary inhibitor of an all EC float was the French unwillingness to peg the franc to the DM. In light of all these considerations though, the American proposition to “sit still” offered the best circumstances.

However, getting the Europeans to agree to a parity adjustment was the least controversial of Volcker’s task. Selling gold into the market to discourage speculators offered the greatest challenge, especially to the French, who still held their gold protectively. Volcker tried to persuade the Europeans to sell gold to stabilize the markets in case the realignment sent them into another speculative run. He worried that another realignment so close to the Smithsonian Agreements would make recovery in the gold market difficult. Higher gold prices did not affect the official price of gold since the markets had been split 1968 and dollar convertibility still had not been restored. However, the psychological impact of the price of gold did affect confidence in the dollar’s stability.³¹⁵ Still, even with the promise of relieving the capital controls still present from the Johnson administration, Volcker could not convince Giscard to give up French gold.

³¹⁵ Volcker, *Changing Fortunes*, 107, recounts that the administration did not consider restoring convertibility because they were confident that they had already set a standard of criteria for dollar convertibility during the current international negotiations on reform. They did not see the value of undermining these efforts with bilateral measures and without safeguards institutionalized in the system “to sustain such a commitment.”

Dollar Devaluation

The Bretton Woods Epitaph

When George Shultz announced the second devaluation on 12 February, under Nixon's direction, he downplayed the move and presented the decision within the context of American trade and monetary reform goals.³¹⁶ Three "interrelated purposes" would be aided by the 10 per cent devaluation, which Shultz described in terms of a change in the par value of the dollar in terms of gold.

1. to improve the trade and payments deficits "in a manner that will support our effort to achieve constructive reform of the monetary system."
2. to "lay legislative groundwork for broad and outward-looking trade negotiation, paralleling our efforts to strengthen the system; and
3. to "assure that American workers and American businessmen are treated equitably in our trading relationships."³¹⁷

The Nixon administration tried to focus on trade and the positive domestic impact of devaluation, but to no avail. Since, in the eyes of the press and investors, the U.S. did not commit itself to defending these parities by returning to gold convertibility the price of gold rose to \$73.30 the week after the announcement due to "continued uncertainty in foreign exchange relationships." As Volcker stated, "Intellectual praise for reform plans and negotiation nuances don't count for much when speculators' money is at stake. Some of them, at least wanted to see us 'put our money where our mouth was' before betting too much on the dollar."³¹⁸ The gold market cut the credibility of the dollar and again, and because of Schmidt's comment that the EC might consider

³¹⁶ For account of Nixon's feelings on the devaluation see the Ehrlichman's notes of the president's meeting with Shultz. Notes; 7 February 1973; Box 7; WHSF:SMOF:Ehrlichman; NPMS. The president wanted the emphasis on how the devaluation would positively affect the trade balance and for the message to stay off the negative impact of the dollar devaluation.

³¹⁷ "Statement on Foreign Economic Policy by Secretary of the Treasury George P. Shultz" 12 February 1973; Box 1770; WHCF:SMOF:Stein: Subject Files; NPMS. The statement was also published by The U.S. Treasury, *The Department of Treasury News*, 12 February 1973.

³¹⁸ Volcker, *Changing Fortunes*, 112. See also, Testimony by Paul Volcker, House Committee on Banking and Currency, *To Amend the Par Value Modification Act of 1972: Hearings*, 93rd Congress, 1st session, 27 February 1973. For figures Memorandum; "Weekly Report on International Finance." 17 February 1973; Box 47A; WHCF:SMOF:Stein: Presidential Memorandum Files; NPMS.

floating,³¹⁹ investors rushed to dump dollars. European banks managed to intervene in the markets in the last week of February until 1 March, when they could not keep up with the purchase of dollars to maintain their parities within the snake and were forced to close their exchanges on the following day. By the time they had suspended intervention, most of the Community currencies had risen 3 per cent above the upper margins against the dollar. This meant that all European currencies had been put “on a floating basis” according to Stein’s international monetary report, and joined the British pound and the Italian lira.³²⁰

On 3 March the president met with the Quadriad to debate whether the U.S. should intervene in support of the dollar. According to the minutes of the meeting, Brandt had sent Nixon a letter telling him that the EC was planning a joint float and would not ask the U.S. to intervene in the markets. Shultz and Stein argued against intervention because thought it would give too much to the Europeans without getting what the U.S. wanted in return, which was reform. Burns argued that not intervening would “be taken in Europe as abdication of leadership and responsibility.” Nixon sympathized with the non-interventionist but was concerned with the political ramifications of the decision and asked Shultz to confer with Kissinger. The NSC Chair advised them that consultation with the allies offered the best measure of political protection.³²¹

³¹⁹ *Wall Street Journal*, 26 February 1973, 1. Schmidt did write to Nixon thanking him for his “spirit of cooperation” before the dollar devaluation. Letter; Chancellor Schmidt to President Nixon; 14 February 1973; Box 55; WHCF:SU:FI-9; NPMS.

³²⁰ Memorandum; “Weekly Report on International Finance” 3 March 1973; Box 47A; WHCF:SMOF:Stein:Presidential Memorand; NPMS.

³²¹ For the minutes see Memorandum; Re: Quadriad meeting of March 3, 1973; Box 91; POF: Memorandum for the President; NPMS, and Kunz, *Butter and Guns*, 215. Nixon responded to Brandt’s letter and also wrote to Prime Minister Heath stressing the need for joint action and that European integration should be considered in the context of strengthening the Atlantic relationship – a concept that would have horrified the French. The Heath letter was worded stronger in this regard adding, “As you know, and I think agree with me, in supporting European integration we have always seen it as a step contributing toward Atlantic partnership and not as a means to enable either side to proceed unilaterally on a matter of fundamental concern to the other.” Brandt’s version says, “As you know, I have strongly supported European integration and intend to continue to do so, but as I believe we both agree, European integration should also be seen as a step towards increased Atlantic cooperation.” See folder Monetary Crisis March 1973; Box 53; NSC:HAK Office Files; NPMS.

Schultz did not have to wait long for his chance to confer with Europe. Treasury received word that the EC was working on a solution to the crisis and wanted to involve the U.S. in the planning at a meeting a few days later. By this time, the administration was looking at the kind of floating that they imagined for the system and had all but abandoned the idea of fixed exchange. Briefing papers show that the administration was debating whether to have a managed or dirty float, which involved a certain degree of intervention in individual markets to keep parity fluctuations within a certain range, or a clean float where currencies were left to the impulses of market conditions. If nations floated in blocs, there would have to be rules to prevent competitive devaluations. The U.S. briefings favored clean floating, and realized that if Europe chose to float in blocs that the Americans would want the market to have a major role in determining the EC's float. If the U.S. decided to go on a free float and the Community managed their float with some intervention, there was a danger that they would keep their rates undervalued and undermine the trade reforms that the U.S. sought. The Americans had to be careful that a joint EC float did not turn into a trade bloc. In the end, they decided that the U.S. did not desire to devalue the dollar more than the recent 10 per cent change and that floating might be the best way to keep it at that level. There was also the fact that floating offered the president more latitude in his economic policies. As Riccardo Paraboni explained,

The system of floating exchange rates also eliminated any need for the U.S. to control its own balance of payments deficit, no matter what its source, because it was now possible to release unlimited quantities of non-convertible dollars into international circulation. Therefore, while continuing to depreciate the dollar in an attempt to recover competitively in the production of goods, the U.S. was no longer saddled with the problem of generating a current account surplus with which to finance its capital account deficit.

However, the considerations on floating did not mean that the U.S. had abandoned reform. Floating, in fact, meant that there would have to be rules on capital controls, when and if to use them and balances of reserve assets would be an exchange rate indicator. As the negotiators still had not agreed to what should serve as the main

reserve assets, gold, dollars, or SDRs, this was still an issue. Nevertheless, the U.S. reports argued that trade liberalization and capital flows should still maintain a large part of their reform negotiations but not as a means of exchange rate manipulation. With these thoughts in mind, Shultz and Volcker were ready to discuss options.³²²

On the European side, the fate of the EMU timetable was at stake and the German Chancellor had already met with Prime Minister Heath on 1-2 March to prepare the way for cohesive Community action, of which Great Britain was now a full member, and would most likely be in the form of a float. Heath was reluctant to join an EC float as the pound was still floating independently of the snake since the last year. Brandt, without consultation with his cabinet or France, offered to support the British pound and underwrite the Bank of London's balances if Heath would commit to a European solution to the crisis. London did not take Brandt up on the proposal,³²³ and France joined Britain in its hesitation for EC floating. The dissensions among them led the Germans to flex more of their economic might to obtain agreement. Barber insisted on certain criteria for the pound to join a float, and Giscard still refused to attach the franc to the DM and was less concerned about foreign capital anyway since the franc was not as strong as the mark and would not shoulder the burden of dollars. Schmidt then threatened an independent German float and asserted this would place speculative pressures on the other EC countries. He also called on the Americans to defend the parities that they had so tactfully bargained for. Brandt responded immediately to try to fix any diplomatic damages saying, "we cannot afford to be anything but good Europeans."³²⁴

³²² Riccardo Paraboni, *The Dollar and Its Rivals: Recession, Inflation, and International Finance*. Ronald Steel and Jon Rothschild, trans. (London, 1981), 89-09. Paper; William J. Casey, "Paper for 2:00 P.M. Meeting, March 7" 6 March 1973; and Jack F. Bennett, "Papers for Wednesday's International Monetary Meeting" 6 March 1973; Box 107; WHCF:SMOF:Stein:Meeting Files; NPMS.

³²³ Brandt, *People and Politics*, 251-252; and Simonian, *The Privileged Partnership*, 157-158. Simonian points out that this is also evidence of the hierarchy of the EC. Italy, in worse monetary shape than the British, was not offered the same deal. Clearly, some members counted more than others.

³²⁴ *New York Times*, 5 March 1973, 1; 12 March, 47; Elizabeth Stabler, "The Dollar Devaluations of 1971 and 1973," in *Murphy Commission Appendices*. vol. 3, (June 1975): 154-155; *New York Times*, 4 March 1973, 1 and 2; 5 March, 1.

Although the Germans seemed to be pressing for a float, much of the discussions among the EC finance ministers that week focused on constructing two alternatives for action. The most preferred course, according to the U.S. Department of State telegram, was to formulate some common action with the U.S. and defend the present parities. Some kind of joint intervention on foreign exchange markets that would include the U.S. and more capital controls, again with the U.S. might slow the tide of speculation against the dollar. The second option was a common EC float, which would only be put in place if the first option fell through in negotiations. The State telegram noted that the assistant finance secretary in Bonn indicated that it “is his impression that the minister’s discussion showed that agreement on such a common float is fully feasible for all...under conditions acceptable to all. He stressed, however, that the common float remains the second alternative for the EC and that the first alternative is the preferred one.”³²⁵

On 9 March, Shultz and Volcker were invited to join the EC in Paris, and the EC urged the U.S. to intervene to maintain current parities. As the Nixon staff had already decided against it, Shultz refused. The President had decided “to go the floating route this time, not the half-way par value route.”³²⁶ Thus, the U.S. left Europe to either continue to mop up dollars, or to just come to terms with a float. With no amicable agreement to be reached at that time, the participants agreed to meet on the 16th and keep foreign markets closed until 19th. Before adjourning, they did manage to issue a communiqué that stated that they agreed that the “existing parities are fundamentally correct,” and that the crisis had been brought on by speculation and they were determined to cooperate to achieve a solution for this and long term reform.

The EC had little choice but to float their currencies. The problem now was how to arrange it. Britain demanded “unlimited financial support for weaker currencies” as a precondition for rejoining the snake – something that the remaining members were unwilling to do. The impasse was only broken after France got the Germans to agree to

³²⁵ Telegram; Department of State; 4 March 1973; WHCF:SMOF:Stein:meeting Files; NPMS.

³²⁶ Interview with Shultz quoted in Odell, *U.S. International Monetary Policy*, 321.

a 3 per cent revaluation of the mark in terms of SDRs for Pompidou's support of a common float. Soon after, Germany, France, the Benelux nations and Denmark announced that they would float together and no longer intervene to support the dollar rates.³²⁷ Britain and Italy stayed outside the snake and vowed to someday rejoin, even though their currencies depreciated 15 per cent and 7 per cent respectively. In order to manage what now became an unofficial floating system, the Europeans got some loose assurances from the U.S. to defend these parities through mechanics for market intervention as a last resort, close consultations, and the expansion of swap facilities among central banks. Shultz temporarily secured a floating system and relieved the U.S. from any burdens on its domestic policies.³²⁸

The float restored the monetary calm in Europe. Capital inflows ceased after the markets reopened on 19 March, and the dollar stabilized allowing EC countries to carry out the monetary and fiscal anti-inflationary policies it had hoped to institute months before.³²⁹ The remaining members declared it a victory for Community integration as the float had freed the snake from the Smithsonian tunnel. However, now the EC had created a DM zone as all the members of the snake were now tied to the mark within a +/- 2.25 band instead of anchoring their currencies to the dollar. The revaluation of the mark in terms of SDRs instead of the dollar had, at least in some part, broken the dollar's

³²⁷ For the details of the meetings in Europe during the crisis see Hellmann, *Gold, the Dollar, and the European Currency Systems*. Schmidt and Giscard had met the week prior to negotiate the franc's entry in the float. Simonian says that the decision was not announced publicly because of the French Assembly elections, which resulted in the retention of Pompidou's supporters. The EC meeting coincided with the election results. See Simonian, *The Privileged Partnership*, 159.

³²⁸ Odell, *U.S. International Monetary Policy*, 323-324.

³²⁹ For the Community reaction to Britain's demands see *New York Times*, 5 March 1973, 1; 12 March, 47; 13 March, 59. For details on the European anti-inflation packages see Kruse, *Monetary Integration in Western Europe*, 136-137. Memorandum; "Weekly Report on International Finance" 10 March 1973; Box 47A; WHCF: SMOF: Stein: Presidential Memoranda Files 1973; NPMS, and Telegram; Department of State from Shultz to Treasury 17 March 1973; Re: Secretary Shultz Visit: March 16 G-10/EEC Communique; 17 March 1973; folder George Shultz (Europe and U.S.SR); Box 953; NSC VIP Visits; NPMS.

hold on the EC. Members saw the float as part of the steady progress toward EMU despite the fact that it dropped two of its members from the snake in the process.³³⁰

The events of early March should have convinced the C-20 the fixed rates were a thing of the past. However, when they met again in Washington barely 3 weeks after the EC float, they held onto the dream of fixed exchange and advocated a regime that “remained based on stable but adjustable par values,” while also noting that floating “could provide a useful technique in particular situations.” The reaction from Europe was not surprising to Shultz since he had met with Pompidou and Schmidt after the resolution of the crisis and their positions on monetary reform had not been altered by the March events. Pompidou still talked about par values and stability and Schmidt wanted to make sure that no one had the impression that Europe was satisfied with the new parities that had been established with the float and would do everything in its power to keep them where they were. He was concerned that the markets would “let the float get out of hand,” that is, that they would actually accept it as a genuine float, when Europe saw it as temporary. Since the float had tied the franc to the mark and also stalled the Community’s plans for monetary union, it is not surprising that the EC hoped for a system it felt was more predictable and traditional.³³¹

³³⁰ Kruse, *Monetary Integration in Western Europe*, 131-133. Some critics saw it differently. Kruse points out that Sweden and Norway, both non-members, joined the float and participated in the multilateral interventions systems but settling their accounts on a bilateral basis. By accepting two outsider nations into the snake, he argues they replaced two who should have been participants – the pound and lira – and undermined the point of the snake, which was to bring the Community closer together economically and politically.

³³¹ Memorandum; Brent Scowcroft to President Nixon Re: Shultz visit with Pompidou; 19 March 1973; and Department of State Telegram; Re: Poehl on Secretary Shultz’ Bonn visit and Paris G-10 meeting; March 1973; folder George Shultz (Europe and U.S.SR); Box 953; NSC VIP Visits; NPMS. “U.S. Interpretation of Foreign Statements and Positions on Monetary Reform.”; 27 March 1973; Box 107; WHCF:SMOF; Stein: Meeting Files; NPMS. France was a “Strong advocate of fixed rates with little scope for floating.” Germany favored flexibility but only in certain circumstances and under IMF supervision. See in Ibid, “Communiqué of the Committee of the Board of Governors on International Monetary Reform and Related Issues.” 27 March 1973.

The Year of Europe

American Dominance or a Celebration of Partnership?

The spring crisis had raised tensions among the allies, but also brought with it a new dimension in U.S./EC relations. Floating may have not offered the best conditions for the integration of the European exchange rates, but it did give the Community some independence from the dollar and demonstrated a commitment on the part of the French by tying the franc to the mark. Although the U.S. did not intervene in the markets to support the Smithsonian rates, the monetary consultation that the American exercised through the difficulties were a welcome change from 1971's events. Shultz had shown that his Treasury was willing to negotiate rather than dictate to the Community when he sent Volcker abroad in February and the secretary established interests when he invited Schmidt, Giscard, Barber, and Japanese finance minister Takeo Fakuda to meet at the White House in the spring of 1973. The Library Group, as the men dubbed it, was unknown to the rest of the monetary community, and its composition and existence were evidence that these nations controlled the fate of international finance. Much like the hierarchy in the EC, where Giscard, Schmidt and Barber dictated Community policy, this was the global version that would eventually evolve into the Group of Five.³³² However, even with these informal channels, Europeans were still frustrated with how the Americans conducted international monetary policy. Giscard and Shultz were often at odds, and the French finance minister blamed the U.S. for the spring crises. Schmidt, who was ideologically closer to Shultz in monetary arrangements, found himself as the peacemaker during these times.³³³ Still, the presence of the Library Group during the spring of 1973 and at international reform conferences throughout the next year, was a healthy addition for dialogue that was sorely needed when European distrust over U.S. initiatives in "The Year of Europe" made dialogue tense.

³³² See Schmidt, *Men and Powers: A Political Retrospective*. (New York, 1989), 157, 158-159 and 173; Volcker, *Changing Fortunes*, 126-127, 134, 142. The Group of Five included the U.S., UK, West Germany, France and Japan.

³³³ Schmidt, *Men and Powers*, 158.

The Year of Europe was an American idea to re-establish better ties with the Europeans because of the recent focus on Asia, namely with the war in Vietnam and Nixon's efforts to normalize relations with mainland China. Henry Kissinger announced the Year of Europe on 23 April with a proposal for a revision of the Atlantic Charter, the outline for the post World War Two world that Franklin D. Roosevelt and Winston Churchill had drawn in 1941. That the Year of Europe coincided with the rekindling of European integration efforts, even with the devaluations, is not surprising. The Nixon administration was supportive of integration, but feared the EC's affect on international trade. The U.S. wanted better relations with Europe, but there was also a sense that the Europeans would turn regional and shut out American goods. By linking the Charter to the Year of Europe, the administration was attempting to establish a formal link with the Community by using its role as military protector, to influence an area where it had lost some control, which was trade. Breaking out from under U.S. patronage had been a stated goal of the French government since de Gaulle. De Gaulle pulled France out of the NATO alliance, and now Giscard and Pompidou repeated their desires to lift the franc and all European currencies above the dollar's dominance in monetary affairs.

To the French, the Year of Europe was a U.S. attempt to infiltrate the EC. In keeping with France's view that the Community serve as a foreign policy element, creating an EMU was a claim of independence from the Americans. Pompidou and Nixon met for the first time since their Azores summit in Reykjavik, Iceland at the end of April 1973 to smooth the tensions from the Year of Europe and Atlantic Charter proposals and to seek some understandings on monetary and trade issues. Nixon had already met with Brandt a week before and had emphasized the plan that Shultz had outlined earlier and hoped that the outlines for reform could be agreed upon by the IMF meeting in Nairobi that coming September. Nixon's chief concern was garnering support from Brandt on the EC trade mandate that was still being passed around the Commission from Pompidou's Azores promises.³³⁴ However, the Germans were not the

³³⁴ Memorandum; Peter Flanigan to President Nixon; Re: Brandt Visit: Economic Issues; 26 April 1973; folder Willy Brandt; Box 918; NSC: VIP Visits: West Germany: Willy Brandt; NPMS.

main hindrance to the mandate as it was the French who complained about the liberal wording of the directive that gave too much latitude to American demands on trade. Thus, part of the purpose for the Reykjavik meeting was convincing Pompidou to withhold his objections.

The political and economic conditions in which Nixon and Pompidou met had greatly changed since the Azores. The parities they had negotiated in December had been weakened, the EC's initiatives on monetary union had stalled due to successive monetary crises, and the U.S. reputation tainted by what France saw as questionable intentions in the Year of Europe. Nixon had to reassure Pompidou that by changing the Charter or establishing some consultative ties, the U.S. was not trying to dominate Europe, or restrain the Community from developing as an independent economic power." Kissinger understood that the independence of Europe and the autonomy of France was a point of pride for Pompidou, and pressed Nixon to calm the president's fears about American domination in Europe. They needed Pompidou's support more of the American led desires for flexibility in exchange rate reform at the IMF meeting in Nairobi that coming September. Nixon had to assure Pompidou that the U.S. still held French relations in high regard but he had to stop short of constructing bilateral agreements that would gain the French president's trust because it might alienate the C-20 or the other members of the EC. However, without French support, monetary reform and initiatives on the Charter would falter.

Treasury and the NSC warned Nixon not to trade concessions on monetary issues for considerations on trade and security. Pompidou would separate the two issues, but Nixon had to remain firm on their linkage. Shultz also warned that Pompidou might use Nixon's weakness in monetary affairs to get an agreement on gold or fixed rates in return for some progress on Atlantic relations. The U.S. had to be resolute against the centrality of gold in the system, since both houses in Congress had passed a bill allowing for private citizens to own gold, expecting that it would be demonetized from international monetary management. As an incentive to move ahead on reforms, Shultz had offered to restore convertibility to the dollar "if adequate assurance of payments

adjustment can be built into the reform and if the reform provides the flexibility which has now come to be widely recognized as necessary.” France supported dollar convertibility, and the administration hoped that it would lean towards flexibility as an option, as it was one of the staunchest enthusiasts of returning to a fixed rate system. By this time, even Germany had recognized the benefits of floating, although it only supported doing so on a limited basis under IMF supervision.

The U.S.’s desire to establish formal consultative ties with the Community was also a part of Nixon’s grand strategy for the meeting and in the motivation for the Year of Europe. Pompidou and Brandt disagreed on the extent to which the U.S. would have access to the leadership of the EC, and Nixon tried to connect better Atlantic relations with better U.S.-Community affairs. Again, although the French felt that the interests were compatible, they were by no means the identical, and were therefore separated. When Pompidou and Brandt met in 20-21 June, U.S./European relations dominated their discussions. Brandt, was more conciliatory to the idea that there be some sort of formal representation of the U.S. with the EC. Even before the Year of Europe, he had insisted that the members include foreign relations with their most active trading partners a priority.³³⁵

However, the amicable discussions in Iceland did not lead to new understandings between France and the U.S., and The Year of Europe would end in failure. France stuck to its demands for fixed but adjustable rates with convertibility, and gold take a central role in reserve assets. Pompidou agreed that the lengthily reform process was destabilizing the new March parities, but he like the U.S., was unable to agree on a plan to promote stability in the system.³³⁶ At the EC meeting at Copenhagen in July, Pompidou succeeded in halting “further substantive discussion with the U.S., until the

³³⁵ For the Nixon administration’s view of the French see Memorandum; Kenneth W. Dam (Assistant Director of the Office of Management and Budget) to Peter Flanigan; 2 January 1973; and Attachment - Department of States’ Bureau of Intelligence and Research “France’s Foreign Economic Policy” 11 December 1972; folder CO 50; Box 29; WHCF:SF:CF:CO 50; NPMS. For the Reykjavik summit see Briefing Book; May-June 1973; folder Pompidou and Nixon Meeting; Box 949; NSC Files: VIP Visits; NPMS.

³³⁶ Memorandum; HAK to President Nixon; Re: Letter from President Pompidou; 7 August 1973; folder France; Box 752; NSC Files: Presidential Correspondence 1969-1974: France; NPMS.

Nine had reached a common position,” which prevented Nixon from meeting with the heads of the EC as an equal on his forthcoming trip to Europe.³³⁷ Both sides wrangled for months on the format of the new Atlantic Charter – the Americans trying to assert their leadership in the process and the Europeans refusing to have the terms dictated to them. Personal troubles eventually took leaders away from the initiative. Pompidou was dying of cancer and Nixon became deeply embroiled in the emerging Watergate scandal.

The Realities of Floating

The Dirty Truth

Everyone had hoped that the March realignments would hold and keep the confidence of the markets to maintain some steadiness in the system and give the C-20 some time to work for solid agreements. In the meantime, the EC carried on and reaffirmed its commitments to monetary integration and put the ECMF into effect, even though the snake had lost many of its members. The float seemed to be working even though it was supposed to be temporary. In reality, since they were still negotiating reforms there was *no* system. The March 16th agreements had set an outline for managing exchange rates, but this was for intervention as a last resort.

In the White House, Shultz was convinced that floating had solved the dollar’s problems and was content to let it adjust to market conditions. He favored clean floating where the government had minimal involvement in determining exchange rates and the language in the March 16th Paris communiqué reflected this. Burns, again, never a fan of floating, believed that if the dollar was going to float it should do so with market intervention, or a dirty float. The market calm seemed to support Shultz’s confidences in the reliability of floating to stabilize the dollar, and the improvement of the trade deficit, in part due to the devaluation, also bolstered the U.S. position.³³⁸ Yet, by late spring economic indicators showed higher inflation, a dramatic rise in food prices, and a

³³⁷ See Memorandum; “Meeting with Chancellor Brandt.” 29 September 1973; folder Brandt Visit; Box 918; NSC Files: VIP Visits; NPMS.

³³⁸ Matusow, *Nixon’s Economy*, 237; *New York Times*, 15 May 1973, 62; 20 May IV, 4; and Memorandum; “Meeting with Troika and Other Economic Advisors” 10 July 1973; NP, folder FI [1971-1974]; Box 27; WHSF:WHCF:SU:CF: FI [1971-1974]; NPMS.

recession in 1974. Add to these factors, the political uncertainties of the Watergate scandal and investors demonstrated just how fickle the markets could be.

At first, the floating dollar managed the speculative pressures well, but when the Bundesbank raised interest rates in May as part of its anti-inflation measures, the dollar plummeted. In June, the DM was revalued 5.5 per cent against the snake currencies, and the Germans were once again the target and began to use the EC multilateral intervention arrangements until the DM reached the ceiling of the snake at the end of June. Schultz was perplexed about the fall of the dollar, as he thought the devaluation had adjusted it to an appropriate value, but by July European bankers implored the Fed to intervene using currency swaps to hem the new surge brought on by an end of the June revaluation of the mark, in part due to the intensifying problems of the previous months. This time, Schultz acquiesced to a dirty float, but only slightly. On 10 July the Fed announced that it was actively participating in the swaps, and this sullied investor fears enough to stabilize the dollar. The move was barely more than a bluff though, as the Fed only spent \$270 million in foreign currencies for dollars that month. After a small improvement, the U.S.D began to fall and was 10 per cent below the March parities by the end of July.³³⁹

Despite complaints from Europe about the lack of intervention from the Fed, State and the Treasury contended that the U.S. was doing all it could to restore confidence in the dollar. Officials pointed to Nixon's plans for balancing the budget, price controls on food, and small improvements in trade figures as evidence of their commitment. France was especially worried about the dollar's decline and Giscard warned that monetary troubles could have important repercussions in the EC which would effect defense and security issues. If the dollar's slip forced more European parity changes then the Community's efforts in monetary union would be jeopardized. Giscard was careful to say that, "Resolving monetary problems would not resolve all other issues...but a failure to resolve the monetary problems would certainly exacerbate

³³⁹ Matusow, *Nixon's Economy*, 237; *New York Times*, 11 July 1973, 7-10; 19 July 1973, 49; and Charles Coombs, *The Arena of International Finance*, 232.

other issues.” Both sides seemed to agree that the March parities were accurate, and the Europeans were hoping that with more intervention from the Fed, the dollar could recover 4-5 per cent of its 10 per cent rate slip. It would ameliorate the pressures on the European currencies and demonstrate U.S. resolve in maintaining the rates.³⁴⁰ The Germans were happy for the small effort, and believed that Burns had exerted some influence against floating and had managed to convince the government that some intervention was needed. Despite this, reports conceded that Congress was still firmly against it, suggesting that intervention would not be commonplace.

The Federal Reserve Board had raised thoughts against floating, however this course was too late as the fluctuations were holding within the margins. By mid-July, as the dollar reached its lowest level, there were fears within the central bank system that another slip could destroy the world economy... There could be no other solution concerning the 18 July announcement that U.S. would support the Dollar. The government is convinced of this necessity driven by the Federal Reserve from outside influences (foreign governments, other central banks), Burns was not alone in succeeding, to impart his point of view on the American government. However one must take into account, that Congress is against intervention.³⁴¹

However, the U.S. was in no hurry to intervene for good reasons. The NSC realized that the depreciation held advantages for the U.S., and in a memo to Kissinger Hormats and Charles Cooper enumerated the positive effects of the devaluation on the

³⁴⁰ Memorandum; Helmut Sonnenfeldt to HAK; Re: Your Meeting with French Finance Minister Giscard d'Estaing; 30 July 1973; and Department of State Telegram; Re: Call on French Minister of Finance Giscard d'Estaing; July 1973; folder CO-Europe; Box 55; NSC Files: HAK Office Files: CO-Europe; NPMS. Giscard was especially worried about French unemployment, as businesses that could not compete with cheaper American products would have to cut their work forces to survive.

³⁴¹ Letter; George-Dieter Gotschlich (German diplomat in Washington) to Udo Loewke (personal assistant to Schmidt as finance minister); 17 August 1973; Box 6005; Helmut Schmidt Papers. [My translation.] Der Federal Reserve Board (und vor allem sein Vorsitzender Burns) hatten erhebliche Bedenken gegen das Floating, die jedoch zunächst kaum in Erscheinung traten, als sich die Schwankungen in Grenzen hielten. Mitte Juli jedoch, als der Dollar seinen Tiefststand erreicht hatte, befürchtete man im Zentralbanksystem, daß ein weiteres Abgleiten das gesamte Weltwirtschafts-system zerstören könnte.. Da es keine anderen Lösungsmöglichkeiten gab, wurde am 18. Juli bekanntgegeben, daß der Dollar auch von U.S.-Seite gestützt werde. Daß auch die Regierung von der Notwendigkeit dazu überzeugt wurde, führt man bei Angehörigen des Federal Reserve Board vor allem auf die Einwirkungen von Außen (ausländische Regierungen, andere Zentralbanken) zurück, da es Burns nicht allein gelungen sei, seinen Standpunkt bei der amerikanischen Regierung durchzusetzen. Allerdings muß man berücksichtigen, daß der Kongreß überwiegend (vor allem Reuss) gegen U.S.-Interventionen ist.

American economy. Devaluation increased the demand for American goods abroad, and created jobs at home. While admitting that the dollar depreciation increased inflation in the EC countries, particularly Germany, where much of the short term capital rested forcing the Bundesbank to lower interest rates and slow monetary growth, the NSC contended that European trade balances were not effected because most of their trade was from the EC. They reasoned,

The boom in the U.S. and most other economies has created a continuing high demand for imports and thereby prevented any diminution of European exports resulting from their currency appreciation. The fact that trade has not been affected explains the lack of strong counter-measures against what all agree is an excessive dollar devaluation. Nevertheless, some Europeans, the French in particular, believe that the United States has been given an unfair advantage by the low value of the dollar.

Cooper and Hormats saw economic benefits for the U.S. but also admitted that they came at a political price. Relations with the French were damaged by the crisis, and they noted Giscard's warning about the sensitivities of monetary issues impacting other areas and attributed France's reluctance to acquiesce to trade concessions and American backed reforms in the C-20.³⁴²

The Europeans had to contend with more difficulties due to the dollar run than the Americans. Since they were floating separately from the dollar tunnel, a rush to one currency affected the all of the snake's participants regardless of the dollar's parity. The capital movements were much smaller than in previous crises, but multilateral interventions had severely depleted the reserves of the snake countries. The European separation from the dollar also forced them to participate in buying dollars. All the EC currencies had appreciated from 40 per cent to 25 per cent of their Smithsonian parities, and 14 per cent vis-à-vis the dollar's March parity. In order to halt this appreciation, European banks had to intervene to support the dollar. Yet, the failure of the U.S. to intervene adequately to support the dollar's parity was not the only source of the snake's

³⁴² Memorandum; Charles A. Cooper and Robert D. Hormats to HAK; Re: Foreign Policy Implications of International Economic Situation; 30 July 1973; Box 55; NSC Files: HAK Office Files; NPMS.

problems. According to Kruse, the members did not adequately coordinate their anti-inflationary policies and wide differences in interest rates attracted disproportionate amounts of speculative capital. The main culprit in this scenario was Germany, which continued to raise rates despite a balance of payments position that suggested otherwise. By pursuing these policies ignorant of how they would affect the rest of the snake, he argued, Germany was looking out for national interests above the good of the Community and the health of the float.³⁴³ Because of this, they also were unwilling to change their policies or float independently and leave the snake. Instead, the Germans had chosen to appreciate the mark in June, and then on 9 July the Community, determined to keep the snake operational, declared that it would intervene to maintain stability by conferring with each other formally.

The fact that capital movements in any amount could still cause problems for the EC was a measure of how independent, how European, the snake had become. That a change in the mark's rate could still trigger dollar troubles was also telling of how stable floating was as a system. The snake endured other speculative attacks because of their interest rate disparities, and yet another revaluation, but this time from the Danes in September. Unless the Community could coordinate their economic policies and create some kind of mechanism for exchange rate alignment within the snake, they were not going to achieve EMU within the decade. International reform negotiations in Nairobi failed to bring France and the U.S. to a compromise, and the general feeling from Germany was that the administration was not interested in working with the international community.³⁴⁴ Hence, the makeshift monetary system crept along with minimal

³⁴³ Kruse, *Monetary Integration in Western Europe*, 146-148.

