

CHAPTER FIVE

The President, Policy Implementation, and the Short Road to Camp David

President Nixon only now enters the analysis to any great extent. His belated appearance accurately reflects the argument of the study in general and of this chapter in particular that the major variables explaining the decision to close the gold window lay not in the Oval Office but elsewhere. The president, for a variety of reasons, did no more than rubber-stamp the recommendation of the decision paper formally presented to him by the Volcker Group in June 1969. The dominant influences on his administration's policy remain the consensus uniting administration officials on the primacy of national autonomy and the structure and process of the administration's policy making.

Moreover, the president's endorsement of the Volcker Group's recommendation accomplished less in terms of establishing actual U.S. policy than it might at first appear. The group recommended that the United States adopt what it labeled an approach of "negotiated multilateral evolution" vis-à-vis the Bretton Woods regime. But this did not represent a coherent approach to policy; instead, it reflected the efforts of the Volcker group to meld disparate policy initiatives. The recommendation's predominant appeal lay in its ability to command the support of a variety of officials whose interests were incompletely congruent.

Actual U.S. international monetary policy between 1969 and 1971, therefore, was set not by presidential decision but to a large extent

during the implementation of policy—a process dominated by the Department of the Treasury. In practice, the Nixon administration's policy on the position of the dollar and the survival of the Bretton Woods regime became one of "muddling through," a policy that, given concurrent developments in international financial markets and in the U.S. economy, was to prove viable for two years. When both the international and the domestic economy unraveled in 1971, however, muddling through was doomed to a rapid demise, as was the postwar monetary regime itself.

In this chapter I trace the course of U.S. international monetary policy from the formal presentation of the Volcker Group's recommendations in the Oval Office in mid-1969 to the opening of the Camp David meeting in mid-1971. That course demonstrates the illusory nature of presidential choice, confirms the power of the Department of the Treasury over the making of international monetary policy, and makes clear the emerging clash between the demands of regime maintenance and those of domestic economic autonomy—a clash that would eventually lead the United States to close the gold window.

THE VOLCKER GROUP IN THE OVAL OFFICE

On June 23, 1969, the president, his top economic advisers, and members of the Volcker Group met in the president's office to discuss the decision paper that the group had spent several months preparing. Informing the president that "basic policy decisions in the international monetary area" were "urgent," the paper emphasized the risks to U.S. freedom of decision making in domestic economic and foreign security policy inherent in the ongoing controversy over international monetary arrangements.¹

That controversy could be interpreted, according to the Volcker Group, "as a struggle over who should assume the main burden for eliminating or adjusting to the excessive U.S. deficit and the form the adjustment should take." Thus the decision paper pointed out to the president that the "outcome will have implications for

¹"Basic Options in International Monetary Affairs," p. 1.

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the constraints that may be applied to our foreign and domestic policies; as compared to the substantial degree of freedom we have enjoyed during most of the postwar period.”² In short, warned the Volcker Group, the stakes involved in the impending presidential decision were substantial.

The decision paper confronted the president with a choice among three courses of action: a unilateral devaluation of the dollar through a rise in the price of gold, an immediate suspension of the convertibility of the dollar into gold, and what was labeled a “multilateral” approach. Despite President Nixon’s adamant insistence that such papers contain several different but equally realistic policy options among which he could exercise a genuine choice, the Volcker Group’s paper offered the president only the illusion of choice: the three options consisted of two straw men (devaluation and an immediate suspension of convertibility) and one real option (the multilateral approach) designed primarily to enable a bureaucratic consensus to form. Neither domestic deflation nor constraints on foreign policy appear as options in the decision paper, although the paper does observe that “the dominant factor affecting the evolution of the international monetary system (and our success in guiding that evolution) will be our ability to contain domestic inflationary forces.”³

Convinced that a unilateral dollar devaluation would be vitiated by the reactions of other countries to what they would perceive as an unwarranted attempt by the United States to improve its export performance, the Volcker Group advised the president against an attempt to resolve obvious problems in the Bretton Woods regime by announcing a rise, either small or large, in the dollar price of gold. To strengthen its case against a devaluation, the Volcker Group reminded the president of the significant domestic “legal and political obstacles” to a change in the gold price: “legally, congressional sanction would need to be obtained, and a Republican administration would be forced to seek approval from an opposition Congress with liberal economic leadership strongly against a gold price change. Republican Banking and Currency Committee leadership (e.g., [William B.] Widnall) shares this view. Extended

²Ibid., p. 9.