³⁴⁴ Letter; Georg-Dieter Gotschlich to Dr. Udo Löwke; 12 September 1973; Box 6005; Helmut Schmidt Papers. "Es gibt hier bereits viele Anzeichen für den Zweifel, ob "die Amerikaner" noch lange Interesse an einer engeren internationalen Zusammenarbeit zeigen werden." There is already a feeling of doubt that the Americans are not interested in international cooperation. Later in the report Gotschlich assessed Nixon's decision making practices – "Dieser Präsident ist von den außenpolitischen Interessen der U.S.A. gepragt (Frieden und Entspannung unter Wahrung der Sicherheit der westlichen Welt in voller Kenntnis der andauernden Gefahr des Kommunismus). Er ist jedoch auch ein Pragmatiker in der Innenpolitik (15. August 1971!)." The letter also describes the feelings of the U.S. government towards the offset agreements it was trying to negotiate with the Germans at that time. In addition to this issue, Gotschlich also observed the C-20 setting and felt that they were finally getting to the fundamental differences that

direction. As it turned out, Europe should have worried less about the American economy and more about the Middle East. Energy was about to wreak plans for monetary integration and tear apart any hope for cohesion within the EC.

Conclusions

The reform negotiations following the Smithsonian Agreements gave Europe a chance to instill their views into developing a new international monetary system, and the destruction of Bretton Woods forced the EC to define its monetary future more clearly. However, as the Community could not agree to all the provisions of the Werner Plan, which envisioned EMU by 1980, integration still reflected national interests and defining the European monetary agenda only went as far as its lowest common denominator. France and Germany, which should have taken to lead and were the only nations able to lead, had different visions for integration. For France, the EC was a vehicle to counter American domination and enhance French prestige in Europe, while Germany feared the economic inequalities of the Community and that without strong plans for coordination, integration might damper the Federal Republic's wealth.

The Smithsonian changes were marketed as the solution to Bretton Woods' problems, but officials on both sides of the Atlantic knew that they were temporary holding measures. The Americans and Europeans knew that the dollar needed to be devalued more to accurately reflect its worth, but hoped that meeting the need half way would convince the markets otherwise, or provide a smoother transition for smoother incremental adjustments. When the pound and lira came under pressure and left the snake, investors shattered the fragile stability that the new parities had promised, which diminished the role of the snake as a vehicle for EMU, and marked the beginning of the snake as a DM zone. The currency movements exposed the inequalities of European economies and the disunity of Community politics, and showed how the Nixon administration's benign neglect was forcing more flexibility on the system. The Smithsonian scheme gave more power to the U.S. to pursue its domestic agenda, and the

separated the nations. He went on to say that the center of power for the development of the system was with the American, japans and the German/French consultations.

Treasury was getting some of the flexibility it wanted, while moving the international community towards floating.

The U.S. refusal to actively support exchange rates damaged its relations with the Europeans, who steadfastly adhered to the hope that the international system would one day return to fixed rates. Their prospects were shattered when Shultz announced that the dollar would float in February, as it was unlikely, given the U.S. position put forth at Rome in September 1972, the Americans would agree to return to fixed parities any time in the future. French and German leaders felt pressured into floating because of the dollar's privileged position, even though they negotiated the Smithsonian rates in the knowledge that the dollar devaluation did not go deep enough to reflect the U.S. payments deficit, but it is also true that the Europeans did not act to relieve their currencies from the burdens of U.S. dominance until forced to do so by crises. The European response was usually reactionary rather than preventive, as floating and parity adjustments were used as last resorts, and the mark's disengagement from the dollar after the February 1973 crisis, was grudgingly implemented when the EC felt it had little choice.

This too heightened European tensions, as France became more threatened by Germany's economic might in the snake, and the Federal Republic became more alarmed by the deteriorating conditions of the French and Community economies. However, national cautions did have their merits. Brandt and Pompidou may have been anxious for progress into EMU, but neither of them was willing to sacrifice his domestic economic and political agendas for it. France seems the obvious culprit here, as Pompidou refused to consider economic policy coordination within the Community structure for fear of any loss of sovereignty. Without correcting the discrepancies among the EC membership, linking currencies would lead to disaster. Yet, since neither the Federal Republic nor the French had yet defined the scope of integration, it was difficult to construct it. The turbulence, both internationally and nationally, was therefore, a mixed blessing. Until, Europeans defined integration, they were hardly equipped to prepare for it.

The European/American monetary relationship was cordial but strained throughout this era. Volcker's consultations with the allies before the February devaluation helped to promote Shultz's and the U.S. image as a partner in international financial circles. It painted him as a man who was willing to consider the impact of American policies abroad, before taking action – a marked contrast from Connally. However, the administration's hands off approach to supporting the dollar's parity conflicted with these cooperative endeavors. Benign neglect exposed the Germans to the dangers of investor whims and left Europe to support a dollar parity that Washington was content to let depreciate in order to obtain the exchange rates it thought were more consistent with national economies. Europe again believed that the U.S. was forcing its own ideas on the system through inaction, instead of at the negotiating table. These feelings were reflected in the negative reaction to the Year of Europe, as France viewed the initiative with suspicion, and not without some validity, that it was a means for the U.S. to establish its voice inside a distinctly European institution.

CHAPTER VI

OIL CRISIS AND NATIONAL INTERESTS: OCTOBER 1973-DECEMBER 1976

For most of the Twentieth Century, the developing world figured little in monetary politics, with the exception of how the industrialized nations would distribute aid and loans. In the 1960s though, Middle Eastern leaders wrestled control of energy supplies from foreign oil companies, and altered the landscape of global political and monetary power. When Arab leaders raised oil prices and imposed embargos to sway Western support from Israel in the 1973 Arab-Israeli War, the implications for national economies and European integration were enormous, and completely unforeseen by Western leaderships. The Oil Crisis would hinder monetary reform, help to establish floating as the international monetary mechanism, cause more difficulties for Atlantic relations, provoke a world recession, exacerbate political and monetary disparities within the EC, and destroy any hope of EMU by 1980.

Arab-Israeli Relations*Political Considerations and the U.S.-EC Relationship*

Since the Six Day War of 1967, Israel had occupied the West Bank of the Jordan River, East Jerusalem, the Golan Heights, Gaza, and the West Bank of the Sinai. The U.S. emerged as the Jewish state's most important ally and helped to push through United Nations Security Council Resolution 242, which demanded that Israel leave occupied territories and "live in peace with secure and recognized boundaries." Israel refused, and was in a constant state of war with its Arab neighbors. Syria and Egypt invaded Israel on 6 October 1973 on the Jewish Holy Day of Yom Kippur, and the conflict was soon in stalemate. In the first days of battle, even though the Soviet Union readily supplied Syria and Egypt with equipment, Nixon had hoped for a cease-fire, and delayed sending supplies to Israel. When the Arabs shunned arbitration and expressed their intent to crush the Israeli state, the president responded with a massive airlift of supplies to the beleaguered nation.

Supplying Israel further strained U.S.-European relations. Failing to consult its NATO allies before commencing the airlift, The Nixon Administration was able to persuade only Portugal to allow the use of its bases for refueling U.S. aircraft. The rest of Europe was unwilling to attach itself to a U.S. policy that had not sought allied opinion, and were loathe to provoke unfriendly relations with the Arabs that might jeopardize supplies of oil. These concerns were justified, as the day after Nixon announced aid to Israel, Saudi Arabia imposed an oil embargo on the U.S. and Holland. The embargo translated into a 16 per cent cut of oil imports for the U.S., which was about 6 per cent of consumption, which was not enough to destroy the American economy, but enough to produce cuts in industrial production. Not wanting to impose too many restrictions on the U.S. lifestyle, Nixon was hesitant to enforce rationing and hoped that Americans would support voluntary energy consumption. Soon though, he announced legislation to reduce the national speed limit, hours at gas stations, and jet fuel use. In December, the president asked Congress to create the Federal Energy Office (FEO) and placed Deputy Treasury Secretary William E. Simon at its helm with Nixon assuming the chairmanship.³⁴⁵

Fearing the same repercussions for pro-Israeli stands, European states scrambled to separate themselves from U.S. initiatives, but they were divided on a unified course of action. France led the charge to find a diplomatic and European-inspired solution to the crisis. In the first days of the war, France led a shaky coalition of EC members in calling for a cease-fire in accordance with Resolution 242. Pompidou's³⁴⁶ motivations were both European, following France's focus to utilize the EC as a extension of French foreign policy and securing European independence from the U.S. in global affairs; and national, because of its colonial ties to Algeria, the Republic had always had a special

³⁴⁵ For more on the Arab Israeli War of 1973 see Frank Aker, *October 1973: The Arab-Israeli War*. (Hamden, CT., 1985); George W. Gawrych, *The Albatross of Decisive Victory : War and Policy between Egypt and Israel in the 1967 and 1973 Arab-Israeli Wars*. (Westport, CT., 2000); Chaim Herzog, *The War of Atonement, October, 1973*. (Boston, 1975); Walter Laqueur, *Confrontation: the Middle East and World Politics*. (New York, 1974); Elizabeth Monre and A.H. Farrar-Hockley, *The Arab-Israel War, October 1973: Background and Events*. Adelphi Papers no. 111. (London, 1974).

³⁴⁶ His opinionated foreign minister Michel Jobert had been the President's primary spokesman during the Atlantic Charter debates, and continued this capacity during the discussions on energy.

relationship with the Arab world. France favored bilateral contact with Arab nations, signed oil contracts with Libya and Saudi Arabia in January 1974.³⁴⁷ The agreements frustrated German and American attempts to form a consortium of oil consuming nations a month later. France was reluctant to join in any endeavor that might jeopardize its supply of energy or its Middle Eastern friendships. Domestically, France had other reasons to want a quick and European favorable end to the oil crisis. The French balance of payments was in deficit, and with the price of imported oil climbing; it would doubtlessly dip further into debt.³⁴⁸ Using its privileged position in the Middle East, France was looking out for its own interests, which were consistent with its policies towards the U.S., but strained its relationship within the Community.

The Germans had more complications involved with their loyalties. Brandt wanted to be a good European, and was in favor of a quick solution to the crisis, which was why when Pompidou called for a Community conference to discuss the Middle East in November, the Germans immediately supported the move, but the Federal Republic did not share the same adversarial relationship with the U.S.. The U.S., though, took some liberties with the friendship by using the port of Bremerhaven to supply Israeli ships without consulting the German government.³⁴⁹ Even without U.S. indifference to German concerns, Brandt had to consider German sympathies for Israel. The German balance of payments position was in surplus, so it could withstand the rise in energy prices for a time, which everyone assumed would be temporary. As before the oil crisis, the more serious concern for the Republic was how higher oil prices would raise

³⁴⁷ Great Britain took this route also. France claimed that it had to seek bilateral deals because “American companies were unwilling to sell crude” to it. According to U.S. oil companies this was a false claim. Memorandum; Simon to Secretary of State HAK; Re: French Government Justification for Bilateral Deal with Saudi Arabia; 25 February 1974; Microfiche, Drawer 13 Folder 33. Subject: Federal Energy Office – International Energy Matters 1974; William E. Simon Papers (WES); and Memorandum; Steve Wakefield (Federal Energy Office) to Bill Simon; Re: Briefing material for visit of French Ambassador Jacques Kosciusko-Morizet; 7 February 1974; Microfiche Drawer 14, Folder 23. Subject: France 1973-1974; WES. The meeting did not take place because the ambassador was detained by weather, but the briefing does offer some insights to the U.S. opinion of the bilateral agreement as well as the figures of that agreement.

³⁴⁸ Simonian, *The Privileged Partnership*, Chapter 7; Kruse, *Monetary Integration in Western Europe*, 149-158; and Kunz, *Butter and Guns*, Chapter 11.

³⁴⁹ Brandt, *People and Politics*, 316, and Simonian, *The Privileged Partnership*, 198-199.

inflation.³⁵⁰ On this, the Community agreed. Although the members were in different economic positions, inflation would affect them all. A reasonable and quick solution was needed to resolve the political crisis so it would not reach deeper into political and monetary issues and then the governments could go about anti-inflationary plans and remedy their economies.

Although the EEC made pro-Arab statements in the closing weeks of 1973, the differences in Community opinion were never greater than in January and February 1974. Secretary of State Kissinger invited the members of the EC to an energy conference in Washington.³⁵¹ After much protest, the French consented to send a delegation and sent foreign minister Michel Jobert, an outspoken advocate of European independence to represent France's interests. Jobert hindered an all EC agreement because he refused to create new institutions that would discuss the oil crisis. Instead, he suggested meeting under UN or OECD sponsorship. Jobert constantly expressed negative views on a common energy policy either with or without the U.S., and France could afford to eschew cooperative measures because of its agreements with Saudi Arabia and Libya. French bilateralism did nothing to endear France to the U.S. or its European partners, like Germany and embargoed Holland, who favored some kind of joint energy group.³⁵²

Germany held a favorable attitude towards an alliance of oil consumers for several reasons. First, it reasoned that a unified stand on energy with the participation of the U.S., could earn enough clout to influence the Israelis to a cease-fire. Second, the Federal Republic feared what would become of the massive accumulation of wealth that was pouring in to the Middle East. Where would all of this new capital go? Would the

³⁵⁰ Ibid, 155. For the difficulties on agreement within the EC on a cohesive response to the energy crisis see Memorandum; Steve Wakefield to WES; Re: Visit of Jens Otto Krag, EC Representative in Washington; 7 February 1974; Drawer 12 Folder 61; WES.

³⁵¹ Schmidt, *Men and Powers*, 161-164, claims that the conference was borne out of suggestions he made to Kissinger.

³⁵² According to the German representative in Washington, the U.S. saw France's behavior at the conference a European problem. "Das Verhalten Frankreichs wird vornehmlich als eruppäisches Problem angesehen." Letter; Georg-Dieter Gotschlich to Udo Löwke; Re: Ennergiekonferenz-Nachlese; 21 February 1974; Box 6005; Helmut Schmidt Papers. See this letter also for German observations on the oil crisis on the U.S. economy.

oil producing nations invest in Western goods and service or accumulate it inside their countries and stagnate capital movements in world markets? Exorbitant payment surpluses in the Middle East might also prompt more parity realignments.³⁵³ Without a strong policy on energy, it was possible that nations might resort to competing devaluations to fix their payments imbalances. This became a real fear since France, which rejected linking energy policy to monetary issues, left the snake and floated the franc in January 1974. Schmidt and Brandt's frustrations with France's energy position were thus related to planning for EMU.

The Economic Impact of Oil

The Franc Floats and the Snake Becomes a Worm

For a time, the franc had been among the strongest currencies in the snake's float. Pompidou had been targeting inflation and promised in previous EC summits and in bilateral meetings with Brandt that it would continue to work on the problem, but he was also not willing to sacrifice economic growth and worsen the French current account deficit. When the oil crisis hit France, officials took the position that more foreign investment could offset higher domestic production costs and they would not have to sacrifice growth. To these ends, the Bank of France began to repeal many capital controls imposed during the July 1973 currency crisis, and lured foreign funds with interest payments on its non-resident bank accounts and by dropping reserve requirements. Officials did not want to slow economic growth to reduce the deficit, but they did want to decrease consumer demand, keep inflation in check, and maintain competitive prices for exporting goods. When domestic demand began to rise at the end of the year, the government cut credit, scaled back spending, raised corporate tax payments and interest rates, and imposed price controls on food, rents, and industries most susceptible to international competition. According to D.C. Kruse, French

³⁵³ See Report; "The Financial and Economic Consequences of the Quadrupling of the Price of Oil"; ca. 15 October 1974; folder International Economic Issues; Box 135; Seidman Files; GRFL. Arabian oil money was flowing back into the western banks at different rates and in both long and short-term investments. The worry was "mismanagement and speculative excesses by banking institutions." The paper called for stricter national banking regulations to control the liquidity in the system.

economic policy “was therefore one of striving for as high level of economic activity as possible – by means of official support, if necessary – while avoiding conditions of excess demand.”³⁵⁴

The French path contrasted drastically to the German plan. Germany had come out better in the oil crisis despite facing the biggest increases among the Europeans in oil import bills. Much of its capacity to emerge relatively unscathed was because of a cushioning a trade surplus.³⁵⁵ France, however, did not have the luxury of a surplus and the persistence of the current account deficit and rising energy prices caused the currency to fall to the lowest limits of the snake.³⁵⁶ The deficit worsened when investors realized French reserves could only cover the cost of oil imports for only the next 18 months. Officials could cope with the capital flight through intervention, although they had already accumulated 300m Units of Account (UA) under the EC’s multilateral arrangement, and 350m UA of dollars to support the franc against the dollar by the start of the year. Besides intervention, France could alter its economic policies, which might stagnate economic growth and was domestically unpopular, or adjust its parity, which would make the snake worthless as a vehicle for European monetary integration. German authorities offered to loan France \$3 billion to keep it within the bands, but Pompidou was not willing to sacrifice growth and employment to maintain the franc’s place in the snake, nor was he willing to take aid from the Federal Republic.³⁵⁷

On 19 January 1974, the French floated the franc but reinstated their belief in fixed parities and assured the Community that they would review the situation in six months to determine the franc’s re-admittance to the snake. With the franc’s departure though, the snake was dead, and all facades of it being the mechanism for EMU had

³⁵⁴ Kruse, *Monetary Integration in Western Europe*, 157. This analysis of French economic strategy comes from Kruse’s observations.

³⁵⁵ See Report; “The Economic Impact of the Oil Price Increase”; 24 January 1974; folder CIEP (2); Box B24; Arthur Burns Papers; GRFL.

³⁵⁶ The franc was not the only currency targeted by speculation because of the oil crisis. The Dutch guilder came under attack because of the embargo and there were smaller adjustments on the mark due to natural fluctuations. See Kruse, *Monetary Integration in Western Europe*, 152.

³⁵⁷ Simonian, *The Privileged Partnership*, 223-224. Schmidt does not mention the loan offer in *Men and Powers*. Report; “The Economic Impact of the Oil Price Increase”; 24 January 1974; folder CIEP (2); Box B24; Arthur Burns Papers; GRFL.

faded. Now instead of discussing the snake's policies in the Committee of Central Bank Governors or the European Council that included all of the EC members – even those who had left the snake -- the remaining members of the “mini snake,” Germany, Denmark, Belgium, Luxembourg and the Netherlands met alone. The devolved to a small DM zone.³⁵⁸

The franc's departure from the snake owed much to rising oil prices, but in reality, the oil crisis affected the EC members' economies equally. As the Community did not coordinate national policies before the oil crisis, each European nation had different economic situations. Thus, when oil prices rose, the members started from different points on the monetary and economic scale, and decided to tackle inflation in accordance to their individual needs. Retail prices rose in all nations uniformly about 2-3 per cent, as the members relied on oil for their total supply of energy nearly equally.³⁵⁹ Similarly, although energy prices did have uniform effects on inflation, every nation's current account went into deficit proportionate to the imbalances among the members before the crisis. As in the case of the currency adjustments, these differences adversely effected the functioning of the snake.

The snake's deterioration reflected the economic discrepancies of the European Community, and dollar floating contributed to exacerbate the differences. The U.S. was also affected by the rise in oil prices, but its motivation to solve the crisis was not because of a concern over the dollar's value. After the initial shock of the oil embargo on the markets, investors realized that the U.S. was not as dependant on Arabian oil as much as Japan and Europe, and currency traders began to buy dollars, and appreciated its value.³⁶⁰ Weaker currencies became targets of speculative attacks as the uncertainties of the energy crisis dragged on. Because of the U.S.'s ability to withstand greater

³⁵⁸ *The Economist*, 26 January 1974, 59-60; and Kruse, *Monetary Integration in Western Europe*, 169-170.

³⁵⁹ The per centage of oil dependence for members of the snake were as follows: Netherlands 50, Germany 55, Benelux 60, France 67 and the only exception with Denmark 95. Non-members figures – United Kingdom 50, Ireland 69, and Italy 74. From *Ibid*, 151. Source: European Communities; Commission; Document of the Commission II/130/74; *Crise Pétrolière et Problèmes Economiques lies à l'Equilibre Extérieur à Moyen Terme des Pays de la Communauté*; 8 March 1974.

³⁶⁰ Memorandum; Herbert Stein to President Nixon; 10 November 1973; folder Weekly International Memos 1973; WHCF:SMOF:Stein: Memoranda to the President; NPMS.

pressures on its currency, officials believed they could afford to wait and negotiate a consensus among the consumers before moving to a dialogue with OPEC.

A Plan on Oil

New European Leadership

Ultimately though, the Europeans found a middle ground to the energy negotiations and its relations with the U.S.. From the U.S. plan, some Europeans, led by Germany, sided with the creation of an oil consumers group to deal directly with OPEC nations.³⁶¹ At the same time, the Community endorsed a Euro-Arab conference on energy, followed French desires to establish bilateral relations with the Middle East. Although Kissinger was unhappy with the addition of the conference into the oil negotiations, it did remove some of the strife from the Atlantic relationship, and OPEC did lift the U.S. embargo in mid March, but the compromise was also smoothed by the Nixon administration's preoccupation with the Watergate affair.³⁶²

³⁶¹ John G. Clark, *The Political Economy of World Energy: A Twentieth-Century Perspective*. (Chapel Hill, NC, 1990), 241-242. The group of consumers eventually became the International Energy Agency (IEA). The IEA met with OPEC nations in 1975 and was ineffective. Instead, the IEA functioned "as an information dispenser and as a voice of persuasion, preaching oil import reduction and advocating realistic domestic energy prices, conservation, fuel switching, nuclear development, and vigorous energy R&D. It emerged within the OECD in 1974, but France refused to join its membership. For a summary of the Department of State and the CIEP analysis on the Washington Energy Conference see Memorandum with attachments; Jon Rose to Peter Flanigan; Re: Donaldson (State) Briefing Papers on February 11 Energy Conference; 28 January 1974; folder International Energy Problems; Box 33; WHCF:SF:FO 6-3 [OPEC] [1971-1974]; NPMS. For all the U.S.'s concerns about forming a unit of oil consuming nations to counter OPEC, there is some evidence that the U.S. was willing to go it alone. Ben Massell reasoned "One way to view the international aspects of Project Independence is as a nonzero-sum-game between the U.S. and OPEC. One option open to the U.S. is to eliminate imports by 1980. The result might be a domestic crude oil price of \$8 (assuming that we do not adopt a policy that subsidizes more expensive energy sources). If the U.S. pursues this policy, there will be tremendous downward pressure on world oil prices. Say, hypothetically, that the world price would drop to \$3. Now consider that some mechanism can be devised to protect the U.S. against market disruption – some form of long-term, enforceable contract. Then the U.S. would gain from trade at any price above \$3. The gain would be partly – but not entirely – at the expense of Europe.... The reasoning considered here suggests that we may wish to consider negotiations between the U.S. and OPEC, excluding Europe and Japan. The latter stand to gain from blacking the negotiations." Memorandum; Ben Massell to NSC, Treasury and The CEA; Re: OPEC and Project Independence; 22 February 1974; folder Project Independence; Box 107; WHCF:SMOF: Stein: Meeting Files; NPMS.

³⁶² Simonian, *The Privileged Partnership*, 244. The scandal also affected the way for accord on the nature of the new Atlantic Charter in late April 1974.

For the Germans, accommodating the French had an international and European dimension that secured the future of monetary union. Bringing France into an international agreement on oil preserved French prestige and brought it back into the cooperative fold. Even the spirit of cooperation was important to keep a semblance of EMU alive since even before the franc left the snake in January 1974 the members still could not agree on the second stage of EMU. Pooling bank reserves, short-term financial assistance, and national transfers of authority was suppose to have commenced in January 1974, but the circumstances of the oil crisis had made disagreements sharper within the Community and they chose to stall the second phase and continue on the present course.³⁶³ Yet, oil was not the only cause for hiatus from EMU, leadership changes in both France and Germany lapsed progress. Pompidou succumbed to cancer in 2 April, and Brandt resigned a month later when his personal aide was arrested under suspicion of spying for the East Germans.³⁶⁴ Fortunately for the EC's monetary ambitions, Helmut Schmidt became chancellor on 16 May and Valéry Giscard d'Estaing assumed the French presidency only days later. Their friendship was strong from years of working together as finance ministers in their respective countries, and the comfort of their relationship would be useful since they had to resume two important diplomatic and monetary tracts – one concerning the restoration of the Franco-German tandem in European affairs, and the other in world monetary reform.

Restoring Franco-German harmony was an important part of the European integration process because few initiatives advanced within the Community without their mutual blessings, and because returning the franc to the bounds of the snake was integral to EMU.³⁶⁵ The leaders held their first Franco-German summit only weeks after being elected to office, and quickly produced accord on issues that had eluded agreement in the Pompidou-Brandt era. Schmidt got assurances from Giscard not to implementing trade

³⁶³ Kruse, *Monetary Integration in Western Europe*, 158-165.

³⁶⁴ For commentary on Pompidou's death and its impact on French politics see *The Economist*, 6 April 1974, 33. Giscard's election strategy and the French economy during the elections, *The Economist*, 4 May 1974, 92-93; 11 May 1974, 35-36; and 25 May 1974, 43-44. For the German scandal see *The Economist*, 4 May 1974, 42-43; 11 May 1974, 31.

³⁶⁵ *The Economist*, 25 May 1974, 79-80; 1 June 1974, 55-56.

barriers to reduce imports and improve France's payments position like the Italians and Danes. He feared that if France decided to take protectionist measures other Community members might follow. This would damage the EC's monetary plans, and achievements recently made with the Common Market.³⁶⁶

The leaders also dealt with the ever-present problem of inflation. Although both countries had previously committed themselves to reduce it, the oil shocks had exacerbated the dilemma, and made the flaws in independently planned national programs obvious.³⁶⁷ Schmidt had pointed out the discrepancies of national policies and the energy crisis in his inauguration speech saying, "...the massive cost increase for the raw material so vital to Western Europe, and the divergent efforts for price stability and increased productivity in the individual EEC countries have led to far-reaching disparities within the Community."³⁶⁸ Without some kind of coordination, domestic efforts could not reduce prices without causing disequilibrium within the snake, and Giscard was eager to show that France could put its economy in order and rejoin the mechanism. Immediately following the summit, Giscard reversed the French state's long held aversion to economic coordination, and announced an economic plan similar to one implemented by Schmidt in the Federal Republic. This was an encouraging sign that Europe's main partnership had been resurrected. Giscard improved France's record on inflation and balance of payments, and ended the impasse in Franco-German relations.³⁶⁹

The Giscard-Schmidt summits held prior to every EC meetings became as important as the Community gatherings themselves, as the leaders discussed topics and made decisions important to European monetary affairs and then submitted them to the members for discussion. It was a pattern that their predecessors established, but the new

³⁶⁶ Simonian, *The Privileged Partnership*, 248-249; and *The Economist*, 8 June 1974, 82.

³⁶⁷ For a detailed report on the effects of higher oil prices on the EC and individual economies see "The Energy Crisis and the European Community" European Community Information Service; 26 March 1974; Microfiche; Drawer 12, Folder 61; Subject: E.C. 1973-1974; WES.

³⁶⁸ "Continuity and Concentration" Excerpts from Helmut Schmidt's inaugural Government Policy statement of 17 May 1974; n/d; folder German Federal Republic [1971-1974]; WHSF:WHCF:SU:CF CO53-2 German Federal Republic [1971-1974]; NPMS.

³⁶⁹ *The Economist*, 13 July 1974, 52.

president and chancellor firmly institutionalized it. In patterning their cooperation, Giscard and Schmidt created more transparency in their intentions for the Community and between themselves and were able to consult regularly on problems as they arose. Although the smaller members of the Community did not appreciate the dominance of this exclusive club,³⁷⁰ little progress on EMU would be achieved without it. It was the fundamental relationship in European integration.

Although the French and German relationship was key to European integration, the dollar still held power in that equation. The C-20 reform negotiations had been put aside to deal with the oil crisis, and the 1973 dollar devaluation with the European float, had created a system of flexible exchange rates merely by default. Floating against the dollar gave the EC currencies some degree of independence from the dollar, but Europeans had not given up their devotions to fixed exchange rates. The international currencies had operated on this makeshift system since February 1973, and Schmidt and Giscard had worried about managing their monies in a world without pegged rates even before the oil problems. Schmidt admitted that joint floating was new territory for Europe, and had tried to hold the snake together as a “delaying action.”³⁷¹ The international monetary system was a primary concern for Schmidt. It was a leading topic of discussion at his last meeting with Nixon in June 1974 when the U.S. president visit Europe for the last time of his presidency, which would come to an abrupt end two months later. He broached the issues of protectionism, inflation and the large trade deficits of Europe. Schmidt wanted to reduce the German surplus to “reduce the deficit of other nations” and questioned the ability of the international payments system to cope with the crisis. He wanted assurances of reform under U.S. leadership. Nixon’s briefings from Henry Kissinger however, had little more to advise than the usual policy

³⁷⁰ Of which Great Britain was often a participant.

³⁷¹ Schmidt, *Men and Powers*, 157-158. Schmidt was committed to keep the mark in the snake but there were voices within Germany that wanted the mark to go on its own. Economic institutes in Essan and Kiel “say openly that thee mark should be allowed to float up and leave the European snake if necessary.” They pressed for tighter money and higher interest rates. *The Economist* article praised the chancellor and the finance ministry for not following tighter policies as they would lead to more unemployment. *The Economist*, 13 April 1974, 109-110.

line -- cooperation under the IMF and World Bank and concentration on trade with the international payments system “strengthened in the interests of world peace and prosperity.”³⁷² Monetary affairs had never been a top interest for Nixon and now that he was facing increased criticism from the Watergate fiasco, he was more inclined to concentrate on defense issues with the chancellor. The EC membership believed it had to agree to some kind of international mechanism in order to construct a stable European Monetary Union. When they settled longstanding differences with the U.S. on the shape of the international system, then perhaps the Community could build a successful monetary union within that system. Much of this depended on the Americans.

Ford, Schmidt, and Giscard

Monetary Relations Get the Executive Treatment

In August 1974, Nixon resigned from office under pressure from the Watergate investigation that implicated him in the scandal. Gerald R. Ford was now President and he immediately focused on the oil problem and rampant inflation.³⁷³ The Europeans looked for consistencies, and though some of the Nixon Treasury had moved on, their philosophies on monetary reform prevailed on the new leadership. William E. Simon, the former ‘energy czar’, was now the Secretary of Treasury and he headed a staff that Paul Volcker described as “convinced currency floaters.”³⁷⁴ George Shultz was gone from Treasury, but the department’s commitment to floating remained. If the Europeans hoped that Ford’s monetary team would support intervention in the markets, they were

³⁷² Briefing Memorandum; HAK to President Nixon; Re: Your Meeting with FRG Chancellor Helmut Schmidt; 26 June 1974; folder President’s Trip (U.S.SR and Europe) June 1974; Box 950; NSC Files, VIP Visits; NPMS. The section on International monetary issues is marked “This is his major concern.” See also Letter; Georg-Dieter Gotschlich to Udo Löwke; 30 January 1974; and his report on Kissinger’s expertise on economic affairs with a *New York Times* article attached “Mr. Kissinger” No Economic Superstar.”; 12 December 1973; Box 6005; Helmut Schmidt Papers.

³⁷³ He focused building on the efforts of Project Independence from the Nixon administration, and launched an ambitious plan to cut oil imports and find new energy sources to make the U.S. self-sufficient by 1980. For an assessment of the condition of the U.S. economy at the start of Ford’s presidency see Memorandum; Arthur Burns to President Ford; Re: Agenda for an Immediate Economic Program; 12 August 1974; folder CEA 1974; Box B24; Burns Papers; GRFL.

³⁷⁴ Volcker, *Changing Fortunes*, 141.

disappointed. “Benign neglect” resurfaced again as Europe feared, and got confirmation of, the new administration’s apparent lack of concern over the effects of Nixon’s monetary actions or how to solve the problems of floating.

The Ford Administration would have to work to restore some harmony in the troubled U.S.-European relationship. A document from the Bilderberg Meetings in February 1974 summarized the situation that Ford confronted in foreign and monetary policy with the corrosion within the alliance and its rapport to European integration. In the 1950s and 1960s, policy makers assumed that unification could be achieved in a “relatively short time” and be a major political and economic player in world affairs, and it was in the American interest to support the endeavor. The EC would serve as the second pillar in the Atlantic alliance, “but it was taken for granted that it would be led by the U.S. from its position of predominant economic power and undisputed military superiority.” However, the paper noted, that the military implications of the “two pillar” concept were not “thought through” as Europe was dependent on NATO and the U.S. nuclear umbrella for its security. Although a liberal economic system through the IMF, free trade, and fixed parities, would presumably benefit both pillars, there was an obvious imbalance to the military responsibilities.

The report noted that indeed many things were wrong with these assumptions, especially regarding integration. Crises had not unified the members of the EC, and the energy shortage actually revealed the

contradiction between the persistent tendency of the member states to use Community membership to serve their separate national interests and their declared goal of creating a full European Union. The result exceeds the worst fears of even confirmed pessimists. The picture shows a mixture of disarray and impotence.

Concerning the American attitude towards European unity, the assessment was just as harsh. The U.S. was disillusioned and ambivalent about integration, on one hand disappointed that the EC had not progressed to share some of the burdens of global leadership and conversely realizing that Community interests would not necessarily be the same as Atlantic interests. It made special mention of a statement from Secretary of

State Kissinger – “we cannot be indifferent to the tendency to justify European identity as facilitating separateness from the U.S.” Yet, the EC had reason to be ambivalent also. The tendency for the U.S. to either ignore or court European opinion on major policy initiatives such as the August 1971 and the Year of Europe, constantly frustrated the continent, even though it knew it was in many ways held captive with its dependence on American military power. The discrepancies between economic and political power made for an unconstructive partnership.³⁷⁵

Within this unsettled state of affairs, Ford faced an oil crisis that exacerbated tensions and brought new disagreements and problems. The quadrupling of petroleum prices hit Europe and the developing nations especially hard, and no nation was unscathed by inflationary pressures and stagnant growth. The phenomenon became known as “stagflation,” where economic growth declined while prices soared. The economic projections for 1974 were grim as prices were set to rise, and industrial output and the current account balances dipped into deficits.³⁷⁶ Following his inaugural focus on inflation, Ford invited the major industrialized nations to a conference on inflation at the end of September. The attendees did discuss inflation, but spent much of their time commenting on the problems of global recession, rising unemployment, budget deficits and tax relief. The conference gave the president a chance to get acquainted with various heads of state and demonstrate his willingness to address a global problem in tangent with domestic initiatives. To these ends, he announced a comprehensive economic package on 8 October that included more benefits from the now 6 per cent unemployed Americans, reeducation job programs, and tax reforms that tried to relieve the burdens of lower and middle class incomes. His energy policies were weak,

³⁷⁵ Memorandum; “Discussion Guidance by the Secretariat” February 1974; Drawer 12, Folder 13; Subject: Bilderberg Meetings; WES.

³⁷⁶ 1974 projections were as follows -- Production Declines (per cent change from November 1973 to March 1974): U.S. -3.1, West Germany -1.1, France -0.8; Consumer price Trends (annual): U.S. [Aug-Nov 1973] 10.0 [Dec 1973-march 1974] 10.1, West Germany 4.2 to 9.9, France 9.9 to 13.1; Current Account Balance [part of balance of payments that refers to both investments and goods and services] (Based on OECD forecasts, first figure is from Oct. 1973 and the second figure in May 1974): U.S. 5.0 to -2.5, West Germany 1.7 to 5.0, and France 0.6 to -6.0. Memorandum; Peter Flanigan; Re: Graphical Illustration of the impact of the oil embargo and oil price increase on some of the major developed countries; 12 June 1974; folder CIEP; Box 31; WHCF: SMOF:Stein; NPMS.

however, and he refused to impose additional taxes on fuel and instead implored citizens to voluntarily curb their energy usage.³⁷⁷

As important as the conference was to discuss controlling inflation, preparing for it gave the U.S. an opportunity to meet with Germany and France and discuss common interests and to forge new understandings in oil and monetary policy. Ford first met with German Foreign Minister and Vice Chancellor Hans-Dietrich Genscher and assured him that the U.S. shared concerns over inflation, but most importantly that the U.S. supported the Federal Republic's recent \$2 billion loan to Italy in return for its promise to embark on a deflationary course and turn away from protective trade policies within the EU. It was an important indication of the health of the German economy especially in a time when most nations could not afford to be so generous. Because the German economy fared better during the crisis than many other nations, the U.S. began to press the FRG to take the lead in the world recession and reflate its economy by reducing interest rates and increasing the money supply to encourage growth. The Germans steadfastly rejected this fearing that doing so would complicate inflationary pressures.³⁷⁸ As the U.S. economy was experiencing stagflation, it was reluctant to take the deflationary path itself and argued that the surplus position that the Germans held was reason enough to take the lead. As the 1970s moved on, this would become a greater source of contention between Germany and the U.S..

³⁷⁷ Herbert Stein, *Presidential Economics*, 213-214. The press didn't seem to be too thrilled about Ford's plan either. *The Economist* did not feel that the policies went far enough. The magazine mildly praised the effort by saying it "couldn't do harm." See *The Economist*, "The President Puts his economic proposal." 12 October 1974, 49-50, and 5 October 1974, 53-54. Ford sent U.S. Ambassador Eberle to Europe to personally explain the program to the heads of state immediately following its announcement. See Memorandum; William Eberle to President Ford; Re: Discussions in Canada, Europe and Japan Following-up Your Economic Policy Message; 17 October 1974; folder Eberle, William D. 9/74-3/75 (1); Box 181; Seidman Files; GRFL.

³⁷⁸ Simonian, *The Privileged Partnership*, 254-255, and Memorandum; HAK to President Ford; Re: Your Meeting with German Foreign Minister Hans-Dietrich Genscher September 26, 1974; 22 September 1974; folder German Federal Republic 8/9/74-10/31/74; Box 33; Country Files, CO 53-2; GRFL. Letter; Federal Minister of Finance, Hans Apel to WES; 3 September 1974; Microfiche; Drawer 22, Folder 62; Subject: Germany 1974-1976; WES. Apel informed Simon about the Italian loan and added "Under the circumstances, our agreement with Italy should not be interpreted as a reaction to recent hints emanating from Washington which have pointed to the evident fact that EC countries hold the primary responsibility to help one another."

Martinique

Preparing for the Era of the Super Economic Conference

France had been a major obstruction to a cohesive energy policy at the Washington conference in February and U.S.-French diplomacy suffered in the closing months of Pompidou's presidency. Giscard was interested in repairing some of the damages, but also had to be careful not to anger the Gaullist faction of his new government by agreeing to anything on the oil issue that might compromise the French advantage with the oil producing nations. Giscard and Ford had agreed to meet in Martinique in December and used the inflation conference to prepare for their upcoming summit.³⁷⁹ The main issue was energy policy, and there were a lot of hard feelings and mutual suspicions to overcome. The U.S. was especially bitter about how France conducted itself in the oil crisis and Kissinger briefing guides for President Ford's meeting with French Foreign Minister Sauvagnargues in September demonstrated how deeply the animosities reached. Kissinger believed that "the French pursued generally disruptive policies in the Middle East after the October war and apparently encouraged certain Arab producer countries to continue their oil embargo against us."³⁸⁰ The crux of the meeting in Martinique, however, was coming to a compromise on forming an oil consumers organization that fit U.S. desires while not alienating the French on their interests with forming some communicative method with the oil producers.

The international press held mixed opinions that the summit would meet with success as the U.S. changed its strategy of seeking lower oil prices and accepted higher prices but moved to finding new sources of energy. The U.S. also wanted France to participate in the International Energy Agency (IEA), a new organization of oil

³⁷⁹ For a thorough but concise view of international monetary affairs at the time of the Martinique meeting, see "Overview of International Financial Developments: 1974 and Prospects for 1975"; n/d; folder Laney Subject" CIEP – International Policy Review – Agency Papers (2); Box 161; CEA Staff Economist Files; GRFL.

³⁸⁰ Memorandum; HAK to President Ford. Re: Your Meeting with French Foreign Minister Sauvagnargues."; "France – September 27, 3:00 P. M. – Secretary's' Office."; folder 8/9/74-10/31/74; Box 18; Country Files: France CO-50; GRFL. For an American assessment of France and the International Energy Program see Memorandum; "Subject: France and the IEP." 25 September 1974; folder Energy: Camp David Meeting 28-29 September 1974; Box B32; Burns Papers; GRFL.

consumers. Pompidou rejected French participation in such an agency and insisted that any energy policy not exclude the oil producers. Conservative French officials felt that the IEA would serve as a platform for U.S. power, and were suspicious of American motives. Giscard was careful to keep his options open and agreed to the formation of the IEA but also secured Ford's assurances that he would not discount dialogue with the producers in the future.³⁸¹

The second deadlock at Martinique concerned the future role of gold in the international monetary system. Notwithstanding the effects of the oil crisis on international reform, negotiations about gold and its reserve status had been a major sticking point between France and the U.S., since the 1960s, and was one of the issues that hindered progress on reform. The C-20, the body of nations that formed in the IMF to negotiate international reforms, had failed to construct a new system. The inclusion of so many participants, which was supposed to bring the concerns of the developing

³⁸¹ See Briefing Papers; Microfiche; Drawer 22, Folder 62; Subject: Briefing Papers Martinique; WES. For international press anticipation and reaction see Memorandum; France Presidential Visit Martinique 12/74; Box 2; Savage Files; GRFL. There is evidence that the Ford Administration was getting frustrated with European attempts to get the U.S. to sit down with oil producers after the Martinique meeting. See Letter; Chancellor Brandt from President Ford; 26 December 1974; folder Shultz, George P.; Box 46; NSA Name Files; GRFL. "...we do not believe that multilateral consumer-producer meetings – whether at the official or unofficial level – will serve any useful purpose until the consumers are thoroughly prepared, and have come to substantial agreement on the common course they will follow – particularly in the financial field. We have not yet reached that stage, nor will we be able to do so in the time frame you suggest. Thus should you decide to go ahead with a multilateral meeting between consumers and producers after the meeting of consumer representatives, the United States would not be able to be represented. I am frank to say that I would consider such a meeting against the spirit of our discussions. I would, of course, regret having to take such a decision. The fact that we would be "unofficially" represented would not change the fact that all the representatives would be men in whom their Governments repose special confidence. Nor would it change the fact that the procedures agreed to at Martinique, partly at your urging, are being abandoned by indirection. Once the principle of unprepared meetings has been established, our efforts on behalf of another principle – consumer solidarity – would be for naught. Better, under those circumstances, to continue down the path of bilateral discussion that some of us are now on." Even with these reservations, the administration sent former Treasury Secretary Shultz to meet with oil producers in Germany for fear that the Europeans would establish a dialogue and American interests would not be heard. See Memorandum; Robert Hormats to General Brent Scowcroft; Re: Shultz and the Secretary; 6 January 1975; Memorandum; Hormats and Oakley to HAK; Re: Your Briefing of Shultz for his Discussion with the Shah and his Meeting with Schmidt's "Private Group"; 6 January 1975; and "Report on Private Group of Five Meeting Kronberg, West Germany."; folder Shultz, George P. 2-3 February 1975; Box 46; NSA President's Name File; GRFL. *The Economist*, 21 December 1974, 43-44. The magazine did not see Martinique as a vehicle to improve relations between the French and U.S..

nations into the fore, had not changed the fact that the negotiations mainly reflected the opinions of the European and Americans. Because of this, the Ford/Giscard/Schmidt era would spell the dawn of the international economic summit. Monetary policy would soon arrive solely at the level of high politics, and conducted directly between the heads of states and their respective finance ministers. Over the next few years, these summits, the first of which would be held in Rambouillet, France in November 1975 determined the shape of monetary reform more so than the C-20 or the IMF. There would be no agreements on the future of gold at Martinique, but again a Franco-American dialogue was a stepping stone to the bigger successes that would follow at the international gathering in Rambouillet.

The U.S. wanted to remove gold from the international monetary system, and Shultz had included this in his outline of U.S. reforms in September 1972 stating, “I do not expect governmental holdings of gold to disappear overnight. I do believe orderly procedures are available to facilitate a diminishing role of gold in international monetary affairs in the future.”³⁸² However, nothing had been done to implement these desires. Indeed, some of the reforms that the negotiators had left unresolved were agreements on the role of gold and how to construct some kind of stable unit to use as a central reserve currency in place of gold once it was gone. The difficulties of keeping gold as a main reserve were evident from the inception of Bretton Woods, but no one could agree on how to make the SDR or any other unit the center of the system.³⁸³ When he met Ford at Martinique, Giscard wanted the U.S. to agree to value reserve gold at market prices, and Ford agreed to this concession because treating the metal as any other commodity fit with American desires to demonetize gold. However, there were other differences on gold that were not so easily settled.³⁸⁴

³⁸² Memorandum; Kenneth Rush to President Nixon; Re: Gold Policy; 7 June 1974; folder FI-9 [1971-1974]; Box 28; WHSF:WHCF:SU:CF:FI-9 [1971-1974]; NPMS.

³⁸³ On the function of the SDR in the international system see Memorandum; “Suggested Talking Points: SDR Valuation and Interest Rate.” 4 January 1974; folder Treasury 1974; Box 191; WHCF:SMOF:Stein:Subject Files; NPMS.

³⁸⁴ Hellmann, *Gold, the Dollar, and the European Currency Systems*, 140, states that the French accepted the role of the SDR and the demonetization of gold but that each nation had two different ideas about what

Under the current IMF rules, members could sell their gold into the markets, and use it as collateral for borrowing but they could not buy gold from the market or trade between central banks at the market price. In the spring of 1974, the Community finance ministers suggested dropping the two-tiered gold market and allowing governments to trade gold between banks at the market price, buy from the markets to add to their vaults, and set up “some sort of mechanism...to limit fluctuations” for the price. The U.S. rejected these proposals believing that it would “create strong tendencies to move the international monetary system back toward an inflexible –indeed explosive – rigidity.” Instead, the Americans wanted sales among governments and the markets with limitations so that no one would sell more than 10 per cent of its reserves in a 12-month period to guard against inflationary gold prices. In addition to this, governments would agree not to try to hold the price within certain limits.³⁸⁵

The U.S. furthered its commitment to demonetizing gold by allowing private gold ownership of bullion, which had been illegal since 1933. Congress was set to lift this restriction at the end of 1974.³⁸⁶ Although it followed U.S. objectives in the international realm, it was a very controversial decision among Ford’s staff. Fed chair Burns argued against Simon, Alan Greenspan, Bill Eberle and Bill Seidman calling the move “ill-timed.” Burns pointed out that although the IMF nations had expressed a desirability to amend the Articles on gold, that they had not yet agreed to the future form of the international monetary system, and that making the decision to relax the gold

demonetization meant. In 1975 France revalued its central bank gold to the market price when the price had reached \$200 an ounce. (No other European nation did this.) By taking the market price the French treasury went from 19.6 billion francs to 75.6 billion francs. Every three months the figure was adjusted to an average of “gold fixings” in the markets during the last 3 months.

³⁸⁵ Memorandum; Kenneth Rush to President Nixon; Re: Gold Policy; 7 June 1974; folder FI-9; Box 28; WHSF:WHCF:SU:CF; NPMS. The European plan was seen as all but inevitable, and William J. Fellner of the CEA thought that “nothing would be gained by our paying lip service to the principle of the worldwide demonetization of gold while watching how this development is taking place. But I think it is very important that if events should take this turn we should not become a party to arrangement involving the practice (let alone the obligation) of establishing the exchange rates of the dollar by means of American gold purchases and sales”. Memorandum; William J. Fellner to Jack Bennett; Re: Meeting of May 8, 1974 on Gold; 9 May 1974; folder CEA 1974; Box B24; Burns Papers; GRFL.

³⁸⁶ Letter; Stanley Ebner to William B. Saxbe; “Executive Order #11825; 17 December 1974; folder Economic Advisor Meeting Agenda 26 August 1974; Box 23; WHCF:FI-9 Monetary systems; GRFL.

markets could put gold at a greater, not lesser importance in the system. In a letter to Secretary of Treasury Simon, he explained,

Recent press reports and market talk suggest that there may be substantial investment and speculative interest in gold if, as presently required by law, the prohibition is lifted. There is thus a rush of extreme price movement in the gold market, which in turn could excite speculative interest in other markets. Beyond that, if U.S. citizens actually were to buy large amounts of gold...there would also be a downward pressure on the dollar in exchange markets.³⁸⁷

The proponents of gold sales contented that private gold sales were in line with the U.S.'s desire to demonetize gold from the system and through a limited Treasury auction of reserve gold it would reinforce this commitment. Simon testified to Congress stating that the bill was consistent with reform goals and that the domestic markets were "not now in a state of high tension. He reasoned that the flexible and "lightly managed" floating rates were serving the markets well, and had avoided "old fashioned exchange rate crises."³⁸⁸

In January 1975, U.S. citizens could purchase gold bullion for the first time in 40 years. The Treasury held an auction for 2 million ounces of gold, and accepted all bids about \$153 an ounce. The price was attractive to foreign banks that had been buying it at \$200 an ounce on the London gold market and German and Swiss banks constituted much of the foreign bidding. Although the auction and the ownership legislature fit the desire of the U.S. to relegate gold to a normal commodity, the Treasury's acceptance of bids over \$153 reassured the Europeans that the Americans were not out to impulsively change the value of gold by selling it at rock bottom prices. As Rainer Hellmann explained, "The United States was not interested in an excessive devaluation of its own

³⁸⁷ Letter; Arthur Burns to WES; 3 September 1974; and Letter from Burns to WES; 13 November 1974; folder Gold: September-December 1974; Box B52; Burns Papers; GRFL.

³⁸⁸ Memorandum; WES to President Ford; Re: Decisions on Gold; 18 November 1974; folder Finance-Gold; Box 19; POF Files; GRFL. Statement to the Subcommittee on International Finance and House Committee on Banking and Currency; 3 December 1974; Microfiche; Drawer 14, Folder 28; WES.

gold reserves, much less of those of Italy, whose solvency was based entirely on gold.”³⁸⁹

Europe Postponed

The Community Assesses the Realities of Europe

The U.S. moved closer to its visions of a gold free system with Treasury auctions and private ownership of gold, but as most there still was no consensus on exactly how gold was to fit in a new monetary system or how exchange rates were to be managed. These were important considerations for Europe, for the EC felt that without a stable international system to manage exchange, the EC felt that it could not construct a stable European mechanism. In Europe, the members of the Community finally admitted that EMU was not going to happen under the current economic and monetary circumstances on the 1980 deadline. However, this realization should not be taken as a step backward but rather a step forward. European monetary union was doomed to fail unless the members took the time to iron out their differences on institutions and economic planning. There was also the fact that one of the partners of the effort no longer belonged to the currency regime of Europe – the franc and the snake. Giscard was determined to bring the franc back to the snake and in September 1974, the French signaled their intent to reenter the diplomacy of constructive monetary politics with the Fourcade Plan. French Finance Minister Jean-Pierre Fourcade wanted to create a “boa” around the snake that would allow more flexibility for European currencies. He also suggested market intervention for the dollar to keep the dollar’s parity at an appropriate “Community level”. The boa structure was suppose to accommodate the divergent

³⁸⁹ Rainer Hellmann, *Gold, the Dollar, and the European Currency Systems*, 140-141. The nations that had much gold in their reserves worried about a dive in the gold price with the influx of so much gold into the markets. Their concerns seem to be unfounded with the introduction of the Treasury auctions. *The Economist* described the impact as “not a total flob, but not as dramatic”. *The Economist*, “Four Months of Gold” 24 May 1975. Memorandum; William J. Fellner to President Ford; Re: International Financial Developments; 3 January 1975; folder FI 1/1/75-2/28/75; Box 1; WHCF; GRFL. According to Dam, *The Rules of the Game*, 270, the balance of central bank gold reserves in May 1975 was as follows – total gold reserves of all Fund members at the official price, \$44.6 billion, (there was \$160.6 billion of foreign exchange reserves) of this \$44.6b, the U.S. held \$12b, France, Germany, Italy, Switzerland and the Netherlands \$19.1b, Japan, Canada, and the UK had less than \$1b each. The LSC and non-oil producers preferred dollars to gold and only had \$2.3b.

domestic economic policies and the Community level parity for the dollar would guard against any floating that might cause havoc with European rates.³⁹⁰ The Plan was unpopular with the EC, but it did signal France's willingness to be a constructive player in European monetary affairs. The EC got its second boost at the Community meeting in Paris December 1974 where the members agreed on new institutions and joined efforts for economic coordination.³⁹¹

Giscard's affable attitude towards the snake was also a matter of national pride. If the franc rejoined the mechanism at the rate that it had enjoyed prior to its departure, it would be a sign of France's economic power and the success of its national policies. Rejoining the snake would also show that France was an equal partner economically to Germany in monetary affairs and that place the franc in the company of Europe's stronger currencies.³⁹² Though regaining entry to the regime made good economic sense as weaker currencies dealt with expensive imports, higher inflation, and were uncut in exporting goods. Giscard announced the franc's impending return to the snake in May 1975 over the objections of his finance ministry and the Bank of France. The move was widely believed to be a political decision rather than based on sound economic indicators, but the French did turn a trade imbalance into a Ffr 6.6 billion surplus. Authorities accomplished this with restrictive fiscal measures to combat inflation and increase exports, an increase in long-term capital inflows from lifting controls on non-resident investments and the elimination of the two-tier currency market. Even with these positive balances though, the press did not think that the franc could hold its position in the snake because of trends in rising imports and consumer demand, and predicted that it would have to leave the mechanism in the following year.³⁹³ The reentry was accompanied by an addition to the Fourcade Plan that there be Community-

³⁹⁰ Horst Ungerer, *A Concise History of European Monetary Integration: From EPU to EMU*. (London, 1997), 138.

³⁹¹ Simonian, *The Privileged Partnership*, 259-262; and Kruse, *Monetary Integration in Western Europe*, 222.

³⁹² *Ibid*, 224-225.

³⁹³ *The Economist*, "Is Giscard a European or a Gaullist in disguise?" 8 November 1974. Kruse, *Monetary Integration in Western Europe*, 224-228.

wide responsibility for intervention in markets with short-term credit facilities to support the weaker currencies of the EC. Again, the proposal was rejected by the members, however, it was an hint to the type of system that would emerge at the end of the 1970s.³⁹⁴

Negotiating Rambouillet

IMF Gold

If there was to be any progress at Rambouillet there were still issues to be settled between the U.S. and the EC. The nations still had to decide what to do with the gold already in central banks and the IMF gold tranches, and determine whether fixed or floating would dictate exchange rates. The U.S. had already started to disengage itself from gold's power in international finance with an auction of Treasury reserves in January and July 1975 that had a limited, yet significant, impact on the gold markets. The larger problem for the international community however, was how to deal with 150 million ounces of IMF gold – would it join the gold in the markets or stay within the Fund?³⁹⁵

First, there was disagreement on who actually owned the gold in the IMF's coffers. During the delicate negotiations of 1975, the U.S. held that gold was in possession of the Fund, whereas France claimed that it was still the legal property of individual nations and should be returned. Those who wanted the IMF to retain gold despite its removal from the system argued that it boosted market confidence in IMF liquidity and enabled the Fund to intervene in the gold markets if necessary. Also, as the main benefactor of developing nations, the organization could use these resources for the betterment of the third world. Johannes Witteveen, the IMF Managing Director wanted to give members a proportionate amount of SDRs to their gold tranches and then sell the gold and use the profits for works in developing nations. This was similar to the German proposal where each nations would receive a portion of the Fund's gold proportionate to

³⁹⁴ Dyson and Featherstone, *The Road to Maastricht*, 114, and Jacques van Ypersele, *The European Monetary System: Origins, Operation and Outlook*. (Brussels: Commission of the European Communities, 1984), 44.

³⁹⁵ At the official price this amounted to \$6 billion. Dam, *The Rules of the Game*, 270.

their quotas, and sell part of the gold to the benefit of some Lesser Developed Countries (LDCs).³⁹⁶

Witteveen outlined an IMF proposal at the Paris Interim Committee meeting in June 1975 that hoped to resolve differences on gold when he submitted that 1/6 of the Fund's gold be returned to the members, 1/6 be sold on the market with the surplus diverted to countries whose GNP was less than \$360 per capita in 1973. The remaining gold would wait for a decision of an 85 per cent majority decision by the members.³⁹⁷ This solution would cut down on the amount of gold that the Fund would have to offer the market, delegates still differed on the Fund's right to purchase and sell gold. To limit gold's monetary power, the U.S. wanted a "one-way exit", which gave the IMF no authority to buy or accept gold once it had sold its holdings. France wanted some retention of buying and selling rights for the Fund, while Germany tried to "avoid the issue by allowing the Fund to go either way...with a large majority."³⁹⁸

Having the Fund participate in the gold markets strained another issue that was how to treat the gold already in central bank coffers. Gold trading between banks proved to be the sticking point in negotiations between the allies and caused some strain between the Simon and Burns. The U.S. did want to demonetize gold, however it was also concerned that central banks might trade gold among themselves or in the markets and raise the gold price, which would by default put it back into the monetary limelight. Hence, the Americans argued in favor of central bank sales of gold to the markets, but in limited and controlled amounts. The EC was concerned about gold sales too, but for different reasons. The Community wanted governments to be able to sell among themselves, but worried that the influx of Fund gold would drive down the price and cut

³⁹⁶ Memorandum; L. William Seidman to President Ford; Re: Negotiating Position on Gold; 28 August 1975; folder Finance – Gold; Box 19; POF Files; GRFL.

³⁹⁷ Memorandum; "Summary of Outstanding Issues One Month Before Interim Committee Meeting."; 6 May 1975; folder GRF, folder International Finance; Box 162; CEA Staff Files: Laney Subject Files – International Finance; GRFL.

³⁹⁸ Memorandum; Sam Y. Cross to Treasury Undersecretary Jack Bennett; Re: Briefing for IMG Meeting, May 8 – Summary of Outstanding Issues One Month Before Interim Committee Meeting; 6 May 1975; folder International Finance; Box 162; CEA Staff Files: Laney Subject Files – International Finance; GRFL.

the value of their reserves.³⁹⁹ The U.S. tried to sway the Europeans at the Paris Interim meeting by persuading Schmidt to accept gold trading between governments only in the case of emergencies. Schmidt instead sided with the French to trade freely under a global limit. Because of this, the negotiation team sent word to President Ford asking for his endorsement to concede to the European position in order to proceed. Burns sided with the emergency option feeling that it was the best way to regulate gold and prevent it from returning to prominence in the system, while Volcker and Simon were prepared to accept global limits to bring the French on board. Ford chose the emergency option.⁴⁰⁰

The EC finance ministers met in Venice two months later and added their approvals and agreed to other terms to make their policies on gold sales among central banks more acceptable to American tastes. The Community agreed not to add to their gold reserves, use gold to settle accounts within the snake, or attempt to peg the price of gold among central banks. The Bank for International Settlements (BIS) would oversee the agreement and each nation would report directly to it the amount of gold that it held and an account of all gold transactions twice a year. The ministers also approved the American request to sell 1/6 of the Fund's gold on condition that each member would receive 1/6 of the gold back into their reserves. The U.S. approved of these terms if the Fund sold its gold over a period of three years and that no central banks would participate in buying the gold.

Compromise between France and the US was also aided that August, when the French also shifted their position and offered to treat gold, exchange rates and an increase in IMF quotas as separate issues instead of going for a complete package agreement.⁴⁰¹ However, this change did not ease the disagreements within the US

³⁹⁹ For a detailed summary of the positions, especially the French view, see Memorandum with attachment; George H. Willis Re: The International Monetary Group Alternates and the IMG Info Group; 21 May 1975; folder Finance; Box 162; CEA Staff Files: Laney Subject Files – Finance; GRFL.

⁴⁰⁰ Memorandum; L. William Seidman to President Ford; Re: Negotiating Strategy on Gold; 10 June 1974; folder Finance- Gold; Box 19; POF Files; Finance- Gold; GRFL.

⁴⁰¹ To accommodate the shift in wealth that the OPEC nations now held, IMF quotas were being reshaped. The U.S. was willing to drop its quota – the amount that governments could borrow that was also

negotiators on this topic, which has been brooding for some time. As Burns and Simon could not agree on whether banks should be able to sell gold freely or drop the American insistence that all gold be banished from the system, William Seidman again sent a request to the president asking him to break the impasse. Simon believed that letting central banks trade gold might affect reserves with an “inflationary rise in world liquidity” but he reasoned,

I’m not entirely convinced that this is bad since there has been a need for additional international liquidity. Our inflation problem has its origins in our inability to curb the growth of domestic liquidity and further lapses in this area will set the stage for more inflation – international liquidity – control will play a small role.

Simon asserted that countries would want to hold on a little gold until prices stabilized and he doubted that banks would establish another system to settle deficits with gold because they would not want to part with it and choose instead to settle accounts with dollars or other currencies. Burns maintained that allowing gold to keep some kind of role in the system while letting banks trade gold at market prices would incite governments to revalue their holdings at market prices, (France had done this), and enable liquidity creation at such a magnitude that would “frustrate our efforts and those of other nations to get inflation under reasonable control.” The Fed chair emphasized caution in isolating gold from other issues of monetary reform until the IMF agreed on what shape the international system might take. Ford directed that a secret ballot be taken among the economic officials and Simon’s view won out.⁴⁰²

proportionate to the obligations of governments to lend the Fund to assist other nations – to 1/3 (from 22.9% to 21.9%) to raise OPEC quotas from 5 to 10 per cent if the majority vote for action in the IMF was raised from 80% to 85% so that the U.S. could sustain its veto power. Memorandum; L. William Seidman to President Ford; Re: Negotiating Position on Gold; 28 August 1975; folder Finance- Gold; Box 19; POF Files; Finance- Gold; GRFL.

⁴⁰² Memorandum; L. William Seidman to President Ford; Re: Negotiating Position on Gold; 28 August 1975; folder Finance- Gold; Box 19; POF Files; Finance- Gold; GRFL. Simon believed that France knew of their disagreements and was using it to stall or gain concessions. He also believed that the French “realize the difficulty in gaining Congressional approval of quota increases in the absence of agreement on the exchange rate issue.” Memorandum; Roger B. Porter to President Ford; Re: Economic Policy Board Executive Committee Vote on U.S. Negotiating Position on Gold; 29 August 1975; folder Finance – Gold; Box 19; POF Files; Finance – Gold; GRFL. The results were: Treasury Position – Simon, Dunlop, Morton, Kissinger, and Seidman. Federal Reserve: Burns. Abstentions: Lynn and Greenspan.

With the US position finally set and the EC compromise in Venice, the parties met at the IMF conference in Washington on 30 August 1975. Even with Europe's more agreeable positions, there was no guarantee of agreement. The U.S. insisted on banishing gold from the system and while France and other nations had conceded to certain limitations, like not settling central bank account balances in gold, they were unwilling to accept the American insistence that gold would never be used. In the end, the Americans did get a unanimous vote from the Fund to abolish gold from the system, and the sale of Fund gold, but this was not the last word. Although the members endorsed the Witteveen proposal, France managed to stall the complete omission of gold from the system by including a clause to "limit all agreements on gold" for the next two years. This meant that the present agreements on gold would be valid for the next two years and at the end of that time, nations would review the gold policy again and either choose to abandon or adhere to it.⁴⁰³

Exchange Rates, Intervention, and German Reflation

The second problem that concerned the Washington IMF meeting was the function of exchange rates. The French, and many other nations, were adamant about including some language in the IMF agreements for the eventual return to "fixed yet adjustable parities", while the Americans wanted to avoid any "legal or moral commitment to par values and instead favored free floating."⁴⁰⁴ The U.S., however, saw

⁴⁰³ Hellmann, *Gold, the Dollar, and the European Currency Systems*, 141-144; and Cohen, *Organizing the World's Money*, 126-128. The official price kept a steady incline, from \$35 an ounce until 1971, then \$38 an ounce from December 1971 until the dollar devaluation of 1973 where it rose to over \$42 an ounce. The market price for gold had skyrocketed to as much as \$200 an ounce. Banks did not use it to settle their debts with other nations since the official price was so much lower than the market rate. However, the IMF charter prohibited them from making a profit on the open market. There were ways around the exclusion though, as banks could use the Bank for International Settlements in Basel as an intermediary to purchase gold. France was among the European countries that took advantage of this loophole, and sought to have some of gold's traditional reserve status preserved.

⁴⁰⁴ France was not alone in its concerns about floating. The *Outline for Reform*, published by the C-20 in 1974, [Committee on Reform of the International Monetary System and Related Issues, *International Monetary Reform: Documents of the Committee of Twenty*. (Washington, DC., 1974).] still viewed floating as a policy option if pegged rates faltered. The C-20 could not agree to specific terms of reform but did put forth six goals of reform. These included, as adapted from Cohen, *Organizing the World's Money*, Chapter 4; 1) stable adjustment of exchange rates through par values but allowing for floating in certain situations; 2) cooperative national efforts to manage capital flows; 3) a unit of convertibility to

France's insistence on fixed rates as a way to improve the franc's competitive position by maintaining an undervalued currency with fixed exchange as it did in the Bretton Woods era. France rejected a clean floating regime because since the spring of 1973, and the dollar had fluctuated against the major European currencies by as much as 20 percent in a span of a few months. Clean floating meant that central banks would not intervene in the markets to support their parities. Giscard feared that accepting floating on these terms would be an endorsement of these erratic movements and would give the money markets a powerful tool in speculation and cut investments in domestic industries.⁴⁰⁵ The French wanted a dirty float, that is some limited intervention by central banks, and this was also strongly connected to Europe's desires to see the U.S. take some responsibilities for the dollar that the EC had already accepted when it had to intervene to keep the fluctuations from effecting the floating of the snake. The remaining members of the snake may have been tied to the deutschmark, but the mark would always be affected by the changes in the dollar's parity since it was among the strongest currencies and a target for short-term capital investments whenever the dollar's rate dipped. Although the U.S. had agreed to some limited interventions in July 1973, they employed these facilities sparingly. Central bank governors, especially the Bundesbank and Swiss banks, complained of the American benign neglect in maintaining its rates and pushed for more intervention in the markets and some restrictions on curbing the ease of short-term capital.

But Giscard was not alone in his discomforts for parity shifts, and the arguments about fixed rates and intervention carried more than a national agenda. As the strongest currency in the small EC snake, Germany felt the dollar movements more acutely than its weaker currency neighbor. In the aftermath of the Arab embargo, the dollar briefly

settle imbalances, "with symmetrical obligations on all countries"; 4) liquidity issues such as the SDR becoming the main reserve asset and diminishing the role of gold and reserve currencies; 5) harmony between the unit of adjustment, convertibility, and liquidity; and 6) aid to developing nations. Memorandum; Brent Scowcroft and L. William Seidman to President Ford; Re: International Economic Summit; 8 November 1975; folder Trips- Foreign Economic Summit – 1975 (1); Box 49; POF Files; GRFL.

⁴⁰⁵ Cohen, *Organizing the World's Money*, 118-120.

strengthened as investors realized that the U.S. was not as dependent on Saudi oil as predicted. The U.S. later benefited from large investments from the oil-producing nations that helped to offset the higher cost of oil that deteriorated the current account, but aided the capital account. Dollar fluctuations were also due to the massive amount of foreign credits that banks used to deal with the deficits of the oil crisis, lower interest rates and lifting capital controls at the start of 1974. Because of this, the dollar was expected to show some “moderate decline” but researchers attributed the continued slip to speculative pressures. During 1975, the dollar fluctuated by 15 to 20 per cent against the EC currencies. For the Americans, parity movements were a necessary part of life in a floating system, and officials saw these fluctuations as stable indicators that avoided currency realignments that would have sparked global monetary crises in a fixed system.⁴⁰⁶ In the opinion of the Federal Republic, there was only marginal stability for the European currencies in this system and it made maintaining the snake difficult on the German banks. For example, in March and May 1974 the DM was at the upper limit of the snake because of speculative capital movements and obliged the government to take in DM 4 billion of foreign currencies to keep the weaker members within the bands. In July and October, it was at the lowest margin despite the Republic’s strong payments surplus because of interest rate differentials and the collapse of a German bank and the Bundesbank had to sell DM 3.5 billion of foreign exchange.⁴⁰⁷

As the U.S. felt that the snake had coped well with the changes, its unease with the Germans was centered in its efforts to get them to take actions to reflate their economy. The oil shocks had produced worldwide recession with high inflation. Inflation started to recede in mid 1975, but leaders were still afraid of stimulating their economies and starting another round of price increases. The U.S. was wary of trading price stability for short-term improvements in unemployment to improve the payments

⁴⁰⁶ See Tew, *The Evolution of the International Monetary System*, 215-216. Memorandum; Meeting with Arthur Burns; 10 March 1975; folder Finance; Box 17; POF Files, Finance; GRFL; and Paper; EMB Limited; “Two Years of Fluctuating Exchange Rates”; 12 April 1975; folder EMB Ltd.; Box K9; Burns Papers; GRFL.

⁴⁰⁷ Report; Sixteenth Report on the Activities of the Monetary Committee; 16 April 1975; folder EC Monetary Committee; Box 158; CEA Staff Economists: Kvasnicka Subject Files; GRFL.

positions of its allies by bending to international pressures to pursue “export-led growth measures.” In short, the allies expected the U.S. to take the lead in expanding the domestic economy to boost confidence in the dollar (that is make it stronger) and stimulate imports from abroad. The Americans argued that despite the dollar’s position, it was the responsibility of all the nations to pitch in and were preaching synchronization of economic policies as an alternative. The U.S. was also quick to point out that the majority of European trade was intra-EC, and that Germany counted for nearly 20 per cent of that total.