³Ibid., p. 19.

emotional debate—even if finally won on the basis of ratifying a ‘fait accompli’—would at the least magnify the market uncertainties and tend to exacerbate the intuitive association of devaluation by the man in the street with inflation, broken promises, and monetary instability.”⁴

In an equally accurate reflection of its earlier discussion of immediately suspending gold convertibility, the Volcker Group suggested to the president that he also avoid any premature closing of the gold window. The appearance of force majeure in such a decision, warned the Volcker Group, would impede the pursuit by the United States of an improved monetary system which “politically, while definitely implying a gradually increasing participation and responsibility for other countries in the management of the international monetary system commensurate with their growing economic power . . . would retain for an indefinite period a major role for the dollar and monetary leadership for the United States.”⁵ While the United States was in reality seeking “a substantial element of U.S. control” over the monetary system, its best chance of gaining that control, in the Volcker Group’s opinion, was to avoid the appearance of seeking it. Closing the gold window was inconsistent, while a multilateral approach was clearly consonant, with that objective. As the decision paper observed, “in the interest of facilitating international harmony, the appearance of U.S. hegemony should not be sought. In more concrete terms, this tends to point to the desirability of working in a context of multilateral consultation and cooperation, so long as this does not, by reducing progress to the lowest common denominator, frustrate needed change.”⁶

Thus the Volcker Group recommended to the president that he adopt its third option, the multilateral approach, adding, however, that “either external developments or a negotiating impasse may at some time, and perhaps soon, justify use of the ‘suspension option.’”⁷ The recommendation of “negotiated multilateral evolution” included six elements. First, “early and sizeable activation of the Special Drawing Rights scheme. . . .” Second, “some realign-

⁴Ibid., p. 34.

⁵Ibid., p. 26.

⁶Ibid., p. 13.

⁷Ibid., p. 47.

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ment of existing exchange rate parities now biased against the U.S. . . . ” Third, following the activation of special drawing rights, “active and sympathetic exploration of the various techniques for introducing a greater degree of exchange rate flexibility into the monetary system. . . . ” Fourth, “expansion of IMF quotas. . . . ” Fifth, at some stage possibly an exploration of “the feasibility and desirability of reserve settlement accounts. . . . ” And, finally, “continued and strong efforts toward removing structural impediments to U.S. trade and reducing the balance of payments costs of our defense efforts. . . . ”⁸

THE PRESIDENT'S RESPONSE

That President Nixon essentially rubber-stamped the Volcker Group's policy paper is congruent with precedents established by his predecessors in office with respect to the conduct of U.S. international monetary policy. The president nominally occupies the position of greatest power within the government on international monetary policy, as he does on all other issues. In practice, however, most presidents have not been consistently active in efforts to determine the course of the government's policy vis-à-vis the international monetary system.⁹ They have, nonetheless, sometimes exerted a not insignificant influence, in accord with the workings of the law of anticipated reaction. In President Nixon's case, for example, his underlings' awareness of his preferences contributed to, although it did not wholly determine, their refusal to consider seriously deflation, foreign-policy constraints, and extended capital controls as potential, partial remedies to the ills of the Bretton Woods regime.

Systemic constraints, a dearth of domestic incentives and a potential surfeit of domestic costs, and the dissociation between high and low foreign-policy issues all play a role in explaining the lack

⁸Ibid., pp. 23-25.

⁹See, for example, Porter's observation that organizational “entities established to address foreign economic policy issues . . . have not succeeded in consistently engaging the President's interest and attention, largely because they have not been tied to a regular work flow with which he must deal” (in Porter, “The President and Economic Policy,” p. 224).

of active presidential involvement in the making of postwar international monetary policy. Given the structure of the Bretton Woods regime, the relatively low (or, perhaps more accurately, the latent) political salience of international monetary policy issues within the United States—devaluation excepted—and presidential preoccupations with the Cold War, issues related to the postwar monetary regime did not normally engage the sustained interest of U.S. presidents. President Kennedy's reputed preoccupation with the dollar and the monetary regime was an anomaly rather than the norm.