Because of this, and since it had come out of the oil crisis increasing its trade surplus by \$8 billion and its current account surplus by \$5 billion, the special target of this U.S. effort was Germany.⁴⁰⁸ Ford was encouraged by Schmidt’s imposition of a \$6 billion tax cut and tax credits for investment in 1975, but the Chancellor resisted doing more than that for fear of courting inflation. Ford visited Schmidt in July on his way to the Conference on Security and Cooperation in Europe (CSCE) in Helsinki, and it was clear that the Germans were not going to sacrifice their economic health for the sake of U.S. demands. Schmidt stated that he believed “recession can only be overcome if it is overcome on an international basis in the same manner by all participants”, but “that overcoming this worldwide recession is only possible if this [the American] most important economy of the Western world leads the way.” He added that he was satisfied with the latest developments of the American economy that Ford had presented to him but that there were still “considerable difficulties to overcome.”⁴⁰⁹ However, Schmidt had few reasons to complain about the health of the U.S. economy and the dollar’s

⁴⁰⁸ Memorandum; Carl T. Bell to John M. Davis; Re: Economic Report for the International Economic Policy Review; 16 April 1975; and Memorandum; International Economic Policy Review – Session I; 2 May 1975; folder CIEP- International Political Review Papers (1); Box 161; CEA Staff: Laney Subject Files; GRFL. Memorandum; Alan Greenspan to President Ford; Re: Background Information for Meeting with Helmut Schmidt on the U.S. economy; 25 July 1974; folder BE 5 6/1/75-7/31/75; Box 19; WHCF:BE 5; GRFL.

⁴⁰⁹ Memorandum; Questions and Answer Session with the President and Helmut Schmidt; 27 July 1974; folder 7/26-28/75; Box 64; WHCF: SP 3-145; GRFL.

strength since the American economy had strengthened faster than the Europeans.⁴¹⁰ By the July meeting, the U.S.D had strengthened considerably against the mark because of higher short-term interest rates and an improvement in the U.S. trade balance.⁴¹¹

The efforts to reflate economies and control exchange fluctuations were strongly connected to the delicate debate between the U.S. and France on intervention and deciding between floating or fixed rates. The United States resisted amendments to the IMF articles to necessitate intervention and argued that resorting to a system of fixed yet adjustable rates would rehash the old Bretton Woods system that worked against the dollar and America's freedom over its own domestic economy.⁴¹² The resistance to fixed parities was not just the prevalent feeling in the executive branch either. Ford's handwritten notes in preparing for Rambouillet noted, "Our Congress has made it very clear to us that any agreement that says or implies a return to fixed rates (par values) would not be accepted."⁴¹³

The French Understanding

Monetary Realities and the Indistinct Language of Diplomacy

In the weeks before Rambouillet, the Treasury found a diplomatic understanding with the French.⁴¹⁴ The compromise was really one of language in defining the difference between what was considered a "disorderly" and an "erratic" parity movement. An amendment to the IMF Articles separated erratic exchange rate fluctuations from disorderly movements provoked by "underlying economic and

⁴¹⁰ For an assessment of the various economic plans and their results see Memoranda; International Economic Summit – 15-17 November 1975; folder International Economic Summit – 15-17 November 1975; Box 311; Seidman Papers; GRFL. Briefing Guides; folder Trip: Foreign Economic Summit 1975; Box 49; POF Files: GRFL. Memorandum; Alan Greenspan to President Ford; Re: Background Information for Summit Meeting on the U.S. economy; 12 November 1974; folder FO 6-1 Economic Summit Conference (France) 11/15-17/75; Box 32; WHCF: FO 6-1; GRFL. .

⁴¹¹ Memorandum; Alan Greenspan to President Ford; Re: International Financial Conditions; 25 July 1975; folder 6/1/75-8/31/75; Box 1; WHCF; GRFL.

⁴¹² Although the EMB Ltd. Research Economists Report "Two Years of Fluctuating Exchange Rates" did recommend regular intervention by the U.S. because of inflationary pressures that disrupted the trade balances between the U.S. and Europe.

⁴¹³ Memorandum; Brent Scowcroft and L. William Seidman to President Ford; Re: International Economic Summit; 8 November 1975; folder Trips- Foreign Economic Summit – 1975 (1); Box 49; POF Files; GRFL.

⁴¹⁴ Volcker, *Changing Fortunes*, 141

financial conditions” and with that distinction; the legal basis for floating rates was born. There were, however, no concrete provisions to prevent governments or banks from engaging in competitive devaluations, there were no firm definitions for what an erratic fluctuation might be, and no settlement on an institution for the members to confer with each other in a floating system.⁴¹⁵ It offered no real solution in economic practices, but it did give both sides the diplomatic ambiguity of some kind resolution. France now felt somewhat comfortable to give up its insistence of fixed rates now that it had a “guideline” for what was considered erratic and what was disorderly in the hopes that the U.S. would turn to manage the dollar a little closer.

Rambouillet

Making Good on Their Deals

Thus, by the time that the leaders met at Rambouillet, the French and Americans had made decisions that eased discussions at the summit and cleared the way for more significant agreements for the next conference set for Jamaica in January 1976. The smaller countries of the Community still rankled at not being invited to the international summits, but the bilateral compromises and the petite group of nations did seem to bring more settlements on monetary issues, which meant that the leaders would opt for future conferences.. At Rambouillet, France finally dropped its requirement that the IMF require returning to fixed rates, which now meant that the Fund could legalize floating -- something that had been done in practice since 1973, but was still illegal under IMF rules.⁴¹⁶

The successful spirit of the meeting did not mean that disagreements were absent. France’s representatives complained about the lack of support the U.S. showed for the

⁴¹⁵ Cohen, *Organizing the World’s Money*, 118-120.

⁴¹⁶ The Ford briefing papers for Rambouillet make no mention of the Treasury’s deal with France and the definitions. They advise the president that the French were sticking to fixed parities. I believe however, that the deal was made only days prior to the conference. See Briefing Guides; folder Trips: Foreign: Economic Summit 1975; Box 49; POF Files; GRFL. There was also some discussion about the legal implementation of the gold agreements. The Europeans wanted all three provisions to go into effect at the same time, while the U.S. was worried about the third part – allowing central bank purchases at market price – because it required an amendment to the IMF Articles. Voting processes took over a year. Briefing Guide; Tab C. Implementation of Gold Agreement; November 1975; folder Trips: Foreign Economic Summit 1975 (3); Box 49; POF Files; GRFL.

dollar. Giscard pointed out that the Federal Republic of Germany and Swiss banks had done the most to support the dollar because they had to halt speculation on their own currencies due to fluctuations in the dollar's parity. In the end, the U.S. agreed to a communiqué that stated that they “intended to work for greater stability in underlying economic and financial conditions in the world economy...our monetary authorities will act to counter disorderly market conditions or erratic fluctuation in exchange rates.” This was not a commitment to intervention however and Simon made it clear that the U.S. would interpret this in the narrowest of senses.⁴¹⁷

The support of the dollar held special significance because of its sustained role as a reserve asset, and this was also connected to another European-American disagreement on the future of gold in the system. In its conferences on reform, the C-20⁴¹⁸ had considered the problems of the dollar as a reserve currency, but in the meetings leading to the Rambouillet and Jamaica summits, the dollar's role in international liquidity, a larger problem than the role of gold, was never discussed. It was a curious strategy. The French, who had always complained of the dollar's privileges, focused on gold. The U.S., which had always complained of the injustices of being responsible for the primary currency, ignored the asymmetry of floating and concentrated on detaching gold permanently reminding its allies of the commitments they made in Washington a few months earlier.⁴¹⁹ At Rambouillet, the differences of opinion did not altogether disappear, but by most accounts the meeting was the stepping-stone for the establishment of guidelines for reform that would be accepted and institutionalized a year later at the Jamaica summit in 1976.

⁴¹⁷ Tew, *The Evolution of the International Monetary System*, 216-217. *The Economist*, “The Spirit of Rambouillet” 22 November 1974.

⁴¹⁸ Cohen, *Organizing the World's Money*, 112. After the Outline for Reform was published in 1974, the C-20 formed the Interim Committee of the Board of Governors on the International Monetary System. It comprised of most of the C-20, and was entrusted with the task of investigating the next steps for reform. Yet, the summits at Rambouillet (November 1975) and Jamaica (January 1976) were dominated by the leading industrial nations – France, Germany, the United States, Italy, Great Britain, Japan and later Canada.

⁴¹⁹ *Ibid*, 126-128; and *International Herald Tribune*, 13 January 1976, 9. For some background see *The Economist*, 13 April 1974, 59.

Jamaica

Making a Three Year Float Legal

At Rambouillet, the U.S. and France had overcome major differences in exchange rates, but these agreements still had to be implemented and ratified by the Fund membership, and this was the purpose of the Jamaica conference.⁴²⁰ France acquiesced to making floating legal, which was a victory for the U.S., but the French still attained language within the amendments for a procedure to return to fixed rates. The Americans refused to agree to a simple majority vote to determine when this might happen and the Treasury inserted a clause that allowed members to float indefinitely in spite of any vote to return to par values.⁴²¹ The differences of opinion on fixed and floating derived from two views of how to achieve parity stability. As Kenneth Dam explained, the U.S. believed that internal stability preceded external exchange rates, which was a departure from the thinking of Bretton Woods where nations were expected to keep their external balances in check at the expense of their domestic economies. In contrast, France did believe that the domestic economy held a high importance because until nations controlled inflation they could not return to a fixed rate system.

Floating was given equal legal status in Article IV of the Fund's charter. Now the members could maintain par values with the SDR or other "common denominator" with the exception of gold, have cooperative arrangements to other members (like the EC's snake), and "other exchange arrangements of a member's choice."⁴²² The third option for currency management in Article IV drew much criticism from reformers and bankers, and demonstrates just how varied global exchange had become since 1971. There were so many methods of currency management by this time that the framers of

⁴²⁰ Simon was pleased with the bilateral nature of the negotiations – "As a final note, let me add that the close working relationships we have developed with the French proved to be the critical element in reaching the accords on the international monetary system. I anticipate continuing to try to work with them closely in the future." Memorandum; WES to President Ford; Re: Jamaica Meetings of Interim and Development Committees; 13 January 1976; folder IT35 International Monetary Fund; Box 4; WHCF:IT; GRFL. The memo also gives a good summary of the Jamaica accords.

⁴²¹ Dam, *The Rules of the Game*, 267-268.

⁴²² Cohen, *Organizing the World's Money*, 115; Dam, *The Rules of the Game*, 256-257; and Hellmann, *Gold, the Dollar, and the European Currency Systems*, 170-171.

the amendment did not define them all and opted to put a catch all phrase to cover them – hence “member’s choice.” Dam illustrated the hodgepodge of international monetary regimes at the time when eleven members were independently floating, seven as part of the snake, “fifty-four currencies were still pegged to the dollar, thirteen to the French franc, ten to the pound and four to other currencies. Five members, mainly in Latin American, were pegged to the SDR, and fourteen were pegged to composites of currencies.”⁴²³

These guidelines gave the members a free choice to manage their currencies with either fixed or floating regimes as long as they did not tie them to gold. With this stipulation, the U.S. added to the agreements about IMF gold made in August 1975, and the Americans closed in on their goal to demonetizing gold completely. Now neither currencies nor the SDR would be connected to gold and the IMF members accepted the bulk of the Witteveen proposal. In order to safeguard against gold returning to the monetary regime, banks could trade gold but could not peg prices or add gold to their coffers for a period of two years. Since it was legal for members to sell to non-members even before the amendment and now members could trade at the market price, the value of gold reserves could increase as members revalued their holdings at the market value.⁴²⁴

Still, the limitations on gold did help the acceptance of the SDR as the principle reserve asset. The Fund gave the SDR more clout by making members pay the 25 per cent quota increase in SDRs, whose value was now determining by a basket of currencies instead of gold. The basket contained sixteen currencies, including the dollar, which were chosen and their value in the basket determined proportionate to their shares in world exports. The currencies were converted daily according to their parities in

⁴²³ Cohen, *Organizing the World's Money*, 127-133; and Dam, *The Rules of the Game*, 258-259.

⁴²⁴ After the announcement of the gold measures, the price fell from around \$137 to \$129.60, which was the lowest price since September 1975 after the Fund publicized the possibility of future gold sales. France also signaled its intention to buy some gold at the first IMF auction, even though it would be a breach of the Fund's articles. France responded that it would “harmonize” its reserves, “the foreign currency proportion of which it is felt has grown excessively because of joint float intervention commitments.” See Memorandum; Burton Malkiel to President Ford; Re: International Financial Developments; 16 January 1976; folder FI 12/1/75-5/31/76; Box 1; WHCF:FI; GRFL.

terms of dollars, which was termed in U.S.D and could be converted into any other currency. Due to the varied methods of exchange rate management among the IMF membership, the basket system provided the best option to give the SDR a worth that reflected market values accurately. Kenneth Dam explained that a par value system, parity changes often had nothing to do with currency adjustments against other currencies, rather they were reflections of market conditions that had already occurred. A currency basket that adapted its value with floating “gave a unique vale for the SDR, without any element of judgment.”⁴²⁵

The last controversy among the Americans and Europeans was to determine how much if any, was the appropriate amount of bank intervention in the floating regime. Although members had a choice of how to maintain rates now, the Fund wanted a certain amount of surveillance on monetary practices so that members would implement policies that insured the stability of an otherwise free floating system. Here, in determining the general rules for floating, the definitions for “erratic” and “disorderly” exchange rates that France and the U.S. had reached in November 1975 were most significant. The problem with a free-floating market is determining when parities are floating out of hand in the short term or and deciding when a currency arrives at its “true” value. Members were expected to keep their parities at “right” levels, but it was difficult to tell what correct levels might be in a floating system, and it was harder to impose rules on countries to keep parities in an un-definable area. The Fund inserted a clause that required members to “intervene in the exchange market if necessary to counter disorderly conditions which may be characterized inter alia by disruptive short-term movements in the exchange value of its currency.” This was much more vague than earlier attempts to define excessive fluctuations where in the past the members called for intervention “as necessary to prevent or moderate sharp and disruptive

⁴²⁵ Dam, *The Rules of the Game*, 200-204 and 275-281. There were problems with the SDR values that worried reformers. The SDR had two roles – one as numeraire, where a country announced a new par value in terms of SDRs that “implied a reciprocal value of the SDR in terms of that currency” – and the other where was the value of the SDR as a reserve asset. See Cohen, *Organizing the World’s Money*, 125-127; and Dam, *The Rules of the Game*, 202. See also *The Economist*, 15 June 1974, 108; 22 June 1974, 65.

fluctuation from day to day and from week to week.” The French-American diplomatic compromise therefore, did not have anything to provide the Fund with an explanation. Indeed, the U.S. could not explain the difference between “erratic” and “disorderly” itself.

In our view, the terms “erratic and disorderly,” while not precisely defined or precisely definable in advance, are synonymous, in the sense that they are both meant to describe a situation in which the markets are not functioning properly. Put another way, it is in our view likely that erratic fluctuations would be characterized by disorderly market conditions.⁴²⁶

As Dam commented, they could not define it, but “they know it when they see it.” Most importantly for the anti-intervention minded Americans, the lack of a definition left intervening in the markets to the discretion of U.S. desires.⁴²⁷

Europe Back on Track?

The Tindemans Report

As the spirit of international monetary reform between France and the U.S. manifested itself at Rambouillet, the EC had a renewal of consciousness in its own affairs. In December 1974, the European Council had asked Belgian Prime Minister Leo Tindemans to chart the way for the future of the Community and bring it back on track now that the EC decided that 1980 was no longer a realistic timetable for integration. Tindeman’s job was made difficult by the fact that, in the opinion of NSC chair Brent Scowcroft, he “received little help from the reports of the EC Commission and European parliament, which proposed minimal reform in their present structures, maximal goals for their future roles, and no enlightenment on how to get from the former to the

⁴²⁶ Quoted in Dam, *The Rules of the Game*, 263. Letter; WES to Henry S. Reuss (U.S. Congress); 3 February 1976; printed in Hearing before the Subcommittee on International Economics of the Joint Economic Committee, The IMF Gold Agreement, 94th Congress, 1st Session (1976), 84. See Dam, *The Rules of the Game*, 259-267; Cohen, *Organizing the World’s Money*, 120-123; and Hellmann, *Gold, the Dollar, and the European Currency Systems*, 171-173.

⁴²⁷ For a summary of the provisions see *The Economist*, 17 January 1976, 81. The magazine called the Jamaica decisions a “so-called reform package” and called the agreements on exchange rates “catches up with events (i.e., legalizes floating) in disgracefully sloppy language to suit all men.”

latter.”⁴²⁸ When Tindemans introduced his report the following year, it presented a controversial view of union that shifted decision-making firmly within the EC and its institutions in an attempt to do away with the bilateral negotiating strategies that determined so much of Community policy. European Union was to be federated, rather than confederated, and this exposed the core of French and German differences on the concept that once again threatened to stall European efforts.

The Federal Republic welcomed increasing the powers of the Commission and its President as well as giving the European parliament the permission to suggest legislation rather than simply endorsing measures from the Commission or newly created Council. As the Germans were comfortable with federated structures that reflected their own government organization, this came as no surprise. However, Giscard’s negative reaction to the proposal put his dedication to Europe in question. Giscard envisioned a directorate of individual nations that would guide the Community and wanted to avoid anything that looked like a supranational organization.⁴²⁹

The second most controversial aspect of the report was the suggestion that Europe could integrate in tiers. Tindemans reasoned that the stronger nations in the EC should not wait for the weaker currency members to go proceed with economic coordination and monetary integration. The snake was still the building block for policy, as Loukas Tsoukalis explained, “It is argued that obligations emanating from participation in the snake should not be limited only to external monetary policy but should be extended to internal monetary and budgetary policy and to all key aspects of economic policy.”⁴³⁰ Strengthening the snake to include internal cooperation would serve to reduce currency fluctuations against the dollar. The two-tier approach rankled the weaker currency nations, who felt that second tier members might suffer in the

⁴²⁸ Memorandum; Brent Scowcroft to President Ford; Re: Prospects for European Union: The Tindemans Report; 2 February 1976; folder European Community 8/9/74-2/9/76; Box 1; WHCF:IT6; GRFL.

⁴²⁹ Simonian, *The Privileged Partnership*, 261-265; Tsoukalis, *The Politics and Economics of European Monetary Integration*, 160-164; and Ungerer, *A Concise History of European Monetary Integration*, 140-141.

⁴³⁰ Tsoukalis, *The Politics and Economics of European Monetary Integration*, 160.

markets for not being included in the stronger tier of development. Many members also saw it as a sign of European disunity.

The Tindemans Report also included something for the United States. The recommendations included a call for the EC to conduct foreign policy, or “external relations”, with a singular voice. It singled out establishing a stronger dialogue with the Americans, something that the Nixon administration had tried to institute in bilateral negotiations with France and Germany and through the failed Year of Europe. As the NSC saw it, the Community’s need to speak with one voice in its relations with the U.S. was “an underlying reason for European construction”. Tindeman’s suggestions seemed to re-open the issue of consultations at the executive level, but at base he was calling for “a frank examination of the question ‘with the object of laying down certain principles and rules determining the content of and procedures for cooperation between Europe and the United States.’” Although this breached the French/German compromise to limit EC/U.S. contacts in political cooperation, the Report did bring out an important fact – that the relationship had not yet been defined. The Ford Administration was cautious not to add to French suspicions that the U.S. was intruding again on European affairs, and with words of support for integration the President was quick to reassure the continental leaders that it was “for the Community to determine how it wishes to proceed.”⁴³¹

The Snake’s Bite Gets Duller

The Franc Leaves Again

In late January 1976, European currencies were in trouble again, as the Italian central bank had to intervene heavily to support the lira from speculators who learned of a drastic decline in the current account and were nervous over political developments in Italy. The franc had enjoyed a period of strength at the end of 1975, and authorities had to intervene to keep it from rising above the bands of the snake. However, the pressure on the lira and the news that the French trade surplus had moved into deficit conspired against the franc’s position in the snake. This was hardly surprising to the financial

⁴³¹ See for example Memorandum; Meeting with EC Commission President Ortoli; n/d; folder European Community 2/10/76-1/20/77; Box 1; WHCF:IT6; GRFL.

community as the press had been predicting the franc's departure since November, and the fact that the franc rejoined the mechanism when the mark was at a low point, which market analysts predicted correctly which was only temporary. If the franc fell from the snake, it was only correcting the franc/DM relationship.⁴³²

In an effort to halt the rise of retail prices, which were growing 11 per cent annually, French authorities froze prices until the end of 1975, and imposed surcharges on corporate and private taxes in the absence of more stringent deflationary measures. Investors were not convinced of the strength of the French economy and by the beginning of March, similar speculative pressures on the British pound and other European currencies contributed to the franc's troubles. The Bank of France intervened heavily, selling \$1.8 billion of foreign currencies, mainly in the form of marks, and lowering currency reserves to \$3.5 billion. French officials finally allowed the franc to float outside of the snake on 16 March, and it settled a few weeks later, depreciating at 3 per cent against the dollar and 5 per cent against the mark. The exit did not make the markets smooth for the remaining members of the mechanism though. The mark remained at the high end of the band, while the Belgians and Danes could not let their currencies float independently because their small economies relied heavily on German trade and so they depended on monetary and fiscal methods to correct their balances rather than floating. The franc debacle forced the Benelux-mini snake, where Belgium, Luxembourg and Netherlands fluctuated only 1.5 per cent, to break apart.⁴³³

For the purposes of European monetary integration, the snake looked like it had lost its place as a building block for the Community, and the EEC Commission published a statement following the franc's departure citing it an example of why the snake was failing – because member nations lacked the political will to agree on concrete policies for economic and monetary union.⁴³⁴ The problems that the remaining

⁴³² *The Economist*, 8 November 1975, 41.

⁴³³ Memoranda; International Financial Developments; 24 January 1975; 13 March 1975; 19 March 1975 and 30 March 1975; folder FI 12/1/75-5/31/76; Box 1; WHCF:FI; GRFL; and Kruse, *Monetary Integration in Western Europe*, 228-231.

⁴³⁴ *The Economist*, 20 March 1976, 69-70.

members of the mechanism encountered when the franc floated independently demonstrated the fragility of the regime and the disparities among EC economies. In fact, the U.S. estimated that the exchange rate instability would last at least another two years owing to the differences in inflation rates, current account balances, and the inclination of governments to “intervene in foreign exchange markets and to use the monetary and trade practices to resist rather than facilitate exchange rate adjustment.” In short, the U.S. believed that nations were still in a fixed rate mindset and resisting necessary floating realignments. The disparities between the franc and mark value made the lack of stability in snake especially acute, and the U.S. did not believe that it could be beneficial without an additional realignment of 7 to 10 per cent of the mark and franc. Seeing as the inflation rates of both countries and their current account balances were so divergent, the Americans did not see integration, much less through the snake, as a likely option.⁴³⁵ The U.S. assessment of the economic and monetary realities of the EC’s two most important members was not without merit. France and Germany spent much of 1976 recovering from the economic uncertainties of the oil crisis, battling inflation, and trying to determine what a floating world might mean to the operation of European currencies.

Where monetary policy seemed to stall, so too did the promise of the Tindeman’s Report, as much of its suggestions went unanswered while Giscard and Schmidt tried to reconcile their differences over institutional organization. When the leaders met in January 1976, Schmidt rejected a French suggestion to form a directorate to guide the Community, and at the EEC meeting in Luxembourg that April, there were no further decisions made on the Tindemans findings. The report seemed to have peaked interest in some subjects, but not enough to provide a strong consensus for the entire membership.⁴³⁶ Other than some resolution on representation for smaller nations at the

⁴³⁵ Memorandum; Prospects for Exchange Rate Instability; 6 April 1976; folder International Exchange Rates; Box 72; Seidman Files; GRFL.

⁴³⁶ Much of the advancements in integration were institutional in 1976. A compromise in representation was worked out between France and Germany in the July 1976 bilateral summit that was formally accepted by the EC at the European Council meeting in July 1976.

July European Council meeting, nothing much was done in the area of monetary integration in the Community. The lack of progress was due to the inability of the members to agree on the form of union as well as political conflicts in France between the Gaullists, the French Communists, and within the president's own party, that caused Giscard much grief in regards to Europe.⁴³⁷

Puerto Rico July 1976

Rambouillet II

On the international monetary front, the leaders had finally overcome an enormous hurdle by legalizing floating, and waited for national legislatures to ratify aspects of the agreements.⁴³⁸ The successful combination of bilateral negotiations and executive-level conferences seemed to be the formula for success and the U.S. and Europe were eager to continue this pattern. However, this time the political and economic climate was different – it was election season for Ford, Giscard and Schmidt – and the issues that confronted the leaders now were not about the fundamental functioning of exchange rates, but more about how to sustain economic growth, containing inflation and keeping parities stable within that system.

Now that the U.S. had secured the system it had wanted, it set about trying to convince the allies to adopt complementary national economic policies to fix payments imbalances and lower inflation. The economic situation of most of the participants had improved by Puerto Rico, but the U.S. targeted domestic strategies as a “precondition for achieving stable underlying economic and financial conditions” for the globe. The Americans reasoned that all surplus countries, not just the U.S., should take the lead to growth, and accept a downturn in their balances to calm currency markets, to ease world recession. The Americans, as well as the French and Germans also targeted deficit nations like Great Britain and Italy and chastised them for their lax attention to the

⁴³⁷ Simonian, *The Privileged Partnership*, 261-265.

⁴³⁸ The articles were accepted by Congress and signed into law by President Ford on 20 October 1976 as Public Law 94-564. A good summary of the international developments to this point are also in Memorandum; Monetary System; December 1976; folder International Economic Report 1976 – ca. 12/13/76 (2) Part I-L; Box 137; Seidman's papers; GRFL.

inflation problem. Without agreements on economic measures against the balance of payments and inflation, they feared that nations would shun domestic fiscal and monetary policies to improve their economies, and turn to protectionist trade measures that would widen the gap between surplus and deficit countries. As an incentive, the U.S. also wanted “any external financial assistance provided by international institutions or friendly governments to be made conditional on the implementation of effective domestic stabilization programs.”⁴³⁹

The Europeans shared the U.S. concerns about payments imbalances and agreed that anti-inflation measures should take precedence over unemployment, but Giscard and Schmidt’s domestic political situations made the European agenda more complex. Both Schmidt and Giscard faced elections in the near future and were under pressure from the rise of opposition parties.⁴⁴⁰ The agendas for the French president and German chancellor were therefore, restrained with a keen eye on reactions at home. In France, Giscard, who had only won 50.8 per cent of the vote in 1974, had tried to institute reforms to sway moderate Socialists to his center and center-right coalition, but the tactic failed to attract the moderates on the left and alienated some conservatives. He then courted conservative Gaullists, who had opposed much of his social initiatives and were against closer relations with the U.S.. Giscard tried to align the conservatives closer to his government in order to prevent the *Union of the Left*, composed of the Socialists, Communists, and Left Radicals from winning a majority in the French Assembly at the

⁴³⁹ *The Economist*, 3 July 1976, 91, 99. For the U.S. agenda at the Puerto Rico summit see Briefing Book; International Financial and Monetary Issues; 4 June 1976; folder Economic Summit Puerto Rico June 1976 (2); Box 39; CEA Greenspan Files; GRFL. Memorandum; Remarks on International Financial and Monetary Issues for Use by the President at the International Summit; folder International Economic Summit 6/27-28/76; Bos 317; Seidman Files; GRFL. [quoted in text above] Briefing Book; International Financial and Monetary Issues – Fundamental Issues; June 1976; folder International Economic Summit Puerto Rico June 1976. Briefing Book (1) 6/76; Box B62; Burns Papers; GRFL. The conditionality issue was still being debated in September 1977 and Secretary of the Treasury Blumenthal believed that the IMF was a valuable tool to force nations with dangerous economic policies to mend their ways. Memorandum; W. Michael Blumenthal to President Carter; Re: The International Monetary Fund (IMF) and “Conditionality.”; 22 September 1977; folder FO4-2 1/20/77-1/20/81; Box FO-33; WHCF: Subject: Confidential; James Earl Carter Library (JECL).

⁴⁴⁰ Memoranda; Political Setting of the Puerto Rico Summit; folder Economic Summit Puerto Rico June 1976 (2); Box 39; CEA Greenspan Files; GRFL. Ian Derbyshire, *Politics in France From Giscard to Mitterand*. (Edinburgh, Chambers, 1990), 35-42; and Michael Loriaux, *France After Hegemony*, 199-201.

1978 elections. The French press was critical of the summit and doubted that anything significant agreements would come from it and was suspicious of not only Giscard's political incentives, but Ford's, as he too was on the campaign trail for presidency against Jimmy Carter. Despite this dour view, the press did see some merit in the exchange of ideas and communication between leaders, and this is arguably how Giscard used the conference. He wanted to broaden his influence on the international scene and to reassure the participants that France's economic recovery was going well even though the franc no longer participated in the snake. Although France had not been hit as hard by the recession as other deficit nations, unemployment and high inflation were chronic, and Giscard assured leaders that the budget would be reduced by half to Ff 20 billion and expansion fueled by private investments rather than banks. He also expected the U.S. and Germany to take the lead in balancing the surplus and deficit divide.

In Germany, Schmidt looked to October, where the Christian Democratic Union (CDU) was expected to make significant gains in *Länder* elections against Schmidt's coalition of Social Democrats (SDP) and Free Democrats (FDP). Should the CDU win enough seats, the FDP might side with it and wreck Schmidt's alliance, and with it the retention of the chancellorship.⁴⁴¹ At Puerto Rico Schmidt was in a powerful position since Germany was holding a strong surplus. He favored industrialized country cooperation, especially to aid developing countries with large deficits. The Americans had been targeting Germany's payments surplus for quite some time, trying to get Schmidt to reflate, but the chancellor did not think "surplus countries should take extra-market actions to reduce surpluses or increase deficits." He resisted reflation because he did not want to jeopardize the surplus, and the SPD was campaigning on sustained growth without inflation while suffering from a larger fiscal deficit. The government had cut taxes, but faced with higher costs for social programs, it was confronted with its commitment to public programs and the difficulties of raising revenues to pay for

⁴⁴¹ On the elections and Europeanism see *The Economist*, 25 September 1976, 79-80.

them.⁴⁴² Schmidt could not allow his government to accept a balance deficit with his party's survival in question.

Further clouding the aim of the summit was the European Community's integration problem. The EC was at a standstill in its efforts for monetary integration, the snake was now a small DM zone, and inter-Community policy coordination had thus far been a failure. Because of this, the thought of harmonizing economies globally seemed to be nothing more than a misguided aspiration. Additionally, because there was not a representative from the EC at Puerto Rico, making cooperative agreements at an international summit without Community representation would aggravate "the present mood of weakness and drift" within the EC. In fact, the German press commented that the absence of the EC helped to strain relations within the Community.⁴⁴³ The U.S. was not immune to these concerns and believed that the members would "muddle ahead" despite its problems, but the Americans also admitted, "we could ill-afford the political and economic instability that would flow from a major unraveling of EC ties among our principle Western European allies." Yet, the question of EC participation was out of U.S. hands. The American view was that the summits were

informal, designed to give political impulse to activities in existing institutions, and are in now way intended to weaken the EC. At bottom-line, of course, it is inappropriate for the U.S. to be more European than the Europeans, and the question of EC participation is a matter France, Germany, Italy and the UK have not chosen to raise with

⁴⁴² At the time of Puerto Rico, the Bundesrat (lower house) passed an excise tax on tobacco and liquor and increased the VAT from 11 to 13 per cent, but the VAT change, which did require the approval of the Bundestag (upper house) was not expected to pass. See Memorandum; Alan Greenspan to President Ford Re: Puerto Rico Summit Overview; 25 June 1976; folder Trips Foreign: Economic Summit 1976 (3); and Economic Situation and Policies in France and Germany; folder Trips Foreign: Economic Summit 1976 (4); Box 49; POF; GRFL. On the coordination issue see Memorandum; Helen B. Junz to Alan Greenspan; Re: Coordination Issue; 17 June 1976; folder Puerto Rico Summit (2); Box 136; Burton Malkiel Files; GRFL. Coordination and concentration meant that financially strong countries were expected to keep interest rate levels low in the U.S. "than would be compatible with domestic policy goals aimed at stability." Junz explained that this expectation derived from the common use of these terms did not mean the same thing to all the parties involved and indeed went against U.S. objectives. She said that instead of using the word coordination, which the EC utilized, U.S. representatives used "consultation" and "understanding" to avoid confusion.

⁴⁴³ Memorandum; Foreign Media Reaction; 28 June 1976; folder Economic Summit Puerto Rico June 1976 (2); Box 39; CEA Alan Greenspan Files; GRFL. All references to the foreign press reaction in this section are from this document.

respect either to Rambouillet – a French initiative – or Puerto Rico. We must keep in mind, however, that how we treat the question of European identity and the EC role in global economic affairs at the summit could affect a range of U.S. foreign policy interests.⁴⁴⁴

The message was clear. It was up to the Europeans to press Europeanism, and in the meantime the U.S. would deal with the continent on a nation-to-nation basis. The U.S. would support the Community without formal ties (as this had been rejected in the past), but be mindful that its relations with Germany, France and the others, would be subject at certain times to the interests of the EC.

The summit did not produce the headline results garnered from previous conferences, but all involved proclaimed the discussion of the economic situation useful for working out a good strategy to control recovery.⁴⁴⁵

Revaluations, Election Revelations, and Integration Hesitation

Parities, Polls, and Pause

Giscard and Schmidt's political quandaries and the disparities among European economies would have the greatest impact on the Community's parities for the rest of 1976. Giscard had agreed to the creation of a directly elected European Parliament in January and after meeting with Schmidt in Hanover in July, the French president agreed on a compromise package for parliamentary representation that the European Council adopted weeks later.⁴⁴⁶ These developments and the implementation of a new capital gains tax bill in prompted Giscard's Gaullist Prime Minister, Jacques Chirac to resign. Their relationship had been tense since 1975, and Chirac frequently complained that Giscard left him out of the loop on decisions of foreign policy and cabinet assignments.⁴⁴⁷ This political unease started to contribute to the decline of the franc, which depreciated against the mark by two per cent in one week. With the Bank of

⁴⁴⁴ Memorandum; Political Setting of the Puerto Rico Summit; June 1976; folder Economic Summit Puerto Rico June 1976 (2); Box 39; CEA Alan Greenspan Files; GRFL.

⁴⁴⁵ Telegram; Re: Puerto Rico Summit Draws Press Reactions; 30 June 1976; folder Economic Summit Puerto Rico June 1976 (3); Box 39; CEA Greenspan Files; GRFL.

⁴⁴⁶ *The Economist*, 10 July 1976, 57; 17 July 1976, 57-58.

⁴⁴⁷ Derbyshire, *Politics in France From Giscard to Mitterand*, 42-44.

France intervening only sparingly in the last weeks of July, but raising interest rates 1.25 per cent, the markets took this as an indication that authorities were not averse to seeing its devaluation. The pessimistic inflation projections that were familiar by then in banking circles had also found their way to investors and weeks of rumors of Chirac's departure spurred speculation on the franc in July and August.⁴⁴⁸

When Chirac resigned in late August, Raymond Barre took over the PM seat as well as the finance minister's position. Barre was one of the most respected economists in the country and his appointment was a boost to Giscard's reputation because Barre was a political outsider and a noted anti-inflationist, and this reassured the markets that the president was serious about France's economic difficulties. A month later, Barre announced an ambitious plan that included price freezes, limits on rent and wage increases, higher interest rates and taxes and curtailing public expenditures with cuts in the money supply. The franc initially regained some of its worth in response to the measures, but Barre's plan was not popular with labor or the business community and barely passed the Assembly. In the coming weeks the franc parity slipped as social unrest and a growing disenchantment with the plan set in. Keeping wages within the 6.5 per cent guideline required the voluntary assistance from unions and the incentives for investment were balanced by the increases in corporate income taxes. This prompted the CEA to comment "The tax parts of the Barre program seem to take away with one hand what they give with the other." Initial analyses showed that private investors were being cautious, and they were waiting to see if the plan improved France's economic picture, and Giscard's popularity, especially against the Socialists and Communists in the 1978 elections. Giscard too had to remain cautious in his initiatives on European integration

⁴⁴⁸ Memoranda; International Financial Developments; 30 July 1976; 9 August 1976; 14 August 1976; folder FI 6/1/76-1/20/77; Box 2; WHCF:FI; GRFL. *The Economist*, 24 July 1976, 69, 28 August 1976, 10-11, 4 September 1976, 37-38.

in the hopes that Barre's plan would turn France around and secure his political future a little more solidly.⁴⁴⁹

As Giscard and Barre tried to raise confidence in the franc, there were rumors about a DM revaluation in the fall. Germany's payments figures continued to show improvement with inflation at half the levels, at 4 per cent, than their European partners. As the remaining members of the snake put off implementing strong stabilization programs and the German economic picture improved, the mark kept hitting the top of the band. The pressure only increased the closer 3 October -- election day -- approached, as Denmark, Sweden, the Netherlands and Belgium sold over \$1 billion worth of DM, which threatened to extend the Bundesbank's target for money supply. The German government refused to revalue prior to the election and even after the results, where the SPD narrowly avoided defeat but its majority was reduced from 46 seats to eight, stood by its decision to maintain its current parity. That was until 17 October when the finance ministers and central bank governors of the snake met in Frankfurt and revalued the mark 2 per cent against the UA, which devalued the currencies of Sweden and Norway by 1 per cent, the Danish krone by 4 per cent, while the Belgians and Dutch held constant. Yet another revaluation prompted *The Economist* to ask if it was indeed worth it to keep the mechanism. The Bundesbank had lobbied to get rid of it, but the chancellor prevailed to maintain it. It was the last link to the Community's plans.⁴⁵⁰

Despite the fact that the recession was causing havoc on European payments balances and inflation rates that caused parity fluctuations and more disunity among the EC's economies, the Community was still attempting to construct some viable monetary arrangement. In July 1976, it was the Dutch's turn at the European Council's presidency and Holland's finance minister Wim Duisenberg submitted his plan for monetary and

⁴⁴⁹ Memoranda; International Financial Developments; 27 September 1976; 16 October 1976; folder FI 6/1/76-1/20/77; Box 2; WHCF:FI; GRFL. Derbyshire, *Politics in France From Giscard to Mitterand*, 44; Loriaux, *France After Hegemony*, 201; and *The Economist*, 25 September 1976, 91.

⁴⁵⁰ Memoranda; International Financial Developments; 30 July 1976; 9 August 1976; 14 August 1976; 29 August 1976; 27 September 1976; 1 October 1976; 8 October 1976; 22 October 1976; folder FI 6/1/76-1/20/77; Box 2; WHCF:FI; GRFL. Kruse, *Monetary Integration in Western Europe*, 230; and *The Economist*, 25 September 1976, 126, (election results) 9 October 1976, 58, and (revaluation) 23 October 1976.

economic integration in an effort to re-start interest in unification. The Duisenberg Plan was ambitious in the face of current conditions, and wanted to bring the countries that had left the snake back in to the fold with “target zones” for their currencies. There would be no legal obligation for intervention, but the plan resurrected something from the Barre plan of the early 1970s, with mutual financial assistance to keep currencies within target zones under certain Community agreed to guidelines. Nations would refrain from policies that might jeopardize their position in their zone, and if a member was in danger of leaving its zone, there would be consultations with the Community on their economic practices and the management of their parity. The concentration on domestic economic policy as a means to bring European economies into line was an attractive method for the EC. Duisenberg’s loose structure to bring about the alignment of exchange rates was flexible enough to accommodate the diversity of the Community’s economies and the snake still fit neatly into the scheme by becoming a target zone itself.⁴⁵¹

The members liked many aspects of the Duisenberg Plan, but since France and Italy had experienced so much parity turbulence in the past year, they were reluctant to join another management method that would tie their currencies to their stronger neighbors. The Council did not act on the plan and instead sent it to the Monetary Committee and the Committee of Central Bank Governors for further study. European integration was not a priority in 1976, because the Community was more interested in controlling inflation and getting their payments deficits under control.

Conclusions

The oil shock made the already tenuous Atlantic relationship worse; creating deep divides on how to deal with the oil producing nations. Huge hikes in oil prices affected the entire Western world, but produced disproportionate inflationary trends in all countries and exacerbated the differences in economies. Because of this, the Americans, French and Germans approached the crisis in different ways, each trying to

⁴⁵¹ Ungerer, *A Concise History of European Monetary Integration*, 139; Kruse, *Monetary Integration in Western Europe*, 239-240; and *The Economist*, 2 October 1976, 69-70.

cater to specific political and economic agendas. The price of oil cost more than harmonious relations; it was a main factor in the French decision to leave the snake mechanism, which destroyed its effectiveness as an instrument for EMU. Subsequently, the snake became a symbol for the dominance of the mark among the stronger currency nations of Europe, and heightened German prestige in monetary circles. The franc was always the weaker of the currencies within the Franco-German tandem, but now it was more pronounced, and this was an area where the French would have to accept its frailty and demonstrate its commitment to economic recovery if it was going to join the Germans as contributors to monetary unification.

Giscard's and Schmidt's ascendancy to leadership reversed the antagonisms in European relations and was instrumental in bringing the franc back to the European fold. Giscard accepted France's secondary position to the mark and made efforts to correct this with coordinated economic planning. This strengthened his image as a European and the franc rejoined the snake for a short time, but the rigidity of the mechanism was too constraining and France continued to struggle with the inadequacies of its economy, and soon dropped out of the snake again. However, this weakness did not carry over to France's power in international monetary relations, where the French shared some prominence with the Germans because of its position as the political head of Europeanism, a role that Germany could not accept because of its past.

Giscard demonstrated that he expected France to have the same bilateral privileges in bargaining for monetary concessions as his predecessors when international monetary reform turned away from large conferences and settled into smaller summits. The French made demands on U.S. policy that forced the Americans to deal with them outside of the formal summit structure, because without these bilateral agreements, there would be no accord at the meetings. In this way, France used its political clout and inflexible stipulations to make its mark on monetary affairs and enhance its prestige. Thus, the Rambouillet conference was a breakthrough in international monetary relations, and it also showed the delicate balance between diplomacy and functionality in international politics. The French/American compromise did not define or put

constraints on fluctuations or interventions. It formally recognized European fears towards floating and its desire to have the U.S. support its parity in the market, but the wording was so vague, it left this up to the discretion of the Americans, who had few intentions of doing so. The agreement marked the re-establishment of friendly relations between France and the U.S. and was really a stepping-stone to more historical developments that formally established an exchange rate regime at Jamaica in January. Settling on a formula for floating finally completed the job that Nixon's August 1971 decisions had set out to do – to create a more flexible monetary system for the dollar.

Although the EC did not realize it at the time, Nixon's decision and those of the subsequent administrations that adopted floating as a policy goal, actually helped integration by decreasing the Community's reliance on the dollar, and forcing it to consider its place in the international monetary system. The process was painful and Europe had to learn to initiate changes within the Community structure and anticipate difficulties, rather than respond to crises orchestrated by the U.S.'s benign neglect. The Europeans' problems would not cease with the Jamaica agreements, but their acceptance of dollar floating did free the EC to concentrate on their own monetary survival. Slowly, France and Germany would come to realize that European unity was their best bet to develop strong economies and establish EC guidelines that managed their currencies' futures. The latter half of the decade saw monetary affairs shift from the international perspective to a European focus. Soon, the Europeans would create the European Monetary System, while the United States looked on, trying to decide how, or even if, American interests would abide with European integration.

CHAPTER VII

PHOENIX FROM THE ASHES: EUROPEAN MONETARY IDENTITY, 1976-1979

The Western financial leaders came away from the economic “super-summits” believing that these sessions reenergized international monetary relations. Behind the scenes bilateralism and smaller conferences proved effective in overcoming differences among the economic powerhouses of the IMF at the expense of the smaller and less developed nations’ influences. The most momentous decisions having been made at Rambouillet and Jamaica, the newly elected Carter administration dealt with the remaining issues of the role of the SDR and gold. However, Carter’s primary monetary concern proved to be the function of the dollar in a floating system. The constant pressures of inflation, higher oil prices, trade imbalances, and payments deficits forced the dollar downwards and compelled the U.S. to take a closer look at its non-intervention position. The dollar’s depreciation wreaked havoc on the mark and European exchange, prompting the Europeans to muse about American benign neglect evolving into malign neglect. Responding to these concerns, the Treasury soon bartered a partnership with European banks to intervene in the markets. Even with the policy about face, Carter continued to insist that economic coordination was the main management tool for exchange rates, and constantly pressed Germany to reflate its economy with the U.S. to counter world recession.

Chancellor Schmidt did not take kindly to Carter’s monetary policies, which added to his growing dislike for the American president on other issues. The requests for reflation strained the German/U.S. relationship, but the market and economic uncertainties also produced an opportunity for integration. With the Franco-German locomotive driving EMU once more, Schmidt would take the initiative with France’s full support and lead the Community on a fast track to monetary union. As in the case of international monetary policy, the effort would be reserved to a small group of designers from Germany, France and Great Britain, with minimal U.S. involvement. America’s monetary leaders would be cautious towards the new endeavor, and would offer their

concerns about the European Monetary System's impact on the international system, even as they remained confident that the dollar's supremacy would not be challenged.

Change, and Yet More of the Same

Jimmy Carter and Benign Neglect Act 2

The first half of 1977 was a period of transition for the United States as Gerald Ford lost his bid for the presidency to James "Jimmy" Earl Carter in November 1976. Like Ford two years earlier, Carter made inflation his top priority and carried on with some of Ford's foreign economic and monetary tactics. Chief among these was making demands on surplus nations to change their domestic economic policies to fit in with the U.S. attitude of stabilizing external deficits and surpluses through domestic deflationary programs. Carter had planned, but not yet announced his intentions to put through an ambitious domestic agenda that focused on lowering the unemployment rate with a heavy emphasis on fiscal measures to stimulate the economy, and balance the budget by 1981. In order for floating exchange rates and payments balances to operate to American desires, he needed to encourage U.S. monetary allies to take up similar agendas.

Immediately after his inauguration, Carter sent Vice-President Walter Mondale to Europe with personalized letters that reflected the concerns the new administration had with each of the nations, and to test the diplomatic waters before the next economic summit in London set for May 1977. In France, Mondale discussed harmonizing the relations of oil producers and consumers, and in Germany he emphasized the U.S. desire for Schmidt to once again take the lead with the U.S. in reflating its economy. The exchange with Giscard seems to have been cordial, with the French president writing to Carter about cooperation and cutting domestic oil consumption. However, Schmidt did not receive the American suggestions well, and thus began a tension-riddled relationship between Carter and Schmidt that endured throughout their tenures. The Chancellor recounted his relations with Carter in his memoirs --

Differences of opinion surfaced even in the first six months of the Carter Administration. Only a few days after taking office in January 1977, Carter...urged us to entertain an expansive monetary and financial

policy. This suggestion, which met with no response, recommended a concentrated Keynesian policy of deficit spending, to apply to the whole Western world. Pointing out that worldwide inflation would be the inevitable result, we rejected the proposal.⁴⁵²

Despite the German rebuff, U.S. officials continued to be vocal for reflation. Where the Ford administration diplomatically focused on both the deficit and surplus nations in their efforts, the Carter team drew attention to surplus countries. Treasury Undersecretary for Monetary Affairs, Robert Solomon, stood before the Economic Policy Council of the UN in March saying that although Japan and Germany had taken the “first steps” to maintain expanding economies, he stressed that “stronger countries must be prepared to accept the deterioration in their current positions that is implicit in their own expansion programs and in the adjustments undertaken by countries in weaker positions.” He cited that the U.S. current account had already slipped from a surplus of \$11.7 billion in 1975 to a \$1 billion deficit and projected a \$6-7 billion deficit for 1977. Solomon called on Germany to do its share.⁴⁵³

In the wake of a conference on employment and inflation held in Oslo, Carter unveiled his economic plan to fight inflation and reach what he termed “normal” unemployment at 4.9 per cent.⁴⁵⁴ The economic policy advisors wanted to make the

⁴⁵² Letter; President Carter to President Giscard; 2 March 1977; folder TA4-11 1/20/77-2/28/79; Box TA-26; WHCF:Subject:Confidential Files; JECL. Schmidt, *Men and Powers*, 187. If anyone wanted evidence of the animosity that Schmidt had towards Carter they need only to look at the title of this chapter – “Jimmy Carter: Idealistic and Fickle”. See also *The Economist*, 9 April 1977, 37-38.

⁴⁵³ Speech; The World Economy in 1977 and the Status of Negotiations on International Economic Issues; 3 March 1977; Box 9; Solomon Papers:Speech Files; JECL.

⁴⁵⁴ A short description of Carter’s program is in Stein, *Presidential Economics*, 216-218. See Memorandum; The Economic Policy Group to President Carter; Re: Economic Recovery Program; 22 January 1977; folder 1/23/77; Box 4; POF; JECL. In March Charles Schlutze, the chair of the CEA and interim director of the CIEP, which would be formally abolished in September 1977, sent a memo to Carter advising the president on a meeting with Fed chair Arthur Burns, who was against the stimulus plan. Carter wanted to gain Burns’s approval for deficit spending and gain his trust with Carter’s introduction of zero-based budgeting to the federal government. Zero-based budgeting was a new method of spending management where departments and agencies submitted their budget requests every year and justified the spending on every program new and already existing from year to year. Each year, the programs are reviewed to see if their importance is still relevant to funding from the government and if another program could either improve on it or overlaps. It was designed to eliminate waste and force the federal government to restrict its spending. Memorandum; Charles Schlutze to President Carter; Re: Discussion with Arthur F. Burns; 7 March 1977; folder 3/7/77; Box 11; POF; JECL. For the structure of

connection between inflation and unemployment because previous administrations' attempts to combat inflation produced unemployment and they did not want to associate their efforts with this negative effect. Also, Carter's team thought it could correct the problem without raising unemployment.⁴⁵⁵

London

Carter Abroad with the G7

In May, Carter went to London to participate in another economic summit, and to meet with his European allies for the first time as president.⁴⁵⁶ Two old issues came into the fore – reflation and intervention. Carter continued to push the belief that economic growth and payments adjustments to lift nations out of global recession. France's situation had improved as the account balance gained \$2 billion, but still held a deficit of \$4.5 billion. Projected figures for Germany's current account showed that it would fall from \$10 billion in 1974 to around \$2.5 billion in 1977, while imports had risen sharply. This showed that the Federal Republic's slow growth efforts were helping its neighbors. Still, the slow and steady approach was not enough for the Carter administration. Carter pressed Germany to implement policies for economic growth and accept an inevitable payments deficit. Again, the chancellor refused, but Schmidt was not alone in his reservations about the impact of the German economy on world recession.⁴⁵⁷ There is evidence that some members of U.S. Congress were not in favor of the administration's strategies either. In a review of relevant issues for the summit, the Joint Economic Committee (JEC) noted, "Even if we could convince them to reduce their current account balances, the impact on world economic recovery would be minor." And that "it is unrealistic to expect Japan and Germany to commit themselves to specific growth

the Carter economic team see Memorandum; W. Michael Blumenthal and Charles Schultze to President-elect Carter; Re: Organization of Economic Policy-Making; 6 January 1977; folder FG 1-4 1/20/77-12/31/79; Box FG 15; WHCF; JECL.

⁴⁵⁵ Memorandum; Richard N. Cooper to Stuart Eizenstat; Re: Anti-Inflation Message; 4 April 1977; folder 4/7/77 (1); Box 16; Staff Secretary: Handwriting Files; JECL. Memorandum; Stu[art] Eizenstat to President Carter; Re: Brief Statement on Anti-Inflation Program; 14 April 1977; folder 4/15/77 (2); Box 17; Staff Secretary: Handwriting Files; JECL.

⁴⁵⁶ See *The Economist*, 30 April 1977, 89-92 for a summary of all the issues.

⁴⁵⁷ See *The Economist*, 2 April 1977, 79-80 and 86.

targets.” Concerning intervention to maintain exchange rates, the U.S. was resolute in its opposition and this time, strongly backed by congressional opinion. It wanted the IMF to develop guidelines for intervention only to “curb disorderly conditions,” but stuck to its position that reducing trade and current account imbalances was the way to achieve healthy parities.⁴⁵⁸

Despite the reservations about getting the allies to commit to growth targets, the U.S. did obtain some assurances from the participants. The Germans committed themselves to five per cent, France owned up to three quarters, while the U.S. took 5.8 per cent. Having just downgraded its expectations for growth prior to the summit, commentators thought this undercut the American bargaining position with Germany, but conceded that the rate would be easier to achieve. Germany, however, would have to implement other programs to hit its 5 per cent target and all that was required of France, by summit standards, was to adhere to the Barre plan and hope for stabilization.⁴⁵⁹

The Federal Reserve Has Its Say

Arthur Burns, Always on the Outs, Remains There

In early summer, Carter started to worry about the effect of interest rates on his economic policies and began to court opinions about how to handle the Federal Reserve rumblings about decreasing the money supply by raising rates. Carter inquired of W. Michael Blumenthal, Secretary of the Treasury, how higher interest rates might affect inflationary trends. Blumenthal responded that “no single weapon” be it restricting or loosening money supply through interest rates or tax policies and budget concerns either “causes or cures inflations or recessions” but that they each have particular effects on the economy in a delayed or immediate fashion. He stated that tight money “except in unusual circumstances” could raise costs and prompts people to buy and invest less and

⁴⁵⁸ Memorandum; Points for the Summit Meeting of the Heads of State and Government 7/8 May 1977; 8 March 1977; folder Helmut Schmidt 2-4/77; Box 6; NSC Files:Presidential Correspondence:Helmut Schmidt; JECL. Memorandum; Summary of a Joint Economic Committee Report on Issues at the Summit; folder 5/5/77; Box 23; POF File; JECL.

⁴⁵⁹ *The Economist*, 14 May 1977, 104-105.

slows economic growth, which in turn leads to a break in inflation. Blumenthal also pointed out that fiscal policies such as raising taxes could also have an inflationary impact if the “added expense is passed along to the consumer,” but that this eventually slows down the economy and becomes anti-inflationary in the long run. Taking these and other factors into consideration, Blumenthal did not think that the administration should support Burns if the Fed chair chose to raise interest rates. He argued, “It rarely stops prices from going up and it creates an environment of confrontation which is self-defeating.” He preferred consultation and cooperation between the executive and the Fed.⁴⁶⁰

Chairman of the Federal Reserve, Arthur Burns, now entered his third administration and continued to be the odd man out in economic policy opinion. Carter had met with Burns earlier in the year to garner support for the anti-inflation and employment package because the advisors realized early that Burns could be a powerful opponent of the fiscal measures. Burns was against deficit spending and against stimulating the economy, and presented the president with some proposals to reduce inflation in March that included curbing government spending and various measures that focused on production costs and employment opportunities that included none of the measures announced in April.⁴⁶¹ Therefore, Burns’s opposition to many of the policies was a concern. In a speech delivered to the graduating class of Carnegie-Mellon University on 16 May 1977, Burns reminded his audience of the economic conditions of 1965 and the dangers of economic expansion with heavy spending. He cautioned, “We are again in a phase of economic expansion that could carry us to much fuller utilization of our resources in a year or two. As that condition is approached, the costly consequences of our earlier incaution need to be remembered.”⁴⁶²

⁴⁶⁰ Memorandum; W. Michael Blumenthal to President Carter; Re: Interest Rates; 15 June 1977; folder Executive FI 7 1/20/77-5/31/79; Box FI-27; WHCF:Executive FI; JECL.

⁴⁶¹ Letter and Memorandum; Arthur Burns to President Carter; Re: proposals to Reduce Inflation; 31 March 1977; folder 4/7/77 (1); Box 16; POF; JECL.

⁴⁶² Letter and speech; Arthur Burns to President Carter; 15 May 1977; folder FG 143 1/20/77-12/31/77; Box FG 188; WHCF:Subject:Executive; JECL.

In June, the dollar began to decline because of concerns about the deficit and the trade balance, as the mark appreciated by four per cent. Burns worried that the depreciation would accentuate inflation and noted that the money supply had grown consistently above the Fed's target rates since March. The Federal Open Market Committee (FOMC), the decision-making body for the Reserve system, raised rates almost two per centage points between April and October, and then let the rate of government securities rise in November.⁴⁶³ As the Fed tightened the money supply, the administration became increasingly anxious about stalling economic growth. Blumenthal and Solomon agreed that the Fed was damaging the administration's efforts, and constantly advised Carter to meet with Burns to turn the situation around, but to no avail.⁴⁶⁴

Harsh Adjectives of Monetary Diplomacy: Benign, Malign and Aggressive Neglect

German Reflation and Deficits Prompt the U.S. to Muse About Intervention

The dollar's slip on the markets the contributed to the tense relationship between Carter and the Fed also stressed U.S./European monetary relations. By August, the fluctuations affected the mark so much that the German press accused the U.S. of manipulating the rates and trying to "talk to dollar down" to make American goods cheaper on foreign markets. Blumenthal visited the Federal Republic in August and met

⁴⁶³ The Federal Funds Rate is the rate banks charge when they lend each other "temporarily idle reserves." When the Fed buys securities on the open market it increases the money supply and sellers deposit the earnings in banks and banks use them in their reserves. If the Fed sells securities bank reserves decrease. The Fed gauges the money supply by the rates that the securities are bought and sold, letting them rise to reduce the supply and fall to increase it. See Memorandum; Charles Schultze to President Carter; Re: Today's Press Reports on Monetary Policy; 1 November 1977; folder FI 1/20/77-12/31/78; Box FI-1; WHCF:Executive FI; JECL.

⁴⁶⁴ Memorandum; Charles Schultze to President Carter; Re: Meeting with Economic Advisers and Federal Reserve Board Chairman; 26 April 1977; folder 4/27/77; Box 20; POF; JECL. Memorandum; Charles Schultze to President Carter; Re: Fourth Monthly Meeting with Economic Advisers and Federal Reserve Board Chairman (Quadriad); 25 July 1977; folder 7/26/77; Box 40; POF; JECL. Memorandum; CEA to President Carter; Re: Background Material on Monetary Policy; 11 August 1977; folder 8/13/77 (1); Box 43; POF; JECL. Memorandum; Stu Eizenstat and Bob Ginsburg to President Carter; Re: Call to Chairman Burns Concerning Possibility that Federal Reserve Actions May Raise Interest Rates; 12 August 1977; folder FI17 1/20/77-5/31/79; Box FI-27; WHCF:FI; JECL. Memorandum; Charles Schultze to President Carter; Re: Federal Reserve Increase in the Discount Rate; 29 August 1977; and Memorandum; Charles Schultze to President Carter; Re: Today's Press Reports on Monetary Policy; 1 November 1977; folder FI 1/20/77-12/31/78; Box FI-1; WHCF:Executive FI; JECL.

with German finance minister Hans Apel to reaffirm the U.S. commitment to floating parities supported by “underlying economic and financial conditions” with intervention in cases of “disorderly” market conditions. According to Blumenthal, Apel supported the floating exchange system and “expressed regret” for the German press, although the Treasury believed the reports were fueled by the private murmurings of German officials.

More importantly though, Apel informed the Treasury secretary that the Federal Republic was unsatisfied with its current rate of economic growth and that it was instituting a new stimulus package.⁴⁶⁵ A month later, Schmidt announced tax reforms, expanded government spending, programs to reintegrate unemployed workers into the labor force, and an energy conservation plan. The U.S. welcomed these measures but was skeptical about the target of 4.5 per cent of real growth that the Federal Republic projected for 1978. Much of the new spending depended on state and local cooperation, and the federal government increase only amounted to one per cent over the previous year. To add to difficulties, the legislature had to pass the tax measures and the CDU had been pressing for tax breaks twice the amount presented by Schmidt’s government.⁴⁶⁶ Still, these efforts were following the direction that the U.S. had been advocating and it helped its relations with Germany.

Even as the U.S. was pleased with Germany’s new commitment to growth, there was another crisis of confidence brewing for the dollar that started to seriously concern the Carter administration in the summer and fall of 1977. The U.S. trade deficit and current account deficits were growing, and this fact had caught the attention of the markets, the media, and the U.S. Congress. In testimonies before Congress, both Treasury Undersecretary Robert Solomon and Fed board member Henry C. Wallich,

⁴⁶⁵ Memorandum; W. Michael Blumenthal to President Carter; Re: Results of My Paris Trip (August 5-7); folder FO 8 1/20/77-1/20/81; Box FO-46; WHCF:Subject:Confidential Files; JECL. In addition to talks on the bilateral monetary front, the U.S. came to an agreement on the “Witteveen Facility,” which was an addition to the IMF’s funding facilities.

⁴⁶⁶ Memorandum; German Program for Stimulating the Economy; and Decisions of the Federal Government to Promote Economic Growth and Employment; 14 September 1977; folder Helmut Schmidt 5-12/77; Box 6; NSC Files:Presidential Correspondence:Helmut Schmidt; JECL.

marked the noted increase on imported oil as a prime reason for the deepening trade deficit. The deficit was partly to blame because of economies of scale. The oil producers could not absorb imports equal in worth to the amount of oil that they exported to the U.S. and Europe. The American dependence on imported oil had risen 80 per cent between in 1972 and 1977 – from 5 million to 9 million barrels a day. Exacerbating the problem was the fact that domestic production of crude oil had decreased by 1.5 million barrels a day, while demand skyrocketed. Solomon estimated that “40 per cent of the increase in our oil imports can thus be attributed to our reduced production, and about 60 per cent to increased oil demand.” Wallich and Solomon agreed that oil imports needed to be curtailed, and the Fed member added, “the greatest contribution that could be made toward better world payments balance would be a decline in the OPEC surplus.” Conversely, trade with non-OPEC members had improved from the lows of the world recession, but economies had not recovered sufficiently to accept more American goods and correct imbalances.

The second and most influential portion of Solomon’s testimony to international monetary relations was “the extent the trade deficit results from rigidities in the exchange rate system.” In effect, Congress was inquiring whether floating required intervention and if intervention by other nations to maintain certain parities was negatively affecting the U.S. trade balance. Solomon explained that since OPEC marked its prices in terms of dollars, the price oil would not increase or decrease if the U.S. decided to revalue or devalue the dollar. Also, he made it clear that depreciation of the dollar’s parity might be the answer if the problem with the trade deficit was from a lack of competitiveness of U.S. goods, but it was due to higher prices of oil that effected all nations, and stagnant growth of world economies. Because of this, Solomon advised more expansion of the U.S. and foreign economies to boost trade and impose measures to deal with the oil problem, and still intervention was only an option to “counter disorderly market conditions.”⁴⁶⁷

⁴⁶⁷ Speech; Subcommittee on International Finance (Exchange Stabilization Fund); 7 October 1977; folder Subcommittee on International Finance (Exchange Stabilization Fund); Box 9; Solomon Papers:Speech

Within the administration, opinions differed as to the impact of the trade and current account balances on the dollar's parity.⁴⁶⁸ The fact of the matter was that the trade deficit was worsening and the dollar was falling. Treasury figures showed that the trade deficit was growing -- \$9 billion in 1976, \$30 billion in 1977 and a projected \$33-36 billion for 1978. The current account deficit was equally discouraging at \$1 billion in 1976, \$18 billion in 1977, and estimates at \$21-24 billion for 1978. Reflecting this was a dollar depreciation of 9 per cent against the mark in the last three months of 1977. Now, the problem was to determine how to stop it or even if U.S. policy should attempt to halt the slide in parities – i.e. was this temporary or a sign of something serious?⁴⁶⁹

Blumenthal believed that the president had to demonstrate a visible resolve in support of the dollar to convince businesses, investors and foreign governments that the U.S. was committed to a strong dollar and combat its “malign neglect” image. In opposition, CEA chair George Schultze and Secretary of State Cyrus Vance, believed that the deficits did not mean that the U.S. economy was weak and pointed to Solomon and Wallich's testimonies about the health of competitiveness of U.S. markets. They also held that the American economy had recovered quicker than other nations and that it could reasonably bear a larger deficit because of this. However, where both sides could not agree on the impact of deficits on the strength of the dollar, they did agree that a comprehensive national energy strategy was needed to combat the effects of high priced imported oil on the economy.⁴⁷⁰

Files; JECL. Speech; Statement by Henry C. Wallich Before the Subcommittee on Trade of the Committee on Ways and Means of the U.S. House of Representatives; 3 November 1977; folder OA#329; WHCF:Subject:Confidential Files:Balance of Payments; JECL.

⁴⁶⁸ Officials also differed publicly on other issues, such as how to get the Germans to reflate and tax rebates. See *The Economist*, 6 August 1977, 22-23.

⁴⁶⁹ Figures provided by Memorandum; Stuart Eizenstat to President Carter; Re: Decision Memorandum on Balance of Payments Options (At your request); 19 December 1977; folder FO4-2 1/20/77-1/20/81; Box FO-33; WHCF:Subject:Confidential Files:Balance of Payments; JECL.

⁴⁷⁰ Memorandum; Charles Schultze to President Carter; Re: Secretary Blumenthal's Memo on the U.S. Balance of Payments and Proposed Measures to Reduce It; 15 November 1977; folder OA#329; WHCF:Subject:Confidential Files:Balance of Payments; JECL. Memorandum; Stuart Eizenstat to President Carter; Re: Decision Memorandum on Balance of Payments Options (At your request); 19 December 1977; folder FO4-2 1/20/77-1/20/81; Box FO-33; WHCF:Subject:Confidential Files:Balance of Payments; JECL.

Carter chose Blumenthal's visible approach and made a statement on 21 December about the deficits and attributing them to oil imports and "slow economic growth in Japan and Germany and other countries." He admitted that the deficits were partly to blame for some of the erratic behavior in the exchange markets and informed that "in the discharge of our responsibilities" the U.S. would consult with its allies and begin to intervene in the markets. The statement prompted some frank correspondence between the Schmidt and Carter on the nature of world economic and monetary difficulties. Schmidt telegraphed Carter the day after his announcement and congratulated the president on his actions, but warned that the recent disturbances in exchange signaled the beginning of a "crisis of considerable dimensions." The chancellor made it clear that Europe had borne much of the responsibility for supporting the U.S. current account deficit was financed not by private capital, but by European central banks, which had bought over \$30 billion in 1977 and then reintroduced them to the U.S.. Schmidt also expressed concern about the overvaluation of some currencies, including the mark, "as a consequence of dollar undervaluation," which threatened to sabotage their joint growth efforts and the future of European integration. Carter's response was less detailed, thanking both Schmidt and finance minister Apel for their supportive comment, congratulated Germany on adopting more expansive monetary and fiscal policies, and once again made the connection of U.S./German recovery clear:

If the United States can adopt a strong energy program, if Japan can achieve its announced growth targets, and if the Federal Republic can fulfill its growth potential, I am confident that the U.S. current account deficit will decline and that disorder in the foreign exchange markets will subside.

Carter continued to push Germany even more saying, "If it appears that these measures will not have the desired result, in terms of domestic growth or international balance, I

trust that you will be prepared to consider whether further stimulus measures by the Federal Republic would be helpful.”⁴⁷¹

Intervention Through Partnership

The Bundesbank and Treasury Swaps

The Federal Republic was indeed accommodating and in more ways than its economic planning. On January 5 1978, the Bundesbank revealed an understanding with the U.S. where the bank would extend a credit line to the Treasury’s Exchange Stabilization Fund, which was really a part of the swap network already in place, where these funds could be drawn upon for intervention in the dollar market. The new credit line was an addition to the facilities already in place between the bank and the Treasury, and really institutionalized the practices that Schmidt had referred to in his letter to Carter. Officials expanded the credit line on 13 March, making \$4 billion available in swaps between the Bundesbank and the Federal Reserve. Through these arrangements, the Federal Reserve Bank of New York became a more active participant in exchange markets and in the first quarter ending 31 January 1978, it sold foreign currencies in the equivalent of \$1.5 billion, a significant amount over the previous record of \$793 million in April 1975. However, as Brian Tew reveals, the official intervention was a joint U.S./German act and its significance is better assessed looking at interventions on the dollar through both nations. By the end of March, the interventions amounted to around \$8 billion, which was a definite policy reversal from the official public mantra of “light intervention” uttered by many a U.S. official, but welcomed by German authorities.⁴⁷²

Least Not Forget

A European Initiative From the Island

For European integration, much of 1977 was about inaction peppered with some practical operative decisions. The Duisenberg Plan had peaked some discussion and

⁴⁷¹ Telegram; 22 December 1977; and Letter; President Carter to Helmut Schmidt; n/d (late December 1977); folder 5-12/77; Box 6; NSC Presidential Correspondence: Helmut Schmidt; JECL. See *The Economist*, 17 December 1977, 11, 35-36.

⁴⁷² Tew, *The Evolution of the International Monetary System*, 218-220. Transcript; Interview by Dr. Otmar Emminger, President, Deutsche Bundesbank, with Reuters on Wednesday, January 25, 1978; folder Otmar Emminger; Box K9; Burns Papers; GRFL. *The Economist*, 7 January 1978, p 11-12,

then quietly faded to the background. The Belgians took the presidency of the Commission in 1977 and proposed doubling the short and medium term quotas of the financial support system in the EC, which the Community accepted and activated in December. The measures were a necessary measure to insure that the EC funds could function if many currencies simultaneously needed intervention and they did not interfere with monetary restraints already in place.⁴⁷³

The United Kingdom was next in line for the Commission presidency and quite unexpectedly in a time when integration was out of sight if not out of mind for the EC, emerged as a sign of greater things ahead. Roy Jenkins, a career parliamentary politician, senior cabinet officer and recently defeated in his bid for prime minister, assumed the presidency after being highly recommended by both Giscard and Schmidt.⁴⁷⁴ Jenkins was highly ambitious and at the beginning of his term, and the members treated him with harsh criticism or indifference, and rejected many of his initial ideas.⁴⁷⁵ Despite the setbacks, he went forward to deliver two of the most influential speeches in Community history. At the Jean Monnet lecture at Florence in October and in another speech in Bonn in December 1977, he called for reconsideration of a European monetary union, and presented much of what amounted to a challenge to the members – “Do we intend to create a European union or do we not?” Jenkins’s speeches included “economist” arguments – economic convergence before unification, and “monetarist” reasoning – about the ultimate goal of integration. As Peter Ludlow assessed, “His case was that the political will to sustain these detailed policies could not be generated unless they were seen within the context of a coherent conception of what

⁴⁷³ Kruse, *Monetary Integration in Western Europe*, 240.

⁴⁷⁴ *The Economist*, 16 July 1977. See also *The Economist*, 3 July 1976, 75-58, 17 July 1976, 58, for French views against Jenkins. They feared that he would welcome pro-institutionalists into the Commission, which might touch upon national sovereignty issues in the EC.

⁴⁷⁵ See Peter Ludlow, *The Making of the European Monetary System: A Case Study of the Politics of the European Community*. (London, 1982), 37-43; and Lieberman, *The Long Road to a European Monetary Union*, 95. Jenkins supported the EC and British membership and participation in it. The story of the development of his ideas on monetary union, which I will not go into detail here, are explained in Ludlow, 43-55.

the Community existed for in the long term.”⁴⁷⁶ Jenkins alluded what the “long term” might look like and tried to bridge the federalist/confederation differences that encumbered French and German opinion saying that the EC could foster a model of its own and leave national functions in tact where they would contribute best to Community efforts and create federalized structures where they would not.

The press was very critical of Jenkins’s renewed call to integration, but the Commission president considered the economic and monetary turbulence of the times an optimum opportunity for France, and especially Germany, to act. He courted the German sense of economic pride in what the Federal Republic had accomplished with the *Wirtschaftswunder*, but most importantly pointed to its experiences with federated government and independent institutions like the Bundesbank. Attached to this flattery, was the knowledge that Schmidt had been frustrated with dollar movements and Washington’s insistence that Germany keep growing its economy. Jenkins, who knew that Giscard had always supported EMU, had also asked the chancellor to put the issue on their bilateral meeting agenda in February,⁴⁷⁷ hoped that these factors would induce Schmidt to take to the idea of rekindling discussion. Jenkins was not disappointed, as Schmidt joined other members in supporting further study of the possibilities at the European Council meeting in Brussels in December 1977 in preparation for the EC Copenhagen meeting in April 1978.⁴⁷⁸ At first glance, Giscard and Schmidt’s support for Jenkins’s initiatives would seem no different from previous efforts to restart integration, but this time results were on the horizon. So it is one of those ironies of history, that the British tenure of the Commission presidency, rather than France or Germany, would mark the actual beginning of the European Monetary System.

However, where Jenkins could claim some of the credit for nudging the EC in a progressive direction, the timing of his efforts was well placed. The U.S. deficits and

⁴⁷⁶ Ludlow, *The Making of the European Monetary System*, 48.

⁴⁷⁷ *The Economist*, 9 October 1976, 71-72 [Giscard upgraded many officials who had worked as Europeanists during the de Gaulle era]; and 12 February 1977, 59.

⁴⁷⁸ Ludlow, *The Making of the European Monetary System*, 55-61, delves into the diplomacy that Jenkins conducted with Schmidt and Giscard and derives much of his analysis from new sources.

parity fluctuations had created the first monetary crisis that involved the dollar, since floating in 1973, and it was having grave effects on European currencies. The mark was appreciating rapidly against the dollar, but the greater problem was that the other currencies within and without the snake were not. The parity movements in Europe continued to be uneven, with the mark appreciating against nearly all of them, and that was a greater threat to the stability of national economies and any future for European integration. Washington insisted that this was "What floating was all about". Yet, no one was certain when this floating would end, which made the chancellor and the German populace, nervous. To calm the markets and at least provide a basis for some economic integration, Schmidt and Giscard were left with a small number of options, and few of them satisfactory. Europe could try to push for fixed rates, something that was impossible to do since the U.S. had secured amendments that gave it the right to keep on floating even if other members chose not to. Fixed rates within the EC were not an option either because of the differences in European economies that was causing much of the difficulties in the first place. Schmidt could succumb to international pressures and continue to reflate, but at the expense of his own popularity at home. The remaining option was to construct a system of monetary management for Europeans by Europeans, and detach its currencies from the dollar to the mark. Considering these selections, Jenkins's design held much appeal.

Although Jenkins initiated discussion, he resigned himself to the background after December 1977, and left the rate of progress to Giscard and Schmidt. Although no one has been able to pinpoint exactly when the leaders decided to embark on another plan for EMU, it is certain that they had to wait for domestic political encumbrances to subside. Giscard was expected to lose significantly in the French Assembly elections in March 1978, and as Barre's economic reforms had failed to bring the turn around in the French economy, the Socialists won more and more of the local and federal governments with each election.⁴⁷⁹ Compounded with concerns over the left was Giscard's

⁴⁷⁹ Memorandum; Robert Hunter to Zbigniew Brzezinski; Re: Henry S. Bloch's Impressions of Pre-election France; 17 August 1977; folder CO51 9/1/77-12/31/77; Box CO-25; WHCF:Executive:CO.

preoccupation with the Gaullist right, which was courting an independent voice with Jacques Chirac and turning away from the centrist government. Schmidt's SPD took a beating at the polls in 1977, and the German press frequently questioned chancellor's leadership. However, by the time of his annual meeting with Giscard in February 1978, Schmidt's image had turned around because of some high profile decisions – namely, according to Ludlow, the successful resolution of a hijacking incident against a Lufthansa jet in Mogadishu, Somalia in October 1977.⁴⁸⁰ There was an economic and monetary necessity of European monetary integration, but the political atmosphere, was for a time, precarious. That EMU made the agenda for the February bi-annual summit was not surprising in the height of the run on the dollar, but public announcements of support from Giscard had to wait, and fortunately, the French electorate was kind. Giscard maintained his position winning a majority of seats, and a reconfirmation of Barre as prime minister, which allowed him to enjoy a margin of support that enabled he and Schmidt to conduct the kind of European agenda they wanted.

Copenhagen

Schmidt and Giscard Press on With Some Unilateralism of Their Own

The leaders discussed the possibilities of EMU during their February meeting and then after Giscard's March victory, accelerated the process. They set to make a proposal to the rest of the EC membership at the April Community summit on 7-8 April, and hardly consulted their partners or indeed their domestic constituents on the endeavor. Schmidt circumvented the scrutinization of the Bundesbank because he expected, and likely would have received, staunch resistance to his plans.⁴⁸¹ Therefore, the planning was left to Giscard and Schmidt, two capable former finance ministers, with some input from British Prime Minister Callahan, and Commission president Jenkins.

JECL. Memorandum; Christine Dodson to Jane Fenderson; Re: Visit of Prime Minister Barre: Notes for Mrs. Carter; 9 September 1977; folder CO 48 9/1/77-12/31/77; Box CO-25; WHCF:Subject: Executive:CO; JECL. *The Economist*, 25 February 1978, 37-40..

⁴⁸⁰ See the discussion of political factors in Ludlow, *The Making of the European Monetary System*, 77-79.

⁴⁸¹ Thomas H. Oatley, *Monetary Politics: Exchange Rate Cooperation in the European Union*. (Ann Arbor, MI., 1997), 57.

In a carefully orchestrated pre-summit dinner and then at the meeting itself, Giscard and Schmidt unfolded their ideas to the members.⁴⁸² Giscard introduced the subject, mentioning that France was interested in either rejoining the snake or something “different and more ambitious.” Schmidt interjected with some guidelines for action, coupled with the caveat that these were personal opinions and had not been cleared with his cabinet or central bankers. The “new Bretton Woods for Europe” would include the creation of a European Monetary Fund (EMF) that would operate the snake’s swap arrangements and capital functions of Community institutions, a collection of resources from each member amounting to 15 or 20 per cent of their reserves, intervention with EC currencies instead of dollars, and more use of the European Unit of Account⁴⁸³ to settle bank transactions.⁴⁸⁴ Some members had reservations about the scheme, and wondered where the dollar and the IMF fit. Schmidt and Giscard assured them that the Fund would continue to serve its current functions of aid to the developing world and surveillance over the currencies of its membership. Concerning the dollar, the leaders pointed to the recent disturbances in the markets and emphasized that the plan was not directed against the dollar but to strengthen Europe’s abilities to cope with fluctuations and exercise more control over them.

The Community Study

Debates and Discussions That Begat the Institutional Process

In the weeks that followed the Copenhagen meeting, the EC prepared reports for the next summit at Bremen, Germany in July. The monetary committee of the Community, with central bankers and ECOFIN,⁴⁸⁵ considered several proposals but

⁴⁸² *The Economist*, 15 April 1978, 57-58, attributed the initiative to Schmidt calling him the savior of EMU, and attributed the dinner to Schmidt’s dislike of large groups during summit gatherings.

⁴⁸³ The EUA was the official unit of account for the European Payments Union (EPU) from 1961 to 1972, and from 1973 to 1979 of the European Community. It originally had the same gold parity as the U.S. dollar, and after the demonetization of gold, was defined by an EC currency basket.

⁴⁸⁴ Ludlow, *The Making of the European Monetary System*, 92.

⁴⁸⁵ The construction of the EC’s monetary and economic bodies were as follows: ECOFIN – nine economic and finance ministers and members of the European Commission, that met at least once a month; The Committee of Central Bank Governors, the Monetary Committee and the Economic Policy Committee were the three most important committees that reported directly to ECOFIN. The Bank Governors met at the Bank for International Settlements in Basel, and elected a chair whenever it chose to

there was at times according to Ludlow, an overwhelming feeling that this was a waste of time and that the disparities of the European economies forbade such hopes of integration at this time.⁴⁸⁶ Nevertheless, they debated the various methods to exchange rate management, and produced some decisions. By May, they produced some rough guidelines for monetary integration, all of which included the continuation of the snake in some form. The first plan extended the snake to take in all EC members by altering exchange rates in small increments or through the voluntary defense of market rates among nations within the mechanism. The second option encouraged member to intervene using trade-weighted basket of currencies that would include the dollar or simply with the EUA. This would not destroy the snake but the formulation of a basket currency would help to create a separate European system. The last alternative was a repeat of the Duisenberg Plan, where nations were grouped in target zones and its partners would intervene to keep each other in that zone should the need arise.⁴⁸⁷ Either plan would mean that governments would have to take a strong domestic economic position to correct payments imbalances. Deficit countries would have to stabilize their prices and surplus nations would have to extend credits to their partners and pursue rigorous growth plans.

In the end, the groups allowed the Monetary Committee to summarize their conclusions for presentation to the European Council. The report included seven basic principles for the construction of any new European system.

1. Include all European currencies
2. Balanced obligations for strong and weak members
3. Not interfere with the functioning of currencies outside the mechanism
4. Inclusion of the snake
5. Joining the regime would place all members at obligation to intervene when necessary and conduct adequate domestic economic policies to the health of the system

do so. The Monetary Committee had senior representative from the finance ministries and deputy governors of the central banks as well as two members of the Commission. Chairmen were elected for periods of two years or more. The Economic Policy Committee changed according to whatever issue needed to be discussed.

⁴⁸⁶ Ludlow, *The Making of the European Monetary System*, 96-98.

⁴⁸⁷ *Ibid*, 99-102.

6. Bring economies closer but without rigidity that would except exchange rate realignments
7. Changes in finance support arrangements⁴⁸⁸

Membership Has Its Privileges

The “Spirit” of Community in a Franco-German Package

While the monetary committee of the Community conducted its own studies, Schmidt and Giscard chose a few advisors to consider the monetary questions, and led this group entirely in secret. In doing this, the leaders allowed the EC serve its functions, but negotiated the usual French/German disagreements in private. While Community members would rightly argue in Bremen that they were completely left out of the process, it was also true that in all the past EC agreements nothing happened unless France and Germany blessed it, and the negotiations that broke any impasse often happened bilaterally anyway. However, the EC was not the only group left out of the planning process, the leaders kept their bank governors and finance ministers in the dark too for fear that they would kill the initiative. Evidence of this would become more prominent, especially with the independent Bundesbank, during the domestic ratification battles in the months after the Community accepted the proposals.⁴⁸⁹

The group notified the rest of the Community of its work shortly before meeting in Bremen. The outline by the secluded group was more interested in form than function and left the details to be debated by the EC and its experts with of course, the close guidance of France and Germany. Its terms encompassed six principles, all of them quite ambitious in light of past difficulties.

⁴⁸⁸ Adapted from Ibid, 103-104.

⁴⁸⁹ The EC was oblivious to the second group, and few persons knew of its existence until *The Economist* mentioned it in a May article. There was a very tight inner circle of officials in Germany and France who were aware of the political and economic steps being taken to create the EMS. Those who knew of the plans were under strict orders that no one in the respective parties or public be notified until release of the decisions after the Bremen summit. See Ludlow, *The Making of the European Monetary System*, 94-97; and *The Economist*, 15 July 1978. Desmond Dinan, *Ever Closer Union*, 104-108, credits the President of the Commission from Great Britain Roy Jenkins with initialising interest in a new monetary system. He encouraged Chancellor Schmidt to pursue the idea and soon Schmidt replaced Jenkins as the prime advocate for the EMS. See Roy Jenkins *European Diary, 1977-1981*. (London, 1989).

1. The European Monetary System (EMS) would welcome members who were not in the snake to join with wider margins pegged around central rates. Intervention would be in the currencies of the member countries and any change in the central rate depended on the approval of the membership. The European Currency Unit (ECU) would serve to settle accounts among nations. Countries without EC membership, but with strong economic ties, could become affiliates.
2. Each nation would hold a supply of ECUs against a deposit of dollars and gold and an amount of member currencies.
3. There will be a coordination of exchange rate policies between EMS and non-EMS nations, through central bank and finance ministry consultations. Concerning dollar intervention, central banks buying dollars will deposit a certain percentage and receive ECUs, and likewise receive a percentage of ECUs against selling dollars.
4. After two years all arrangements and institutions, i.e. The European Monetary Cooperation Fund,⁴⁹⁰ will combine to create the European Monetary Fund.
5. Deficit and surplus countries must institute policies for more stability.
6. That the proper EC groups study these provisions and make suggestions to their function by 31 October 1978.

In brief, the new program would let national currencies fluctuate within a narrow band, with central banks given authority to intervene to keep creation of a European unit that worked much like the SDR, and would give the EC some freedom of action in managing its parities. Now Giscard and Schmidt looked forward to creating a concrete and functioning shape to their vision and sent their envoys to the Community members to explain the plan's points.

Bremen

Giscard and Schmidt Get Their Rubber Stamp

The French president and German chancellor arrived in Bremen with two tasks before them. First, they had to obtain support for their idea of the EMS; and second they wanted to lay the foundations for function to its skeletal form.⁴⁹¹ The disparities between the members' economies would not make either of these missions easy, and

⁴⁹⁰ The EMCF required EC members to pool 20 per cent of their gold and used this as collateral for intervention issues.

⁴⁹¹ *The Economist*, 15 July 1978, 10-11

despite the harmony with which France and Germany had worked; there were still some differences between them. The countries within the snake were happy to see that both proposals called for its continued existence in some form, and this was supported by the Federal Republic. Giscard had interjected some French history into the plan with the use of the moniker ECU for the European unit, since it was the name of a coin used in the days of Louie IV's France. He also hoped that it would be used as a currency and a unit of account, but there were no specific tactics for this at the time of Bremen. Weaker currency nations like Italy were worried about the 1 per cent width of the proposed bands, and demanded a wider margin. There were also debates about the role and function of the EMF, something that both Giscard and Schmidt believed was the center of the new system that would provide assistance to weaker economy countries.

However, part of the role of the Bremen summit was to obtain a European consensus for the Franco-German proposal. The release of the report provoked anger from some members because of the secrecy in which the leaders produced it threatened to derail their efforts. A good deal of the conversation at the meeting centered on the complaints of those who had been left out of the loop. The British, represented by Prime Minister Callaghan, had been a part of the small group, but alienated from the discussions as it became clear that the UK was not in the same mindset as the Franco-German camp. He was especially bitter about the provisions and lobbied several EC members to put a hold on the document and allow further study on the matter. By the end of the meeting, the others quashed his efforts. Giscard and Schmidt had won over their European partners to what *The Economist* would dub the "supersnake," and all agreed that the text should be included in its entirety within the communiqué of the summit. With its inclusion, the initial diplomatic obstacles were overcome and the leaders could count the Bremen summit a success for Europe and for French and German relations.⁴⁹²

⁴⁹² A good account is in *The Economist*, 15 July 1978, 49-51.

Bonn

American Opinion In A European Matter

The Carter administration was cautious through much of the theatrics of the European debates, choosing to see where, or even if, the EC was going forward with its plans for EMU. So, throughout the first months of 1978, officials concentrated on fixing the trade and payments deficits hoping to calm the markets. When the president went to Paris and Brussels in January 1978, he focused on multilateral trade negotiations (MTN) with the EC, and as always urged the Federal Republic to keep its economy growing.⁴⁹³ The U.S. continued to stress the importance of anti-inflation measures and focused on these issues when Carter went to the international economic summit at Bonn in July.⁴⁹⁴ This did not mean, however, that the U.S. totally ignored the EC's initial monetary endeavors. In the months preceding the summit, the U.S. was guardedly observing the Community's EMU plans, and had made some subtle remarks to put the American opinion into the fold. Carter's team generally took the same position that previous

⁴⁹³ Memorandum; Ambassador Robert S. Strauss to President Carter; Re: Briefing Paper on Trade Issues for Your Visit to Paris and Brussels in January 1978; 19 December 1977; folder Stop Papers, Brussels 1/6/78; Box 6; NSC Trip Files; JECL. Memorandum; Robert Hunter to Christine Dodson; Re: List of Topics for Visit Bilaterals; 6 December 1977; and Briefing Book; Trip Outcome: Paris and Brussel; n/d; folder Europe, Asia 12/29/77; Box 6; NSC Trip Files; JECL. On trade and the dollar see Memorandum; John Renner to Zbigniew Brzezinski; Re: Briefing on International Economic Policy for your CFR Speech; 21 February 1978; folder FG6-1-1 Zbigniew Brzezinski. 1/20/77-1/20/81; Box FG-25; WHCF:Confidential Files:FG; JECL. Carter sent Treasury Secretary Blumenthal to Germany in February and received assurances from Schmidt and other German officials that the Federal Republic was doing all it could to stimulate growth without inflation, and was constantly reviewing the situation to see if additional measures were warranted. See Memorandum; Henry Owen to Vice President Mondale; Re: Your Meeting with Count Lambsdorff; 2 February 1978; folder CO54-2 11/1/77-1/20/81; Box CO-26; WHCF:Confidential Files:CO; JECL. Letter; President Carter to Helmut Schmidt; 9 February 1978; folder Helmut Schmidt 1-12/78; Box 6; NSC Presidential Correspondence:Helmut Schmidt; JECL. However, there was one member of the NSC staff who felt that the reflation issues with the Germans were having negative effects on relations and urged NSC Chair Brzezinski to comment that they "stop urging the Germans to be an economic locomotive. Regardless of the merits of our case, Germans of all political and economic persuasion are untied in opposing this role. They disagree with our economics (however sound), resent our pressure (however gently applied), and cannot resist the political credit from standing up to us." Memorandum; John Renner to Zbigniew Brzezinski; Re: International Economic Policy; 27 February 1978; folder BE 1/20/77-1/20/81; Box BE-1; WHCF:Confidential Files:BE; JECL.

⁴⁹⁴ For U.S. economic strategies at Bonn see Briefing Book; Economic Summit – Bonn; folder FO 6-5 1/20/77-1/20/81; Box FO-44; WHCF:Subject:General; JECL. Newsletter; *U.S. Treasury News*. Remarks by W. Michael Blumenthal; 30 June 1978; Box FO-44; WHCF:Subject:General; JECL. Paper; Summit Briefing Paper: Economic Policy; 3 July 1978; folder Summit Briefing Papers; Box 6; NSC Trip Files; JECL.

administrations had followed, that European integration needed to be led by European initiative, not at the urging or direct intervention of the U.S.. The U.S. hoped for integration because it wished to have the Europeans share in some of the burdens of the Cold War arena. The U.S.'s main concern about the EC was in trade negotiations, since officials had confidence in the ability of the U.S. economy to dwarf most other nations on the globe, keeping the flow of goods and services was paramount to keeping the dollar strong. Temporary weaknesses in the dollar's strength did not diminish the capacity of the U.S. economy, or challenge its supremacy in international monetary affairs, so American officials were not worried about a new European currency usurping the dollar's role.

Until Bremen, there was no official notification of the monetary preparations apart from the general guidelines announced from Copenhagen, but there is little doubt that the U.S. was oblivious to Schmidt and Giscard's plans. *The Economist* reported that the U.S. had "discreetly informed the Nine's governments that it strongly supports Mr. Helmut Schmidt's plan for a new EEC currency zone."⁴⁹⁵ In a speech in May, Robert Solomon cautioned against "exchange rate zones" and warned "exchange rate stability cannot be imposed on the system but must be the result of sound domestic economic policies."⁴⁹⁶ Solomon's position stuck with the U.S. position that properly managing domestic economies properly managed floating rates. If nations did this, there was no need for additional exchange systems. At the Bonn summit, Carter continued to follow this line of thinking and got assurances from Schmidt about reflation of the German economy. Authors have suggested that the chancellor agreed to this because he wanted to ease U.S. fears about the EMS and secure American support. When Callaghan visited Carter in late March, the president wrote to Schmidt and gave no indications that he and the Commission president had discussed the EMS. The letter mentioned inflation and international trade instead. Documents show that Schmidt notified Carter of his

⁴⁹⁵ *The Economist*, 27 May 1978, 55-56.

⁴⁹⁶ Speech; Managing Foreign Exchange Risk; 15 May 1978; folder Remarks Before the International Herald Tribune/Forex Research Ltd. Conference; Box 12; Solomon Papers:Speech Files; JECL.

intentions to implement new stimulus measures as early as April 1978. Two weeks after Jenkins visited the U.S. in March, the chancellor met with Henry Owen of the NSC and told him that the Federal Republic was considering a stimulus package if it did not reach its growth target in 1978. As this was an unpopular decision in the Federal Republic, Schmidt could not commit to this publicly, but Owen admitted that he was unclear about the timing. Various German officials believed that the FRG should announce a tax cut before or during the summit, while Schmidt himself seemed to favor waiting until after Bonn. Whether some of the motivation for German reflation could be attributed to obtaining U.S. support for the EMS is unclear, but U.S. briefings did suggest that Schmidt was willing to give such concessions for compromises in economic policies at Bonn from several nations, not just the Americans.⁴⁹⁷

Even after the chancellor informed Carter of the decisions made in Bremen, U.S. officials still felt the need to proceed with caution on the EMS front, mainly because they were still unsure of how it would affect the dollar. Political considerations, like better relations with the EC, had to be weighed against the tactical realities of monetary policy. Treasury was privately worried that EMS might signal a weakness in the dollar and trigger harsh market reactions. Whatever its form, EMU had to take “full account of any possible difficulties posed for the United States and the international monetary system” and not prevent “the dollar exchange rate from responding to underlying economic and financial factors.”⁴⁹⁸ As long as the scheme did not effect floating, with the U.S. belief that domestic policies controlled exchange, or necessitate changes in IMF rules, the EC could expect an amount of support from the U.S..

⁴⁹⁷ Letter; President Carter to Helmut Schmidt; 27 March 1978; Memorandum; Henry Owen to President Carter; Re: Chancellor Schmidt’s Messages to You About the Summit; 8 April 1978; Letter; President Carter to Helmut Schmidt; 11 April 1978; folder Helmut Schmidt 1-12/78; Box 6; NSC Presidential Correspondence: Helmut Schmidt; JECL. Ludlow, *The Making of the European Monetary System*, 120, claims that there was significant discussion among the Treasury, the State Department and various members of the EEC to calm U.S. fears.

⁴⁹⁸ Quoted from Memorandum; Henry Owen to President Carter; Re: Summit Briefing Material; 11 July 1978; Memorandum; W. Michael Blumenthal to President Carter; Re: Up-Date on European Monetary Arrangements; 15 July 1978; folder Summit II; Box 13; NSC Trip Files; JECL. Memorandum; Henry Owen to President Carter; Re: European Monetary Cooperation; 11 July 1978; folder Helmut Schmidt 1-12/78; Box 6; NSC Presidential Correspondence: Helmut Schmidt; JECL.

The U.S. pushed aside doubts about EMU by the time of the Bonn summit. Carter's goal was to regain the momentum lost from the London meeting when the participants failed to meet their growth targets. Schmidt and Giscard intended to use the summit to bring up international monetary issues with the Americans, and smooth any Atlantic difficulties that might arise from EMS. The dollar's drop in the markets put exchange rates on the agenda on equal footing (in the minds of the EC) with domestic anti-inflationary packages and trade deals so dear to U.S. strategies. Schmidt wanted "a general U.S. blessing for European monetary unification." The Americans were cautious at Bonn because there were several parts of the program, although in its infancy, that were potentially disadvantageous to the U.S.. Blumenthal noted that the Germans believed that EMS would appreciate European currencies vis-à-vis the dollar so there would not be a need for adjustments, and that France and Italy had secured a concession on the "partial re-monetization of gold" at high prices. The Treasury secretary also observed that the EC had not decided if it would use dollars "to meet their internal foreign exchange rate obligations to each other or that at least the net effect would be neutral when the dollar is under pressure." Until the U.S. was certain that the scheme would not adversely affect IMF rules or dollar floating, it supported integration in general, but reserved its full endorsements until the EC agreed to the details. The position was "neutral," the Treasury reasoned, to avoid being caught in the middle of European disagreements, and the U.S. set six criteria for its approval:

1. Intra-European intervention arrangements could not put pressures the dollar
2. No limitations to the floating dollar rates
3. The scheme could no be biased in favor of the EC in the international system
4. Arrangements could not discriminate against U.S. trade or capital flows
5. Gold could not function as a prominent part of the system
6. Arrangements could not subvert the role of the IMF as the "central monetary institution for the world economy"⁴⁹⁹

⁴⁹⁹ Quoted from Memorandum; Henry Owen to President Carter; Re: Summit Strategy; 3 July 1978; folder Germany 7/13-17/78 Economic Summit [1]; Box 13; NSC Trip Files; JECL. Memorandum; International Monetary Policy; n/d; folder Economic Summit; Box 6; NSC Trip Files; JECL. Memorandum; W. Michael Blumenthal to President Carter; Re: Up-Date on European Monetary Arrangements; 15 July

With these points in mind, Carter supported the idea of integration in Bonn, but did not endorse EMU. After the summit, Solomon testified before the Senate Committee on Foreign Relations and reiterated these concerns.⁵⁰⁰ Despite the cautious tone of American statements towards monetary unification, the U.S. could count the summit a success because it got what it wanted from the meeting.⁵⁰¹ Schmidt decided, after a three day meeting with his cabinet, to put proposals for massive growth measures before the legislature in August. Carter was most pleased with this action as the Germans demonstrated that they could participate in EMU and not abandon the domestic initiatives that the U.S. felt were so crucial to their beliefs in exchange rate management. In October, the U.S. announced its own anti-inflation measures that resulted from the discussions at Bonn.⁵⁰²

All in the Details

Domestic Complaints, and National Compromises

Now, after having notified the world of their intentions, the EC turned to work out the details of EMS.⁵⁰³ As the monetary authorities of the Community regrouped, studied and presented various proposals for the system, conflicting opinions emerged between the members and now that EMS was in public discussion, Schmidt and Giscard

1978; folder Germany 7/13-17/78 Economic Summit [1]; Box 13; NSC Trip Files; JECL. See also Briefing Book; Papers on German and French positions on summit issues, the macroeconomic policy sections; folder Economic Summit; Box 6; NSC Trip Files; JECL.

⁵⁰⁰ Speech; Statement Before the Subcommittee on Economic Policy, Committee on Foreign Relations; 24 July 1978; folder Statement Before the Subcommittee on Economic Policy, Committee on Foreign Relations; Box 12; Solomon Papers:Speech Files; JECL. Much of Solomon's speech was directly lifted from the text of the briefing books from the Bonn summit.

⁵⁰¹ *The Economist*, 22 July 1978, 73-74.

⁵⁰² Letter; President Carter to Helmut Schmidt; 2 August 1978; folder Helmut Schmidt 1-12-78; Box 6; NSC Presidential Correspondence:Helmut Schmidt; JECL. Memorandum; Christine Dodson to Richard Hutchenson; Re: German Stimulus Package; 8 August 1978; folder CO-54-2 7/1/78-12/31/78; Box CO-27; WHCF:Subject:Executive:CO; JECL. Memorandum; Henry Owen to President Carter; Re: German Reaction to Your Anti-Inflation Program; 26 October 1978; and Telegram; October 1978; folder Helmut Schmidt 1-12-78; Box 6; NSC Presidential Correspondence:Helmut Schmidt; JECL.

⁵⁰³ The following summarized information on the formation of the EMS can be found in more detail in Ludlow, *The Making of the European Monetary System*, Chapters 5 and 6; Daniel Gros and Niels Thygesen, *European Monetary Integration*. (New York, 1992), Chapter 2; Oatley, *Monetary Politics*, Chapter 3; Simonian, *The Privileged Partnership*, Chapter 10; and Ungerer, *A Concise History of European Monetary Integration*, Chapters 13 and 14.

had to deal with domestic criticisms and interests. The members agreed that whatever form the EMS took, it needed to retain the flexibility of the snake to allow for smooth and small parity changes, and economic coordination was tantamount to any operation of the new system. Thus, three issues emerged as the biggest controversies – the shape of the system itself, what role the ECU might assume, and the powers of the European Monetary Fund.

The Community quickly split into two camps on the structure of the system. The weaker currency nations, led by the French, advocated something completely different from the snake. Since the French had already left the snake mechanism several times, they proposed a basket system where the ECU determined the central rate at which all currencies fluctuated and put the responsibilities of intervention on the bank whose currency went above or below ± 2.25 per cent. Much like the procedure for the value of the SDR, a collection of Community monies would determine the value of the ECU, each composing a portion of the unit in terms of their weighted economic strengths. The French wanted to make the ECU the center of the system, but there were problems with the basket concept. It was biased in favor of the stronger currencies. If the stronger nations held more of the basket, it also had more control over the ECU's central rate, allowing it to fluctuate against the other currencies at a greater limit. Weaker currencies would have a smaller percentage of movement from the ECU as a result and have to intervene more often.

The members of the snake, led by Germany's powerful Bundesbank, rejected the basket system. Schmidt had been careful to omit the bank from the initial stages of planning for the EMS, but now the bank asserted itself in the process to protect its sovereignty over German monetary affairs and to assure that the Community adopted stringent rules for exchange rate management. Bank officials advocated a system much like the snake mechanism – a parity grid. A grid system assigned each currency with a fluctuation limit based on a central rate termed in ECUs. Each partner pair could move in relation to one currency's central rate in relation to another currency, and central banks would have to intervene if their currency moved beyond their assigned margins.

Because these currencies were tied to each other, a movement of one to the ceiling and the other to the bottom would require intervention by both banks. As an added bonus for the Federal Republic with the strongest currency, the scheme planted responsibility for a rise in the DM's value to all member nations, alleviating the strain on Bundesbank reserves.

The Bundesbank and German finance ministry disagreed with the generous use of reserves embodied in the proposals for EMF – indeed, they rejected the Fund completely – stating that there would be no transfer of reserves without the Banks' approval. They argued against the use of short and very-short term credits and believed that if the credit mechanisms used to support intervention in a grid system were limited, this would encourage governments to accept disciplined economic and monetary policies. A weak currency country that had limited foreign reserves to intervene in the markets would soon be forced to raise interest rates to shrink its money supply and defend its rates, while strong currency nations could amply intervene and lower rates to expand their supply. The commitment to price stability and intervention limitations were a large part of the German strategy. Federal Republic officials outright rejected the basket system because of its emphasis on mandatory interventions, easy credit, and the fear that most Community interventions would involve marks, would expand the money supply and push German inflation to the European norm, which was nearly double then the FRG's rate. Allied to this criticism was the Bank's responsibility to make certain that its autonomy, which was sanctified by German law, was kept intact, and that German reserves were safeguarded by the prudent actions of this sacred institution.

Because of the Bundesbank's strict criteria for the EMS, the negotiations remained in deadlock for much of the late summer. The Germans refused to accept the basket system or the ECU as the main indicator for parities, and rejected a Belgian proposal that offered a compromise between the plans. By the time Schmidt and Giscard met in Aachen on 14 September, the atmosphere surrounding the negotiations put

success in doubt. Fortunately, Giscard reversed the French position and accepted the grid system, thus saving the initiative.⁵⁰⁴

The Aachen concessions were essential not just because of the importance of the Franco-German blessing on European integration, but also because of Giscard's willingness to accede to what were mostly German domestic criticisms. Schmidt needed French support especially since the chancellor had been under intense pressure, as integration was unpopular at home. The population believed it drained German resources, since the Federal Republic paid the most to the EC budget and received the least in return. The CDU/CSU opposition had been an ally of the Bank and finance ministers during the EMS debates. Giscard did not escape the decision unscathed though. Gaullists accused him of giving in to German national interests. Giscard retaliated by stating that linking the franc to the EMS was necessary so that France would not continue to be a second power to Germany. He hoped that tying the franc to the DM would help control French inflation, and spur the economy. This position won support, surprisingly, from the Socialists. Francois Mitterrand of the Socialist Party stated that, "any well thought out monetary system capable of ensuring national independence, observing the interests of the Third World and of not confining to a few the absolute mastery of monetary channels, any effort towards a certain monetary order or stabilization or union seems to us desirable." The French Right eventually came around to this idea of Europe. The party made a statement supporting the EMS, but also

⁵⁰⁴ There were also problems with accepting this grid system. Critics have claimed that it holds a built in deflationary or anti-growth bias. The "asymmetrical" nature of the system dominated by the German monetary policy and its low inflation. Therefore, the Bundesbank is not obligated to worry about fixed exchange rates, it instead focuses on the dollar-mark relationship and pulls the other currencies along with it. The anti-growth and low inflationary measures are of concern to the French and would be more so in the Mitterrand era as growth was a economic policy focus due to the high unemployment and lack of technological advancement in the French economy. Michael J. Baun, *An Imperfect Union: The Maastricht Treaty and the New Politics of European Integration*. (Boulder, 1996): 20. For a more detailed report of how the EMS effected Germany's economy and the Bundesbank's praise of the system, see Deutsche Bundesbank, "Exchange Rate Movements Within the European Monetary System," *Monatsberichte* 41, 11 (November 1989), 28.

pointing out that the difficulties ahead were numerous, and could only be overcome with the solidarity of the French Republic.⁵⁰⁵

Dollar Dilemmas and the Last Slide of the Snake

Washington Remains Euro-Cautious and Defends the Dollar...Again

Schmidt and Giscard could be satisfied about their deal at the Aachen meeting, but the U.S. was still wary about the details of EMS when they met again in Washington for the annual IMF conference a week after. Officially, the American position had not changed from July, and the U.S. was still supportive of integration, but with more reservations now that some of the details had been discussed and publicized. High on the list of concerns was how European interventions would affect the dollar, whether they would artificially keep certain currencies like the mark from appreciating in accordance with the domestic economic realities. There was also the worry that excessive use of dollars in these interventions would put more pressure on dollar rates. As it was still unclear how much the dollar would be used in the EMS, the U.S. could not be sure if this was a danger.⁵⁰⁶ To insure that the EMS would not encroach on the IMF, the U.S. gently reminded the Europeans that while the Fund amendments had allowed nations to pick various exchange rate systems, they were still expected to submit to some surveillance from the IMF.

The Americans were also skittish about the impact of a new European monetary system on the dollar because the markets had started to act up again in the fall as the payments and trade deficits continued to grow, in part due to rising oil prices because of the cut in supply from the Iranian Revolution. Carter announced more anti-inflation measures – reductions in federal spending, price and wage standards – in late October in the hopes that this would regain market confidence.⁵⁰⁷ The dollar had steadily

⁵⁰⁵ Ludlow, *The Making of the European Monetary System*, 142.

⁵⁰⁶ *Ibid.*, 190-192.

⁵⁰⁷ Carter still had not fulfilled his promises from the Bonn summit to reduce oil imports. By December, the administration was considering raising U.S. crude oil prices to the world level and other measures. See Memorandum; Richard N. Cooper to Stu Eizenstat; Re: Recommendation for the President on U.S. Oil Pricing Policy; 15 December 1978; folder TA-4-11 1/20/77-2/28/79; Box TA-26; WHCF:Subject:Confidential; JECL.

depreciated 18 per cent against the DM by the end of October, despite the interventions of February and March, and the Treasury and Federal Reserve announced a major policy revision. From now on the U.S. would “intervene in a forceful and coordinated manner” in the markets. The Fed raised the discount rate by one per cent. Currency swaps with Germany, Japan and Switzerland were increased, and the Treasury scheduled gold sales to “at least 1-1/2 million ounces monthly beginning in December.”⁵⁰⁸ The U.S. drew upon its reserve tranche in the IMF and sold \$2 billion of its SDR allotment to foreign banks and issued up to \$10 billion of foreign currency denominated securities, known as Carter bonds. The administration defended these policies saying that they were part of the standing anti-inflation programs that the government had focused on throughout its tenure. And, while it is true that the participants of the Bonn summit endorsed these and Carter’s anti-inflation provisions were a part of what the administration called for in its strategy for the western nations, the Treasury and Federal Reserve moved to defend the dollar’s parity. In response to the economic and monetary packages, the dollar appreciated 15.5 per cent against the mark in November.⁵⁰⁹

The dollar’s decline in the middle of negotiations for EMS spurred some public debate on how this would affect the outcome of the consultations. Since the dollar’s decline forced a 2 per cent adjustment to the mark in October, commentators wondered if the realignment was a segue for the developing EMS. Bundesbank president Emminger reproached these speculations saying that this did not prepare the way for more monetary integration, rather it demonstrated how much more difficult adding more nations to a system would be.⁵¹⁰ Emminger was correct in pointing out that the stronger

⁵⁰⁸ Mailgram; Mailgram to Governors and State and Local Officials; Re: The Economy; 1 November 1978; folder FI 18 7/1/78-1/20/81; Box FI-27; WHCF:Subject:Executive FI; JECL.

⁵⁰⁹ In 1988, Tew, *The Evolution of the International Monetary System*, 220-222, surmised that the administration was trying to cover this fact, but he pointed to the numerous reports from the Federal Open Market Committee (FOMC) that specifically mentioned its intent to support the dollar. Documents from the Carter Presidential archives confirm his view. See Mailgram; Mailgram to Governors and State and Local Officials; Re: The Economy; 1 November 1978; and Memorandum; Joint Statement by Michael Blumenthal and William Miller; 1 November 1978; folder FI 18 7/1/78-1/20/81; Box FI-27; WHCF:Subject:Executive FI; JECL. See also Ludlow, *The Making of the European Monetary System*, 248-249.

⁵¹⁰ *Ibid.*, 197; and *The Times*, 25 October 1978.

currency countries were having enough trouble of their own in maintaining parities and that the addition of weaker and diverse members would make the EMS more, not less complicated. Whatever the lessons, the fluctuations once again demonstrated the impact of U.S. policy on European monetary affairs and the necessity of the Community to take some control over its currencies that defined Europe and gave it some independence from the dollar.

The Dream and the Debate

Domestic Critics and the Bundesbank Gets Its Way

As the Community monetary authorities looked ahead to the Brussels conference on 4-5 December, the members stepped up their efforts to settle the details of the EMS, while Giscard and Schmidt tried to remove domestic obstacles to its final acceptance. As the prime provocateur of monetary integration, Schmidt was determined to overcome the suspicions and hindrances of the Bundesbank and any other group that might stand in the way of progress. The chancellor did this through numerous concessions and political courtship that left the EMS greatly shaped by German demands, and the extent to which he was ready to do so was exemplified in his attendance at a Bundesbank meeting in November, the first time a chancellor had ever done so.

In France, national conflicts started to arise over many aspects of the EC's development and they would eventually spill over to the implementation of the EMS. First, critics of the new system were suspicious of Germany's aims and saw monetary integration as a tool for Germany to maintain its markets and establish a European reason to keep with their deflationary policies as a bulkhead to American pressures. Giscard answered the skeptics by asserting that binding France to the German led European endeavor would enhance its economic status and that in time, the monetary power of the Republic would match its prowess in military affairs. Second, Gaullist opposition leader Jacques Chirac returned to the scene again and started campaigning against direct European Parliament elections, which had been one of the primary reasons

he had resigned the prime minister post in 1975. Finally, there was the growing rumble of condemnation from the agricultural sector about the effects of EMS on the CAP.⁵¹¹

Although the Aachen compromise had removed a significant barrier to the plans, the monetary authorities were still debating and in some cases adding to the domestic strife that surround the course of EMS. Part of the Belgian compromise the Bundesbank did not reject was the grouping of the parity grid with a divergence indicator that would determine when currencies were too far off their parities and require intervention. The divergence indicators were different depending on the country's monetary position, with the strongest nations having less room to move and the weaker countries given more latitude. The margins were not limitless however, and they were calculated on a bilateral movement of 2.25 per cent against all other currencies,⁵¹² snake and non-snake. When a currency reached 75 per cent of its maximum spread then the central banks should intervene. The Bundesbank accepted the smaller margin for the mark, but refused to sign on to mandatory intervention. Instead, against French and Italian wishes, they suggested that movement beyond the rate trigger consultations. Despite, efforts to convince them to acquiesce, German authorities remained unmoved and eventually prevailed.

Brussels

EMS Defined

In December, the EC met in Brussels to finalize the arrangements for the system. The resulting mechanism was undoubtedly European, but dominated by German desires with a hodgepodge of concessions, demands and some disappointments shared throughout the Community membership. The Germans retained part of the snake structure and limitations on intervention requirements. The plan expected economic coordination on both surplus and deficit nations, within margins called the Exchange Rate Mechanism (ERM). Currency re-alignments were allowed within the ERM, and

⁵¹¹ Ludlow, *The Making of the European Monetary System*, 198-205.

⁵¹² Except for Italy, which was allowed +/- 6 per cent, the members of the EMS would have a +/-2.25 per cent margin.

once the currency reached the edges of the band, intervention was “compulsory” to prevent the exchange rates from moving outside the band. Much like the parity grid of the snake, the interventions spread the central bank responsibility among the members as stronger currency nations had to buy weak currencies, and vice versa. However, countries were required to act even before their currencies reached the point of leaving the ERM because of the 75 per cent divergence indicator. All currencies were fixed at +/- 2.25 around the central rate with the exception of Italy, as a precondition for its admittance, was permitted a +/- 6 margin.

The French retained some of the plan for the ECU to serve as a significant part of the arrangement, since the Community accepted it as the unit of measurement for state budgetary purposes and banks as a means of settlement, with a plan for its use by businesses and the general community for financial transactions. Initially, the ECU’s “value and composition” was derived from the value of the EUA and then later would be determined by a basket of nine Community currencies, whose ratio was reviewed in the first six months after a country joined the mechanism, and then every five years or when a member’s parity changed by 25 per cent. The central rate of the margins was termed in ECUs, and agreed upon by the members. Central banks had to deposit 20 per cent of their gold and dollar reserves with the EMF against the issue of ECUs, but since the Bundesbank rejected to formal transfers of its resources into any Community institution, banks kept these funds in their possessions for the EMF. The gold deposits were valued at the market price of the previous six months. In case of massive rate movements, the ECU was guaranteed by gold and dollar reserves contributed by each member.⁵¹³

⁵¹³ For full text of the agreement see Letter; Helmut Schmidt to President Carter; 6 December 1978; folder Helmut Schmidt. 1-12/78; Box 6; NSC Presidential Correspondence: Helmut Schmidt; JECL. Paul De Graue, *The Economics of Monetary Integration*. 2nd ed. (Oxford, 1994), 98-103, and 142-144, is a straightforward and easily understandable description of the complexities of monetary policy; other sources that helped my understanding of the EMS and the information contained in this paragraph include -- John Drifill and Paul Turner “Monetary Policy and the EMS.” in George McKenzie and Anthony J. Venables, eds. *The Economics of the Single European Act*. (New York, 1991), 139-151; Alex Roney *The European Community Fact Book: A Question and Answer Guide to 1992*. (London, 1990). Chapter 12 outlines, in simple terms, what the EMS is; and Urwin, *The Community of Europe*, 183. The EMS replaced the floating exchange rate (“snake” and “tunnel” method of the Smithsonian Agreement), which was difficult for single nations to control the erratic movements of their currencies. Floating currencies

Bitter Pill of Realpolitik

One Last Dose of European Reality Before the Afterglow

Schmidt and Giscard had achieved what seemed impossible only a year before. They had created a European method of exchange rate management that would serve as a stepping-stone for the grander goals of European unity that operated within the IMF structure. However, when the delegates met in Brussels on 4 December there was dissonance despite their labors to institute a smooth transition for EMS by the first of the year. The problems of the CAP that had arisen on the political agenda in France resurfaced in the Brussels discussions. Chirac had stirred up domestic hostility to the changes that the EMS would bring to the CAP and coupled this complaint with his long-standing opposition to the European Parliament. Since the Gaullists were keen on using the plight of farmers against the president, Giscard was wary of the impact this issue might have on his popularity, and so the French minister of agriculture made it an issue at the Community meeting the week following the Brussels summit. The ensuing battle over the future of MCAs postponed French entry into the EMS. The battle suddenly ended in March 1979, when France unexpectedly withdrew its demands and announced full participation in the EMS. Doubtlessly, Giscard's objections were political rather than functional, and he used the issue to prove that he was not completely compliant to German will by taking a resolutely French stand.⁵¹⁴

The Atlantic Reaction

It's Not So Bad...

The Americans accepted the EMS as a viable member of international monetary society. The provisions within the text of the system were careful to include third party countries in its consultation processes through "co-ordination" and "concertation with the monetary authorities of these countries," and "remain fully compatible with the

are subject to much speculation and more devaluations than fixed systems like the EMS. The EMS is fixed because its members tie the value of their money to the ECU, and therefore have the confidence that the value is backed by gold and dollars.

⁵¹⁴ Ludlow, *The Making of the European Monetary System*, 262-264, and 279-283. And also Dinan, *Ever Closer Union*, 107-108.

relevant articles of the IMF agreement.”⁵¹⁵ U.S. officials publicly welcomed the system and the European achievements, and we confident that the dollar’s supremacy in the international system would not be challenged by the EMS. The IMF structure had been preserved and EMS did not hinder dollar floating or return gold to a position of prominence in international monetary affairs.

Conclusions

The Carter administration used economic summits to encourage nations to alter their domestic economic agendas in order to tackle inflation and beat the world recession, but its policy remained in line with the U.S. vision of exchange rate management. The U.S. wanted floating so that it had the most control over its economy without worrying about the external imbalances and fixed rates that had forced American policy-makers to choose between the domestic prosperity and the health of the monetary system. Carter tried to manage the dollar’s parity in line with free market thinking and intervene as little as possible, but found this to be impossible as the trade and payments deficits worsened. American officials blamed other nations for their the lack of commitment to economic growth, and the European countries charged the U.S. with purposefully deflating the dollar and placing burdens on their own currencies and trade. The constant push for surplus-laden Germany to reflate made the Federal Republic leaders feel that they were being blamed for pursuing prudent and safe methods of economic planning and monetary policy.

At the heart of the conflict were contradictory views of how the international system should work and how nations should manage it. The Jamaica agreement allowed for a choice of exchange mechanisms, but the vague language of intervention meant that some nations would utilize the markets selectively, as in the case of the EC, while others would attempt avoid them completely, like the U.S.. This often put strains on relationships or produced accusations that one partner was not doing its share to bolster the health of its economy and was burdening the others with its neglect. In this, both the

⁵¹⁵ Letter; Schmidt to President Carter; 6 December 1978; folder Helmut Schmidt. 1-12/78; Box 6; NSC Presidential Correspondence:Helmut Schmidt; JECL.

Europeans and Americans were at fault. The U.S. could not expect domestic policies and economic coordination to wholly maintain the dollar, and the EC could not expect its currencies to be strong without some economic synchronization within the Community. The U.S. had to be flexible in its approaches to intervention and was finally forced to be so when it failed to keep inflation down, enact suitable energy policies, and correct payments and trade deficits. The Europeans had to commit themselves to stricter guidelines within the EC to protect their parities from each other's economic difficulties and external threats to stability.

The Community understood that it had to band together to form a stronger and independent currency zone long before 1978, but political and economic differences, especially between France and Germany, had prevented this from happening. Schmidt's and Giscard's seemingly sudden success to create something that the Community had struggled to construct for nearly a decade, is due to their personal commitment to EMU, and Franco-German bilateralism. The smaller EC countries may not have been happy with the secretive nature of the negotiations, but they realized that no matter how dubious the process had been, some real progress had been made, and they were eager to bring their input into the discussions rather than be left behind or stall the momentum of integration.

The domestic opposition to EMS also strengthened the system and the chancellor's and president's patience with the electorate, while their courting of political and financial institutions demonstrated their resolve. The Bundesbank was able to use its good reputation to create a mechanism that safeguarded the mark but was not too stringent to exclude the weaker currencies. Schmidt's and Giscard's concessions to Bundesbank demands were instrumental in getting public approval for EMS, despite the difficulties that developed later with the CAP.

The improved relationship between France and the U.S. in international monetary circles had helped the American attitude towards the EMS initiative, because they were less suspicious of the Giscard government initiating monetary union as an aggressive attack against the dollar. Hence, Franco-American bilateralism aided to ease

tensions in Community-American and Atlantic relations. Still, the U.S. reaction to the EMS was cautious and reserved. Initially, American officials wanted to make sure that the system was not a way for the Europeans to undermine IMF reforms and exercise some control over U.S. monetary policies. When they saw that EMS strengthened Community currencies and economies without deteriorating the dollar or the Fund's position, these fears abated.

CHAPTER VIII
CONCLUSIONS: AMERICAN MONETARY HEGEMONY AND THE EUROPEAN
CHALLENGE

The Bretton Woods system established the foundation for global monetary management among its membership, but it could not keep up with the rapid changes in an era where international interdependence competed with national interests. International monetary affairs between the U.S., France, and the Federal Republic of Germany from Bretton Woods to the creation of the European Monetary System, progressed through three distinct periods – the rise and fall of Bretton Woods (1944-1971), the infusion of flexibility in exchange rates in both Europe and the international system (1972-1975), and lastly, the emergence of an independent European mechanism (1976-1979). Throughout these eras, U.S. decisions regarding economic and monetary policy had a direct and guiding affect on European monetary integration, while France and Germany used their dissention as a means to shape America and international monetary policies, and struggled to create a consensus between themselves.

The French/American relationship was adversarial from the beginning of Bretton Woods' construction. France's monetary fears that one currency would come to dominate the system came true with the dollar's dominance in the reserves of the world's banks. Whether this could have been avoided is not within the scope of this study, however it did place France at odds with the Bretton Woods structure from the inception of the system. As the IMF membership tried to correct the problems with the dollar and maintain stable liquidity, the French made their reputation in international monetary affairs demanding concessions almost constantly contrary to American desires. The motivations for French demands were for the good of its own national interests. Authorities insisted on a greater role for gold in the system to heighten the worth of French reserves, which were mostly gold, but they also collected this gold partly out of fear for the weakening dollar. As a result, French efforts to protect the franc had some

damaging market consequences on the dollar and made U.S. officials ever suspicious of France's goals. The strategy seemed malicious and nationalist and there was some evidence of this intent, with authorities like Jacques Rueff clamoring for a return to the gold standard, mixed messages from de Gaulle, and criticisms about the U.S. payments deficit from the finance ministry, but the ambiguities in French objectives did enhance its standing in monetary affairs. As France was often the nation leading the charge against U.S. dominance of the system, this complemented its political clout and enhanced its importance in international monetary politics even with a weaker currency than its European partner, the deutschemark. France used this prestige almost as a type of harassment against U.S. goals, which demanded that the Americans treat France with special attention and more bilateral talks during the GAB and SDR negotiations, because the U.S. needed France's endorsement on IMF reforms.

France also saw international monetary negotiations as a counter to German economic might in Europe. In the 1960s, France and Germany were still building their economies and their mutual trust, and integration was a vague notion of something more substantial for constructing the future of Franco-German relations. Germany concentrated on its own economic health and preferred to conduct monetary relations on the international rather than European level. This usually meant siding with the American view, not only because of Germany's strong Atlantic ties, but because the Germans disapproved of the way France chose to run its economy and devalue the franc rather than follow what the Bundesbank considered stronger fiscal and monetary policies. The Federal Republic suffered from its successes in the early years of Bretton Woods, and as the dollar slipped in value the mark appreciated, forcing Germany to revalue and cooperate with the Federal Reserve to control capital flows and stem inflationary pressures in Germany.

France used European integration as the centerpiece to its efforts to establish a European identity in monetary politics. On the continent, France could take the lead in creating a monetary regime for Europe, and exclude direct American influence. This was a role that Germany, although controlling the most powerful economy in Europe,

could not take. Politically, the Germans needed to show that they were dependable and peaceful partners for the future of Europe. The Federal Republic needed to have France as its partner to make German intentions trustworthy. In monetary circles, German financial prudence in European monetary policy, lent the EEC credibility.

The United States coped with a mounting payments deficit and successive presidents pledged to uphold the dollar's obligations with gold for fear that reneging on Bretton Woods's provisions in its infancy would upset the stability of the system. However, as the deficit worsened and attempts to remedy the problems in the system failed, Nixon's administration decided that the system was no longer beneficial to American interests in August 1971. Why was it left to Nixon's decision? First, there was the perspective of power that Nixon brought to the presidency. Nixon would not compromise American prestige in any way unless forced to do so by extreme circumstances. In the first years of this presidency, the economy and the dollar's situation had not approached this point for him to alienate the allies in monetary policy. The U.S. still held a heavy payments deficit, but the markets still held confidence in the dollar even if there were some academics and analysts who thought it needed to be devalued.

Although his economic team approached reforming the system as the first choice like the previous administrations had, they placed the emphasis of their planning to put U.S. interests first. The CEA did this from the start of Nixon's presidency when McCracken suggested unilateral monetary actions if they could not come to some agreement with the Europeans. With John Connally as Treasury secretary, decisive unilateralism was almost assured. The Treasury had established the America first attitude with the Volcker Group even before Connally arrived, and even though Volcker's recommendations included cooperative measures, the under-secretary was not above taking actions to free the dollar from the burdens of Bretton Woods once all other avenues of negotiations had been exhausted. The administration tried to focus on trade issues with the allies, aided again by Peter Peterson's CIEP reports that put the U.S. in the victim role, targeted by "unfair" European and Japanese trade restrictions. The sole

supporter in favor of keeping Bretton Woods was Federal Reserve chair Arthur Burns, with whom Nixon had already had personal differences, and despite respecting Burns's authority on monetary affairs, the president believed that most bankers put international commitments before U.S. considerations. With the key officials set to protect the interests of the dollar, the trade deficit in 1971 set the stage for action. Coupled with a recession, growing inflation, gold reserves dwindling, and the dollar weakening dramatically, the personalities and criteria were in place for unilateral actions in the New Economic Policy.

Although Nixon had not conferred with the allies about the NEP, he understood what the impact would be on their economies and the political relationship with the Europeans. Suspending convertibility was as much as a political consideration as it was economic. The administration knew that the privileged position of the dollar gave it clout over the reform negotiations and added the trade surcharge to try to get concessions on what it really desired, which were deals on trade. More flexibility in exchange rates put the power of economic planning back into the hands of the president, and better trade maintained confidence in the dollar. When the U.S. failed to gain the deals it wanted and dropped the surcharge, it lost a valuable bargaining chip against Germany, which thrived on an export-led economy, and the EC. Pompidou would not support lifting trade restrictions or giving the U.S. any kind of preferences in the Community as long as it had gotten the adjustments he demanded in the Azores. Thus, the U.S. may have gotten France's support for parity adjustments, but it did not achieve its trade goals, which further solidified the adversarial view that the Nixon administration believed existed between the U.S. and the EC.

The atmosphere of the negotiations from August to December was tense between the allies, but this was not because the abandonment of Bretton Woods was unexpected. The French finance ministry had been preparing for what it saw as the inevitability of its collapse, and already both Kennedy and Johnson had considered it as a serious, albeit last-ditch option. By this time, governments, bankers, U.S. Congress, and investors believed that the Bretton Woods parities were archaic and needed to be altered. For the

members of the IMF, the difficulties lay in how to do it in a manner that did not upset the stability of the entire system. The problem for the U.S. was how to adjust the parities to its advantage and not disrupt the system. Private channels had not been persuasive enough to evoke changes in flexibility that the U.S. wanted, so officials used the dollar's unique position to force these changes upon the members, and this is what provoked rancor in its relationships with the Germans and French.

The Smithsonian rates did not reflect the true adjustments warranted by economic realities in Europe or the U.S.. France felt that the unilateralism of the Nixon administration cut into its efforts in international monetary politics and hence required the now customary bilateral conference in order to obtain the Smithsonian accords. It is clear from the French-American Azores meeting that neither side was willing, or able, to adjust their parities to the extent they believed that was necessary, but they hoped that the increments were enough to calm the markets until further adjustments could be made. The Azores transcripts also give some insight into France's monetary strategies. The public tone was belligerent, almost an attack against the dollar, but the private discussions were less so. Pompidou's nationalism may have desired to disengage the dollar from its central role, but his pragmatism understood that this was impossible and dangerous for the system and the franc.

As part of this transition, Pompidou used the changes to introduce a European dimension into the equation with the snake mechanism. The purpose of this was twofold. First, he could claim some contribution to European integration and enhance the French status within the EC as a motivator of continental interests. Second, it made good monetary sense to restrict the fluctuations of European currencies in order to keep them stable and stronger. German Chancellor Brandt embraced the snake because rejecting it would make Germany look anti-European, but mostly because the GFR supported measures within the Community that promoted coordinated economic policies and this was a step in that direction. However, since the mark was the strongest currency in Europe, Germany could rest assured that it would be a dominating force within the snake, which would have both good and bad consequences. Through the

snake the Germans could have some control over its functions, but it would also be attractive to those fleeing from a weaker dollar. Smithsonian was to be transitory, while the snake might adapt to future conditions.

The Smithsonian rates did not survive in part because they were not designed to be permanent and it would seem that the U.S. had few intentions of supporting them. Although Shultz replaced the brash diplomacy of Connally in the Treasury, his ideas on flexibility and floating for the good of the dollar were responsible for the “benign neglect” of the Smithsonian rates, as Nixon concentrated on the domestic economy without a worry as to the international complications. The markets began attacking the weaker currencies first, which exposed the weaknesses and interdependencies of the new rates as well as the divisions within the snake mechanism. Initially, this placed the burdens of keeping the rates stable upon Germany, and Bundesbank officials chose to employ capital controls over revaluation in order to preserve the snake and the Smithsonian rates. This did contribute to an improvement in the Franco-German relationship, but the lack of U.S. intervention was also pushing the snake closer to becoming a D-Mark zone, which was undesirable to the French since tying the franc to a scheme dominated by the mark’s parity was politically unacceptable. When the barrage of speculation became too great, the EC should have immediately committed to a joint float against the dollar, but national interests prohibited the Community from making a cooperative effort until forced later to do so. That France refused to endorse the joint float for fear of creating a mark zone was an indication of how little had been done for integration. The snake needed coordination in economic planning and monetary policy to be an effective tool for EMU, and without this it was just a reflection of the disunity within the EC.

The events surrounding the second dollar devaluation in February 1973 did not revive harmonious monetary relations between the allies, but the diplomacy involved in the decision-making did. Volcker’s whirlwind negotiations to bargain for the parity adjustments helped put EC-U.S. relations back on cooperative and friendly terms and improved Shultz’s image in international financial circles. This, as well as his informal

meetings with the Library Group, painted him as a man who was willing to consider the impact of American policies abroad, somewhat overdue, before taking action – a marked contrast from John Connally. The February adjustments were a stopgap measure though, and months later the snake currencies floated with the mark and against the dollar. The float was exactly what the markets and European integration warranted, and brought the EC a small degree of independence from the dollar, but again, the Community had reacted to U.S. policies rather than taking the initiative. In the end, the U.S. obtained what it wanted – a floating dollar – and continued to manage it with the least intervention possible.

The nations concentrated on reforming the international system during this time, but the oil crisis put this and European integration on hold in late 1973 and through much of 1974. The adversarial relationship between France and the U.S. only intensified, as France tried to extend its reputation as the American alternative to lead the international community, when Pompidou refused to join a consortium of oil consumer nations for fear of alienating the OPEC nations, and dip the French trade and payments deficit further into debt because of higher oil prices. The oil crisis pushed economies across the globe into deficit and wrecked initiatives for EMU. The members of the EC managed their economies so differently before oil prices rose, that the crisis only exacerbated their differences and made agreement less likely. Higher oil prices forced the franc out of the snake and weakened France's economic stature within the Community and made the snake into the very thing that France had tried to avoid -- a D-mark zone. In order for France to regain some of its monetary credibility and return to the snake, it was going to have to implement policies that had been endorsed by Germany, which would look like Paris was taking direction from Bonn.

However, the arrival of new leadership in all three countries in the mid mid-1970s improved these situations. France became less confrontational with the U.S. and Germany. Giscard's credentials as former finance minister enabled him to coordinate economic policies with Schmidt with minimal political hostility in France. Giscard kept France's role in the EC alive by returning the franc to the snake, if only briefly, and

demonstrated his Europeanism and attention to France's economic difficulties by appointing pro-Europe Raymond Barre as prime minister. Utilizing their friendship to the greatest advantage, Giscard and Schmidt established a pattern of bilateral conferences that set the stage for renewed Franco-German cooperation that preceded every EC meeting, where they spearheaded Community initiatives. France and Germany were always the main motivators for the EC, for without either nation's endorsement, there was rarely action. However, the Giscard-Schmidt pattern of bilateral consultation before Community meetings made the hierarchy more pronounced within the EC. While the decision-making process was weighted equally among the members, the bi-annual summits between the leaders, and the established quarterly meetings between their finance ministers, accelerated progress on integration. Regular consultation meant that disagreements could be ameliorated and proposals finalized before they reached the EC.

The Europeans also felt that they could work with the Ford administration, and did not feel that the new American president was trying to gain a voice in the EC or interfere with integration. Ford supported integration but did not believe that it was likely because of the economic differences within the Community. Unlike Nixon's staff, the Ford team did not seem threatened by Europe, but realized that EC interests would not always match the U.S. agenda. Officials did not aggressively seek to establish formal consultative ties with the EC as Nixon did, and instead concentrated on removing trade barriers with the institutional structures already in place within the EC, negotiating international reform within the IMF, and of course continuing to court the French with special bilateral treatment. Ford continued this tradition when he met with Giscard at Martinique to secure France's support for the International Energy Agency and carried out close negotiations with the French to try to negotiate the removal of gold from the international monetary system in preparation for Rambouillet.

Where France, Germany and the U.S. had always conferred bilaterally to clear disagreements and make way for agreement in the IMF, they agreed, through a French suggestion, to shrink international economic conferences from the C-20, which included both the industrialized and developing nations, to a small band of the seven richest

nations. The international summits pushed monetary policy further into the exclusive domain of the industrialized nations, but the arrangement did serve allied interests well as they seemed to focus the members on finally reforming the system in Rambouillet and Jamaica.

France was the most obvious political beneficiary as it used its bilateral meetings with both the U.S. and Germany in concert with the international conferences in order to negotiate its monetary demands within Europe and the world. There were two issues on which there was still strife in monetary relations – the issue whether the U.S. would support its parity and the issue of gold in the future of the system. France held out for concessions on floating rates before the Jamaica agreement legalized them, but the U.S. and French agreements on currency fluctuations were insignificant and did not effect the functionality of floating in the system. The vague definitions of “erratic” and “disorderly” market conditions did not set any guidelines for intervention; they just loosely recognized French (and German) concerns. Without restrictions, the U.S. was free to decide on its own if dollar movements warranted action.

Gold was always a point of conflict between the U.S. and Europe. Since the 1960s, France had put its trust in gold and much of its reserves were filled with it, so the French were hesitant to completely demonetize it, but quick to revalue it to open market prices. The U.S. wanted to make sure that it could not return to a prominent role in the system, because of fears that it might re-instate fixed exchange for the dollar. The Federal Reserve sales of gold were part of the plan to separate it from currency values, and the determination of SDR values by a basket of currencies rather than gold seemed to break the hold of gold over the system. However, the Americans were always watchful of ways that they believed the Europeans were trying to re-introduce gold into the system and felt threatened by French and European insistences that banks be allowed to buy and sell it on in the open markets.

The monetary reforms made at Rambouillet and Jamaica that legalized floating and detached the SDR from gold left the Carter administration to convince the rest of the world that coordinating domestic economies could manage international exchange. The

administration carried non-interventionalism into their monetary philosophy and refused to interfere with market forces on the dollar until forced to do so. Despite Carter's efforts to calm the markets with several economic plans, the dollar started to slip in 1977. Instead of intervening straight into the markets the Fed worked with the Bundesbank swaps, which helped to alleviate the burdens on Germany but was in reality just a temporary measure before the U.S. admitted a reversal to its non-interventionalist position.

Still, the U.S. preferred to let the domestic economy support the dollar, a strategy that looked more like neglect to the Europeans than concern. The U.S. expected the Germans aggressively reflate their economy and accept payments and trade deficits, but Schmidt resisted and chose to reflate gradually and not risk high inflation. The American put severe diplomatic pressure on Germany, which damaged the U.S.-German relationship and made Germany feel that it was being punished for being successful, and pushed Schmidt farther into Europeanism and farther out of Atlanticism. In many ways, this was similar to the Bretton Woods scenario. Leaders were resistant to alter beneficial policies for their own nations for the betterment of the international system. Schmidt needed an incentive that was closer to home, and the benefits of an independent exchange regime under the EC provided that incentive.

Giscard and Schmidt wanted to gain more control over currency fluctuations and obtain some more distance from American monetary policies, but their governments were in no position to do so until late 1977. Both nations had good reasons for creating EMU, but several factors prevented them from acting until then. The franc's second departure from the snake in 1976 solidified France's secondary status in economic policy, and it needed time to recover. The French had to admit in certain terms that German plans for EMU were much more economically sound than France's strategies, and agree to some type of economic coordination within the Community. Giscard realized that any mechanism that France entered into would be dominated by the stronger DM, which was something that was politically unacceptable to the far right of France's National Assembly. Schmidt needed a stable mechanism for the DM that

relieved it from the burdens of the dollar, and did not place the onus of supporting European exchange on Bundesbank reserves. These were the Chancellor's criteria in order to secure domestic support. Within the EC, Roy Jenkins had prepared the way for the discussions about monetary integration in the Community, and Giscard and Schmidt had only to wait for their political positions to strengthen before they acted. The leaders maintained the secrecy of their preparations and dictated their plans to the EC in many ways, much as the U.S. had done to the allies in 1971. The members, though angry at the Franco-German tactics, did not want to be responsible for halting progress and also recognized that a European regime held more benefits than disadvantages for their nations. Economic coordination had been a topic of discussion for nearly a decade and France had blocked it. Now, with France leading the way with Germany, the biggest hindrances had dissipated.

The U.S. had always been supportive of European integration, and continued to do so through the EMU negotiation process. As long as the new mechanism was compatible with IMF guidelines, did not infringe on the Fund's functions, did not demonetize gold, and did not interfere with the dollar's ability to float, then Americans did not feel threatened by European monetary management. The U.S. was also confident that the EMS would not challenge the dollar's supremacy in international circles. Still, it is curious that U.S. officials could treat such a historical occurrence in monetary affairs with almost indifferent nonchalance. However, since the Nixon administration emphasized trade as the backbone of its monetary management, the U.S. has been more concerned about trade and tariffs arrangements with the EC than Europe's collective monetary arrangements. Since the Americans now depended on a floating dollar, the trade issues were more prominent in their economic strategies.

Yet the EMS did hold consequences for the future of the dollar. American policies in the 1970s designed to accommodate the short-run, posed risks to the American monetary position vis-à-vis Europe and the international system. Nixon severed the dollar and the world from the constraints of fixed exchange rates, and his actions evolved to give France and Germany the opportunity to create a distinctly

European voice in international monetary affairs. Although the EMS was born of European initiatives, France and Germany were still responding to what they saw were failures in U.S. policy. American benign neglect pushed the EC into action and forced its members to overcome their differences. By the 1990s, however, the Europeans had coordinated their economies, established institutions for the management of a common monetary policy, and moved to the next level of monetary integration introducing a single currency, the Euro, for the twelve members of the European Union (EU) in 2002. As the European Union integrates its economies further, the combined strengths of its membership will come to rival the capacities of the U.S.. The U.S. has already responded to this threat with the North American Free Trade Agreement (NAFTA), which will establish a zone of free trade, investment, and smoother immigration between the U.S., Canada, and Mexico by 2004. Thus, the U.S. has had to respond to the challenge of European initiatives, which were a result of its own pursuit of national interests. Still, the Euro is challenging the dollar's position as one of the premier investment and reserve currencies it surpassed the dollar's rate in July 2002, and maintained this rate above the dollar for much of 2003. In 1944, the U.S. hoped to rebuild the economies of Europe, but sixty years later some Americans wondered if they had succeeded a little too well.

GLOSSARY

Balance of Payments: Includes the account of all recorded financial exchanges made between countries. The balance of payments is divided into current and capital accounts. The current account consists of *invisible* [trade of services rather than tangible goods], *visible* [trade of goods rather than services], trade (the balance of trade is part of the balance of payments current account), and the capital account includes all movements of capital [international investments, private or public, which include intergovernmental loans] in or out of the country.

Bank for International Settlements (BIS): Bank located in Switzerland that acts as a central bank for national banks and invests in the markets for them.

Basel Agreement: agreement in 1961 that established “swaps” between central banks as a means to support currencies.

Capital: general term that usually applies to the holdings of an individual or group either foreign or domestic (cash, skill or equipment, etc.).

Capital account: part of the balance of payments that takes into account the international movements of capital that include government loans.

Common Market: Short term for the EEC, European Common Market, which specifically refers to the establishment of freer trade among the European members.

Convertibility: currency that can be exchanged for another currency in an equal amount of gold.

Deficit country: Reference to a nation that has a deficit in its balance of payments. Sometimes used with the trade balance also.

Devalue, devaluation: to reduce the value of a currency. Usually used when this is officially done by a government or state financial agency.

European Commission: The major decision making body of the EC, established in 1967.

European Council: Brings together the heads of state from all the member nations of the EC and the president of the European Commission.

European Economic Community (EEC): Established by the Treaty of Rome in 1957, the EEC was the title given to the first group of nations that embarked on closer integration efforts for the European continent in economics, politics and defense. The EEC evolved into the Economic Community (EC), and then the European Union (EU).

Eurodollar: American dollars held in the foreign branches of U.S. banks.

Exchange controls: prohibitions made by banks or monetary authorities to restrict the flow of currency between countries. Methods include no foreign owned bank deposits, limiting interest paid on accounts, or limiting bank transactions in domestic currencies.

Exchange rate: The rate at which one currency can be traded against another.

Exchange Stabilization Fund: An extension of currency swaps that the U.S. Federal Reserve holds with other central banks, in particular with the German Bundesbank, to support the dollar.

External Debt: The amount owed by a nation to foreign lenders.

Fiscal Policy: The taxation and spending policies of a government.

Fixed Exchange Rate: System where the values of national currencies are set vis-à-vis another currency and cannot fluctuate from that point. Also called pegged exchange rates and par values.

Flexibility: movement of exchange rates

Floating Exchange Rate: determining the value of a currency according to market conditions and supply and demand. Floating relies on the health of the domestic economy to maintain stable parities with minimal fluctuations. There are two kinds of floating – clean, where the government or central bank intervenes in the markets minimally, and dirty, with officials buying and selling currencies (intervention) in varying degrees to keep rates within a certain limit.

G-10: Group of Ten. Group of members in the IMF who negotiated the General Agreements to Borrow (GAB). They include Belgium, Canada, France, Italy, Japan, the Netherlands, Sweden, the United Kingdom, the U.S., and the Federal Republic of Germany. Switzerland also became a member.

General Account (GA): Main account of the International Monetary Fund (IMF) where members supply a certain amount of their reserves (25 per cent in gold and the rest in the member's currency) to the Fund for later use to support their currencies during exchange fluctuations.

General Agreements to Borrow (GAB): Arrangement by the G-10 members of the IMF to lend the Fund money for loans for the use by other members to support currencies.

General Agreements on Tariff and Trade (GATT): international organization where members try to negotiate free trade and the reduction of tariff barriers. Today it is known as the World Trade Organization (WTO).

Gold pars, mint pars: the method to determine national currency exchange rates in ratio of gold during the gold standard era. Also called "par values".

Gold Pool: Established in 1961, the pool divided the supply of gold among several central banks, which attempted to sell the gold in the world markets to control the price and maintain the \$35 to an ounce rate that was set in the Bretton Woods agreement. It was designed to save American reserves so that the Federal Reserve would have enough gold to back the amount of dollars in the system.

Gold Standard: method of monetary exchange based on the amount of gold in the world; commonly refers to the international monetary system in the 17th through early 20th centuries, but the term also applies to any system where gold was used as the main unit to support national currency values.

Gross Domestic Product (GDP): measurement of all the goods and services produced by within a country in a year

Gross National Product (GNP): measurement of all goods and services produced within a country and overseas, in a year.

Inflation: economic condition usually characterized by the quick rise in prices and wages, which results in the currency being able to purchase less and long-term savings depleted. There are two types of inflation – cost-push inflation and demand-pull inflation. In cost push inflation; industries will raise prices to cover

higher wages, which produces a wage-price spiral. In demand-pull inflation, more borrowing and a high demand for credit pours more money into the economy and produces a boom that raises the Gross National Product and prices.

International Monetary Fund (IMF): An international organization created by the Bretton Woods agreement of 1944, to manage the credit facilities of its members and keep the stability of the international exchange system.

Intervention: see floating exchange rates.

Joint Float: When several countries decide to float their currencies together against a central rate or another currency.

Liquidity: general term for an asset that can be converted easily into a cash value. Economists and bankers will also use the expression with regards to financial institutions having enough assets to cover their obligations.

Long-term: In loans this usually means more than 10 year. With bonds and other investments the duration usually means that they will not mature for a year.

Margin: In exchange rates, a margin is the limit above and below a certain rate, where currencies are allowed to fluctuate in value. In fixed rate systems, the margins are narrow.

Monetary Policy: General term used for the management of the amount of currency that a central bank decides to release or suppress in the market. An expansive monetary (loose money), policy generally promotes growth in the domestic economy by releasing more money for use with low interest rates for loans, while a restrictive policy (tight money), absorbs currency back into the reserves with high interest rates.

Money Supply: M1, M2, M3 and L. Generally, M1 is the currency held by the public that includes travelers checks; M2 is M1 plus savings deposits, and money market mutual fund shares held by individuals; M3 is M2 plus large deposits and money market mutual funds by institutions; and finally L encompasses long term liquid assets (cash or anything readily convertible into cash), including M3, and non bank investments in savings bonds, short term Treasury securities and

bankers' acceptances (used often in international trade where a bank draws on itself and agrees to pay the face value if the drawer of the draft does not pay. The bank can also sell acceptances on the money market when they mature. Importers or exporters obtain financing this way and the risk is minimal as the bank only deals with highly rated companies).

Par Values: See fixed exchange rates.

Petrodollars: Money (usually in dollars) paid to the oil producing nations for petroleum.

Parity: another term for exchange rate or a currency that is equal in value.

Quadriad: U.S. executive meeting with the Secretary of the Treasury, the Director of the Office of Management and Budget, the Chair of the Council of Economic Advisors, and the Chair of the Federal Reserve.

Recession: A downturn in a nation's economy when the GNP declines in two consecutive quarters and the unemployment rate increases by two per cent. Various economic indicators are used however to determine a recession.

Reflate: to embark on either monetary or fiscal policies to spur growth in a nation's economy.

Reserves: general term used for the amount of money or in some cases gold, that a bank holds to cover its debts and services. When used in terms of the Federal Reserve or other central banks, it means the ability of that bank to back the amount of national currency in the system.

Revalue, revaluation: to increase the value of a currency. Usually used when this is officially done by a government or state financial agency.

Run: unexpected investor behaviors, usually involving the withdrawal of funds from an institution in favor of another to get better returns. This is also commonly used when investors 'target' currencies by selling them in favor of other monies where they believe their values will appreciate in the future. Related to speculation.

Short-term: Applied to many types of investments that mature in less than a year. Typically used to describe bonds and securities of 30 to 91 days.

- Snake:** European method of currency management, where the EC members agreed to limit the fluctuations of their currency values to +/-2.25 per cent from the U.S. dollar. It operated inside the “tunnel” margins of the Smithsonian accords.
- Special Drawing Rights (SDRs):** a form of international liquidity held and created for the IMF to provide members with credit in addition to the General Account and the General Agreements to Borrow. The SDR exists only as a unit of credit between governments and is not a currency unit in circulation. Initially, the SDR was valued in terms of gold, but as gold was demonetized from the system it became valued in terms of a basket of currencies.
- Speculation:** Term used mostly in relation to currency trading where investors will try to anticipate changes in values of monies to get the highest yield on their investments.
- Stagflation:** Economic phenomenon for high inflation and the lack of economic growth.
- Surplus nation:** A country that has a surplus in its balance of payments or trade figures.
- Swap:** a system of currency support, established by the Basel Agreement of 1961, where central banks exchange currencies for a limited time to support each other’s monies in the markets, and then reverse the transaction once the markets are stable.
- Trade deficit:** When a country imports more foreign goods than it exports its own goods.
- Trade surplus:** when a nation exports more of its won goods than imports foreign goods.
- Tranche:** usually referred to with the IMF’s gold tranche where 25 per cent of a member’s quota had to be gold bullion. Can also be used in regards to the amount of reserves a bank must hold in its vaults to cover loans and other transactions.
- Treaty of Rome:** Treaty that established the EEC, European Economic Community, in 1957. Signed by France, West Germany, Belgium, Luxembourg, the Netherlands, and Italy.

Triffin Dilemma: Flaw pointed out by Robert Triffin, a Yale economist, in 1960 about the Bretton Woods system. He noted that the presence of a dollar glut threatened the stability of the system as the U.S. accumulated large external deficits and lacked the gold in its reserves to back the amount of dollars distributed in the world.

Troika: U.S. Executive meeting that involves the Secretary of the Treasury, the Director of the Office of Management and Budget and the Chair of the Council of Economic Advisors.

Tunnel: Vernacular name given to the exchange rate margins of the Smithsonian Agreement of December 1971 where the IMF membership agreed to allow currencies a wider band of fluctuation of +/-4.5 per cent.

Wirtschaftswunder: “Economic Miracle” A German term, which refers to the remarkable recovery of the Federal Republic’s economy following the Second World War.

REFERENCES

Archival Records

Bank of France, Bank of France Archives, Paris, France

Willy Brandt, Personal Papers, Ebert Stiftung, Bonn, Germany

Arthur Burns Papers, Gerald R. Ford Library, Ann Arbor, MI

James E. Carter Presidential Papers, James E. Carter Library, Atlanta, GA

John Connally Papers, Lyndon B. Johnson Library, Austin, TX

French Finance Ministry Papers, Finance Ministry Archives, Fontainebleau, France

Gerald R. Ford Presidential Papers, Gerald R. Ford Library, Ann Arbor, MI

Valery Giscard d'Estaing, Presidential Papers, French National Archives, Paris, France

Lyndon B. Johnson Presidential Papers, Lyndon B. Johnson Library, Austin, TX

Richard M. Nixon Presidential Papers, Archives II, College Park, MD

Georges Pompidou, Presidential Papers, French National Archives, Paris, France

Helmut Schmidt, Personal Papers, Friedrich Ebert Stiftung, Bonn, Germany

William E. Simon Papers, Laffeyette College, PA

Newspapers & Periodicals

The Economist

The Financial Times

Frankfurter Allgemeine Zeitung

International Monetary Fund Survey

Jahreswirtschaftsbericht der Bundesregierung

Monatsberichte

Le Monde

Newsweek

The New York Times

The Times

Books & Articles

Aker, Frank. *October 1973: The Arab-Israeli War*. Hamden, CT: Archon Books, 1985.

Barnet, Richard J. *The Alliance: America-Europe-Japan Makers of the Postwar World*. New York: Simon and Schuster, 1983.

- Baun, Michael J. *An Imperfect Union: The Maastricht Treaty and the New Politics of European Integration*. Boulder, CO: Westview, 1996.
- Bernstein, Edward M. "The Reform of the International Monetary System." *Moorgate and Wall Street* (Summer 1965): 5-16.
- Bernstein, Serge. *The Republic of de Gaulle, 1958-1969*. Cambridge, MA: Cambridge University Press, 1993.
- Bloed, Arie and Ramses A, Wessel. *The Changing Functions of the Western European Union: Introduction and Basic Documents*. Boston: Nijhoff, 1995.
- Bloomfield, Arthur I. *Monetary Policy Under the International Gold Standard, 1880-1914*. New York: Federal Reserve, 1959.
- Bordo, Michael and Dominique Simard, and Eugene White, *France and the Bretton Woods International Monetary System: 1960 to 1968*. Cambridge, MA: National Bureau of Economic Research, 1994.
- Bourges, Hervé. *The French Student Revolt: The Leaders Speak*. New York: Hill and Wang, 1969.
- Brandt, Willy. J. Maxwell Brownjohn, trans. *People and Politics: The Years 1960-1975*. U.S. ed. New York: Little Brown, 1978.
- Bredin, J. *La République de Monsieur Pompidou*. Paris: Fayard, 1974.
- Brinkley, Douglas and Richard T. Griffiths. *John F. Kennedy and Europe*. Baton Rouge, LA: Louisiana State University Press, 1999.
- Cairncross, Sir Alec and Barry J. Eichengreen, *Sterling in Decline: The Devaluations of 1931, 1949 and 1967*. Oxford, England: Blackwell, 1983.
- Calleo, David P. *The Imperious Economy*. Cambridge, MA: Harvard University Press, 1982.
- Cassel, Gustav. *The Downfall of the Gold Standard*. London: Clarendon, 1936.
- Chalmers, Eric. *Monetary Policy in the 'Sixties*. London: Griffith, 1968.
- Clark, John. *International Dictionary of Banking and Finance*. Chicago: Glenlake Publishing, 1999.

- Clark, John G. *The Political Economy of World Energy: A Twentieth-Century Perspective*. Chapel Hill, NC: University of North Carolina Press, 1990.
- Clendenning, E. Wayne. *The Euro-dollar Market*. Oxford: Clarendon, 1970.
- Cohen, Benjamin J. *Crossing Frontiers: Explorations in International Political Economy*. Boulder, CO: Westview, 1991.
- . *Organizing the World's Money: The Political Economy of International Monetary Relations*. New York: Basic Books, 1977.
- . *The Future of Sterling as an International Currency*. London: Macmillan, 1971.
- Cohen, Stephen D. *International Monetary Reform, 1964-1969: The Political Dimension*. New York: Praeger, 1970.
- Coombs, Charles A. *The Arena of International Finance*. New York: Wiley, 1976.
- Curtis, Thomas B. and John Robert Vastine. *The Kennedy Round and the Future of American Trade*. New York: Praeger, 1971.
- Dam, Kenneth W. *The Rules of the Game: Reform and Evolution in the International Monetary System*. Chicago: University of Chicago Press, 1982.
- De Grauwe, Paul. *The Economics of Monetary Integration*. 2nd ed. Oxford: Oxford University Press, 1994.
- Debbasch, Charles. *La France de Pompidou*. Paris: Presses Universitaires de France, 1974.
- Degen, Robert A. *The American Monetary System: A Concise Survey of its Evolution Since 1896*. Lexington, MA: Lexington Books, 1987.
- Derbyshire, Ian. *Politics in France From Giscard to Mitterand*. Edinburgh: Chambers, 1990.
- Deutsche Bundesbank. *The Deutsche Bundesbank: Its Monetary Policy Instruments and Function*. 3rd ed. Deutsche Bundesbank Special Series, no. 7. Frankfurt: Deutsche Bundesbank, 1989.
- Diebold, William. *The Schuman Plan: A Study in Economic Cooperation, 1950-1959*. New York: Praeger, 1959.

- Dinan, Desmond. *Ever Closer Union? An Introduction to the European Community*. Boulder, CO: Lynne Rienner, 1994.
- Drifill, John and Paul Turner. "Monetary Policy and the EMS." in George McKenzie and Anthony J. Venables, eds. *The Economics of the Single European Act*. New York: Macmillan, 1991.
- Drummond, Ian M. *The Gold Standard and the International Monetary System 1900-1939*. London: Macmillan Education, 1987.
- Dyson, Kenneth and Kevin Featherston. *The Road to Maastricht: Negotiating Economic and Monetary Union*. London: Oxford, 1999.
- Eckes, Alfred E. *A Search for Solvency: Bretton Woods and the International Monetary System, 1941-1971*. Austin, TX: University of Texas Press, 1975.
- Eichengreen, Barry J. and Jeffrey A Frankel. *On the SDR: Reserve Currencies and the Future of the International Monetary System*. Berkeley, CA: Berkeley University Press, 1996.
- Eichengreen, Barry J. *Reconstructing Europe's Trade and Payments: The European Payments Union*. Ann Arbor, MI: University of Michigan Press, 1993.
- , ed., *The Gold Standard in Theory and History*. New York: Methuen, 1985.
- Einaudi, Luca. *Money and Politics: European Monetary Unification and the International Gold Standard*. New York: Oxford University Press, 2001.
- Einzig, Paul. *A History of Foreign Exchange*. London: Macmillan, 1962.
- Emden, P.H. *Money Powers in Europe in the Nineteenth and Twentieth Centuries*. London: Sampson, Low and Marston, 1937.
- Finch, Thomas. *Barron's Dictionary of Banking Terms*. New York: 1990.
- Friend, Julius W. *The Linchpin: French-German Relations, 1950-1990*. New York: Praeger, 1992.
- Forsyth, Douglas J. *Restoring International Payments: Germany and France Confront Bretton Woods and the European Payments Union*. Working Paper 111. Madrid, Spain: Centro de Estudios Avanzados en Ciencias Sociales, 1997.
- Gallarotti, Giulio M. *The Anatomy of an International Monetary Regime: The Classical Gold Standard, 1880-1914*. New York: Oxford University Press, 1995.

- Gardner, Richard N. *Sterling-Dollar Diplomacy*. Expanded ed. New York: McGraw, 1980.
- Garritsen de Vries, Margaret. *International Monetary Fund 1966-1971*. 2 vols. Washington, DC: International Monetary Fund, 1976.
- . *International Monetary Fund 1972-1978*. 3 vols. Washington, DC: International Monetary Fund, 1982.
- Gawrych, George W. *The Albatross of Decisive Victory: War and Policy between Egypt and Israel in the 1967 and 1973 Arab-Israeli Wars*. Westport, CT: Greenwood Press, 2000.
- Gilbert, Milton. "The Gold-Dollar System: Conditions of Equilibrium and the Price of Gold." *Princeton Essays in International Economics*. Princeton, MA: International Finance, 1968.
- Gillingham, John. *Coal, Steel, and the Rebirth of Europe 1945-1955: The Germans and French From the Ruhr Conflict to Economic Community*. New York: Cambridge University Press, 1991.
- Gimbel, John. *The Origins of the Marshall Plan*. Stanford, CA: Stanford University Press, 1976.
- George, Stephen. *Politics and Policy in the European Community*. 3rd ed. Oxford: Oxford University Press, 1996.
- Gomes, Leonard. *International Economic Problems*. London: MacMillan Press, 1978.
- Goulden, Joseph C. *Meany*. New York: Atheneum, 1972.
- Gowa, Joanne. *Closing the Gold Window: Domestic Politics and the End of the Bretton Woods System*. Ithaca, NY: Cornell University Press, 1983.
- Gros, Daniel and Niels Thygesen. *European Monetary Integration*. New York: St. Martin's, 1992.
- Haberler, Gottfried. "International Aspects of Inflation." In Philip Cagan et. al. *A New Look at Inflation*. New York, American Enterprise Institute for Public Policy Research, 1973.
- Haldeman, H. R. *The Haldeman Diaries: Inside the Nixon White House*. New York: Putnam, 1994.

- Hall, Peter A. *The Political Power of Economic Ideas: Keynesianism Across Nations*. Princeton, New Jersey: Princeton University Press, 1989.
- Ham, Peter van. *The European Community and Central Europe: Integration, Collaboration & Discord Since 1947*. New York: St. Martin's, 1993.
- Harrod, Roy F. *The Life of John Maynard Keynes*. New York: Harcourt, 1951.
- Hellmann, Rainer. *Gold, the Dollar, and the European Currency Systems : The Seven Year Monetary War*. New York: Praeger, 1979.
- Henning, C. Randall. *Currencies and Politics in the United States, Germany, and Japan*. Washington, DC: Institute for International Economics, 1994.
- Herzog, Chaim. *The War of Atonement, October 1973*. Boston, MA: Little, Brown, 1975.
- Hogan, Michael J. *The Marshall Plan: America, Britain, and the Reconstruction of Western Europe, 1947-1952*. New York: Cambridge University Press, 1987.
- Hollanded, Martin, ed. *Common Foreign & Security Policy: The Record & Reforms*. London: Pinter Publishers, 1997.
- Horsefield, J. Keith, ed. *The International Monetary Fund.. 3 vols*. Washington, DC: International Monetary Fund, 1969.
- Jacob, Robert and Alexander Skidelsky. *John Maynard Keynes: A Biography*. 2 vols. New York: Penguin, 2000.
- Jeanneney, Jean-Marcel. *Forces et faiblesses de l'economie francaise, 1945-1956*. Paris: Librairie A. Colin, 1956.
- Jenkins, Roy. *European Diary, 1977-1981*. London: Collins, 1989.
- Johnson, Brian. *The Politics of Money*. New York: McGraw-Hill, 1970.
- Johnson, Harry G. "The Sterling Crisis of 1967 and the Gold Rush of 1968." *Nebraska Journal of Economics and Business* 7 (Autumn 1968): 3-17.
- Johnson, Norris O. *Eurodollars in the New International Money Market*. New York: First National City Bank, 1964.

- Kaplan, Jacob and Günther Schleminger. *The European Payments Union: Financial Diplomacy in the 1950s*. New York: Clarendon, 1989.
- Katzenstein, Peter J. *Policy and Politics in West Germany: The Growth of a Semisovereign State*. Philadelphia, PA: Temple University Press, 1987.
- Kenen, Peter B. *Economic and Monetary Union in Europe: Moving Beyond Maastricht*. Cambridge, MA: Cambridge University Press, 1995.
- Kemmerer, Edwin. *Gold and the Gold Standard*. New York: McGraw, 1944.
- Kennedy, Ellen. *The Bundesbank: Germany's Central Bank in the International Monetary System*. London: Royal Institute for International Affairs, 1991.
- Keynes, John Maynard and D. E. Moggridge. *Activities 1941-1946: Shaping the Post-War World: Bretton Woods and Reparations*. New York: Macmillan, 1980.
- Keynes, John Maynard. *Proposals for an International Clearing Union*. London: H.M. Stationary Office, 1943.
- Kindleberger, Charles P. *Marshall Plan Days*. Boston: Allen, 1987.
- Kissinger, Henry. *White House Years*. Boston: Little Brown, 1978.
- Klassen, Karl. "Die Verwirklichung der Wirtschafts- und Währungsunion aus der Sicht der Deutschen Bundesbank." *Europa-Archiv* XXV (1970): 453-458.
- Kolodziej, Edward J. *French International Policy under de Gaulle and Pompidou. The Politics of Grandeur*. Ithaca, NY: Cornell University Press, 1974.
- Kruse, D.C. *Monetary Integration in Western Europe: EMU, EMS, and Beyond*. London: Butterworth Scientific, 1980.
- Kunz, Diane. *Butter and Guns: America's Cold War Economic Diplomacy*. New York: Free Press, 1997.
- Lacouture, Jean, and Patrick O'Brian, trans. *De Gaulle: The Rebel, 1890-1944*. Vol. 1. New York: Norton, 1990.
- and Alan Sheridan, trans. *De Gaulle: The Ruler 1945-1970*. Vol. 2. New York: Norton, 1991.
- Laqueur, Walter. *Confrontation: The Middle East and World Politics*. New York: Bantam Books, 1974.

- Liberman, Sima. *The Growth of European Mixed Economies*. New York, 1977.
- , *The Long Road to A European Monetary Union*. Lanhan, MD: University Press of America, 1992.
- Loriaux, Michael. *France After Hegemony: International Change and Financial Reform*. Ithaca, NY: Cornell University Press, 1991.
- Ludlow, Peter. *The Making of the European Monetary System: A Case Study of the Politics of the European Community*. London: Butterworth Scientific, 1982.
- McAllister, R. *From the EC to EU - An Historical and Political Survey*. New York: Routledge, 1997.
- McCormick, John. *The European Union: Politics and Policies*. 2nd ed. Boulder, CO: Westview, 1999.
- Maisel, Sherman. *Managing the Dollar*. New York: Norton, 1973.
- Marsh, David. *The Bundesbank: The Bank That Rules Europe*. London: Heinemann, 1992.
- Martinet, Gilles. *Le Système Pompidou*. Paris: Seuil, 1973.
- Matusow, Allen. *Nixon's Economy: Booms, Busts, Dollars, and Votes*. Lawrence, KS: University Press of Kansas, 1998.
- Mayer, Martin. *The Fate of the Dollar*. New York, New York Times Books, 1980.
- Ménudier, Henri. *L'Allemagne selon Willy Brandt*. Paris: Stock, 1976.
- Moggridge, D. E., ed. *The Collected Writings of John Maynard Keynes*. 26 vols. New York: Cambridge University Press, 1980.
- Monre, Elizabeth and A.H. Farrar-Hockley. *The Arab-Israeli War, October 1973: Background and Events*. Adelphi Papers, no. 111. London: Adelphi, 1974.
- Mouré, Kenneth. *The Gold Standard Illusion: France, the Bank of France, and the International Gold Standard, 1914-1939*. New York: Oxford University Press, 2002.
- Nrgaard, Ole, Thomas Pederson, and Nikolaj Peterson. *The European Community in World Politics*. New York: St. Martin's, 1993.

- Nuttall, Simon J. *European Political Cooperation*. New York: Oxford University Press, 1992.
- Oatley, Thomas H. *Monetary Politics: Exchange Rate Cooperation in the European Union*. Ann Arbor, MI: University of Michigan Press, 1997.
- Odell, John S. *U.S. International Monetary Policy: Markets, Power, and Ideas as Sources of Change*. New Jersey: Princeton University Press, 1982.
- Officer, Lawrence H. *Between the Dollar-Sterling Gold Points: Exchange Rates, Parity, and Market Behavior*. New York: Cambridge University Press, 1996.
- Paraboni, Riccardo. Jon Rothschild trans.. *The Dollar and Its Rivals: Recession, Inflation, and International Finance*. London: NLB, 1981.
- Patat, Jean-Pierre and Michel Lutfalla, Patrick Martindale and David Cobham trans. *A Monetary History of France in the Twentieth Century*. New York: St. Martin's, 1990.
- Paxton, Robert O., and Nicolas Wahl. *De Gaulle and the United States: A Centennial Reappraisal*. Providence, RI: Berg, 1994.
- Piening, Christopher. *Global Europe: The European Union in World Affairs*. Boulder, CO: Lynne Rienner, 1997.
- Pinder, Jonathan. *European Community - The Building of a Union*. 2nd ed. Oxford: Oxford University Press, 1995.
- Pompidou, Georges. *Entretiens et discours*. Eduard Balladur, ed. 2 vols. Paris: Plon, 1975.
- Preeg, Ernest H. *Traders and Diplomats: An Analysis of the Kennedy Round Negotiations Under the General Agreement for Tariffs and Trade*. Washington, DC: Brookings Institute, 1970.
- Rees, David. *Harry Dexter White: A Study in Paradox*. New York: Coward, 1973.
- Reston, James Jr. *The Lone Star: The Life of John Connally*. New York: Harper and Row, 1989.
- Rials, Stéphane. *Les Idées politiques de Président Georges Pompidou*. Paris: Presses Universitaires de France, 1977.

- Roussel, Eric. *Georges Pompidou*. Paris: Lattès, 1984.
- Roney, Alex. *The European Community Fact Book: A Question and Answer Guide to 1992*. London: Longman, 1990.
- Roosa, Robert V. *The Dollar and World Liquidity*. New York: Random, 1967.
- Ross, Kristin. *May '68 and Its Afterlives*. Chicago: University of Chicago Press, 2002.
- Rueff, Jacques. Roger Glémet, trans. *The Monetary Sin of the West*. New York: Macmillan, 1972.
- *Le lancinant problème des blanches de paiements*. Paris: Payot, 1966.
- *Combats pur l'ordre financier: Mémoires et documents pour servir à l'histoire du dernier demi-siècle*. Paris: Plon, 1972.
- *Politique économique*. Paris: Plon, 1979.
- Rueff, Jacques and Fred Hirsch. *The Role and the Rule of Gold: An Argument*. Essays in International Finance, no. 47. Princeton, NJ: Princeton University Press, 1965.
- Safire, William. *Before the Fall*. New York: Doubleday, 1975.
- Scammel, W. M. *International Monetary Policy: Bretton Woods and After*. New York: Wiley, 1975.
- *The Stability of the International Monetary System*. New Jersey: Rowman and Littlefield, 1987.
- Schmidt, Hellmut. *Men and Powers: A Political Retrospective*. Ruth Hein, trans. New York: Random, 1989.
- Schwarz, Jürgen. *Die Europapolitik Frankreichs unter Georges Pompidou als Problem der westeuropäischen Gemeinschaftsbildung*. Ebenhausen, West Germany: Stiftung Wissenschaft und Politik, 1973.
- Servan-Schreiber, J. J. Ronald Steel trans. *The Spirit of May*. New York: McGraw, 1969.
- Simonian, Haig *The Privileged Partnership: Franco-German Relations in the European Community 1969-1984*. Oxford: Clarendon, 1985.

- Singer, Daniel. *Prelude to Revolution: France in May 1968*. New York: Hill and Wang, 1970.
- Sobol, Dorothy M. *Europe Confronts the Dollar: The Creation of the SDR, 1963-1969*. New York: Garland, 1982.
- Solomon, Robert. *The International Monetary System*. New York: Harper, 1977.
- Stabler, Elizabeth. "The Dollar Devaluations of 1971 and 1973." *Murphy Commission, Appendices*. vol. 3, (June 1975): 154-155.
- Staff, Grant. *The Common Agricultural Policy*. New York: St. Martin's, 1997.
- Stein, Herbert. *Presidential Economics: The Making of Economic Policy from Roosevelt to Reagan and Beyond*. New York: Simon and Schuster, 1984.
- Steinherr, Alfred. *30 Years of European Monetary Integration From the Werner Plan to EMU*. New York: Longman, 1994.
- Strange, Susan. *International Economic Relations of the Western World 1959-1971. International Monetary Relations. Vol. 2*. New York: Oxford University Press, 1976.
- *Sterling and British Policy: A Political Study of an International Currency in Decline*. London: Oxford, 1971.
- *The Sterling Problem and the Six*. London: Chatham House, 1967.
- "The Dollar Crisis, 1971", *International Affairs* 48 (April 1972): 191-216.
- Swann, Dennis. *The Economics of Europe: From Common Market to European Union*. 9th ed. London: Penguin, 2000.
- Tew, Brian. *The Evolution of the International Monetary System 1945-1988*. London: Hutchinson, 1988.
- Treverton, Gregory F. *The Dollar Drain and American Forces in Germany*. Athens, OH: Athens University Press, 1978.
- Triffin, Robert. *Europe and the Money Muddle: From Bilateralism to Near-Convertibility, 1947-1956*. New Haven, CT: Yale University Press, 1967.
- *Gold and the Dollar Crisis: The Future of Convertibility*. New Haven, CT: Yale University Press, 1960.

- . *The World Money Maze: National Currencies in International Payments*. New Haven, CT: Yale University Press, 1966.
- Tsoukalis, Loukas. *The Politics and Economics of European Monetary Integration*. London: Oxford, 1977.
- . *The New European Economy Revisited*. 3rd ed. London: Oxford, 1997.
- Ungerer, Horst. *A Concise History of European Monetary Integration: From EPU to EMU*. London: Quorum, 1997.
- Urwin, Derek. *The Community of Europe - A History of European Integration*. Reading, MA: Addison-Wesley Longman, 1995.
- Volcker, Paul and Toyoo Gyohten. *Changing Fortunes: The World's Money and the Threat to American Leadership*. New York: New York Times Books, 1992.
- Weber, Arnold. *In the Pursuit of Price Stability: The Wage-Price Freeze of 1971*. Washinton, DC: Brookings Institute, 1973.
- Weil, Gordon L. and Ian Davidson. *The Gold War: The Story of the World's Monetary Crisis*. New York: Holt, 1970.
- White, Harry Dexter. *A Preliminary Draft of a Proposal for a United and Associated Nations Stabilization Fund*. Washington, DC: U.S. Treasury, 1943.
- . "The Monetary Fund." *Foreign Affairs* 23 (January 1945): 195-210.
- White, Nathan. *Harry Dexter White: Loyal American*. Waban, MA: Bloom, 1956.
- Williams, John H. "Currency Stabilization: The Keynes and White Plans." *Foreign Affairs* 21 (July 1943): 645-658.
- Williams, Charles. *The Last Great Frenchman: A Life of Charles de Gaulle*. New York: Wiley, 1993.
- Winand, Pascaline. *Eisenhower, Kennedy and the United States of Europe*. New York: St. Martin's, 1993.
- Williamson, John. *The Failure of World Monetary Reform, 1971-1974*. New York: New York University, 1977.

Wolfe, Martin. *The French Franc Between the Wars, 1919-1939*. New York: Columbia University Press, 1951.

Yergin, Daniel. *The Prize: The Epic Quest for Oil, Money and Power*. New York: Simon and Schuster, 1991.

Ypersele, Jacques van. *The European Monetary System: Origins, Opportunities, Outlook*. Brussels, Commission of the European Communities, 1984.

VITA

Michelle Frasher Rae
frasherrae@gmail.com

EDUCATION

Ph.D. History, 2003
M.A., 1997
B.A., 1994