The structure of the Bretton Woods regime itself worked strongly against the president's devoting his scarce time to monetary issues. That structure demanded that the United States conform to a standard of behavior unique within the system, remaining passive with respect to the level of its effective exchange rate. Unless the exchange rate became impossible to sustain, the United States was not to act affirmatively to affect the dollar's value in exchange markets. The passive role that the Bretton Woods regime assigned to the United States, therefore, rendered presidential attentiveness to the dollar and the international financial system as a whole relatively inefficient in the absence of a severe, dollar-centered crisis in the exchange markets.

Because of the structure of the U.S. economy, moreover, presidents could afford to expend relatively little energy on such issues. Heads of state of European countries had more cause to be familiar with and concerned about the setting of international monetary policy. Their countries were proportionately much more heavily engaged in international trade than was the United States and national competitiveness in international markets was for them a much more critical variable in determining aggregate economic activity. Both competitiveness and macroeconomic health, in turn, depended in part on the level of the exchange rate and, because the rate could be altered (at least in theory), it was a powerful policy tool that heads of European governments could not ignore. The structure of the U.S. economy made it much easier for American presidents to neglect Bretton Woods and the dollar.

Nor, structural considerations aside, did most presidents want even to contemplate changing the dollar's exchange rate. Given the U.S. balance-of-payments deficit, any change in the dollar's value would have logically implied a devaluation of the dollar with respect

to gold. Most American presidents, Nixon included, considered a devaluation the equivalent of political suicide. Schlesinger's frequently cited recollection of President Kennedy's attitude toward the dollar is a vivid example of the abhorrence with which American presidents regarded the prospect of devaluation. Recalls Schlesinger, "Kennedy . . . used to tell his advisers that the two things which scared him the most were nuclear war and the payments deficit. Once he half-humorously derided the notion that nuclear weapons were essential to international prestige. 'What really matters,' he said, 'is the strength of the currency.'"¹⁰

The British government's aversion to devaluation of the pound echoes in Schlesinger's recollection, evoking an instinctive association between reserve currency status and world power, and a fear that devaluation would destroy both simultaneously.¹¹ It is not altogether clear that either American presidents or British prime ministers understood why they mentally linked the two—why, that is, they believed reserve currencies underpinned world power. It is possible, of course, that they were well aware that the exercise of power on a global scale was eased by the use of their national currencies as important elements of other countries' reserves; that they understood that the reserve role of their currencies permitted an expansive foreign policy and the acquisition of corporate empires overseas without an overriding concern for the foreign-exchange costs thereby incurred; that they understood that reserve currency status gave them leverage over states confronting serious balance-of-payments deficits.

The problem with such an explanation is that there is no persuasive evidence that presidents, and perhaps prime ministers as well, thought about the issue in such sophisticated terms. It is clear that presidents on the whole were determined not to allow payments considerations to constrain their grand foreign-policy schemes.¹² It is not clear, however, that they realized it was the

¹⁰Arthur M. Schlesinger, Jr., *A Thousand Days: John F. Kennedy in the White House* (Boston: Houghton Mifflin, 1965), p. 654.

¹¹For perceptive analyses of the importance the British attributed to the reserve role of sterling, see Stephen Blank, "Britain: The Politics of Foreign Economic Policy, the Domestic Economy, and the Problem of Domestic Expansion," in Katzenstein, *Between Power and Plenty*, pp. 89-138, and Strange, *International Monetary Relations*, pp. 153-55.

¹²As amply evidenced by the refusal of presidents to adjust foreign policy to the demands of the U.S. payments accounts.

reserve role of the dollar that enabled them in part to escape that constraint.

Nor is there any evidence that private groups who themselves, for different reasons, were intent on avoiding presidential recourse to a dollar devaluation persuaded presidents to link state power in the international political system to the continuation of the dollar's reserve role. As Stephen Krasner has observed, it does not seem to have occurred to most American elites, including bankers and financiers, that the dollar's value might change.¹³ Interest-group pressures therefore do not adequately explain presidential opposition to devaluing the dollar.

The aversion instead may have been instinctive, a product perhaps of presidents' believing that devaluation would so damage their prestige domestically as to undermine seriously their power to act effectively abroad. The \$35 per ounce price of gold had been established by Congress in 1934 and, as Susan Strange observes, "much American opinion had come to regard this price as no less sacrosanct than the flag, the Constitution, Thanksgiving and blueberry pie [*sic*]."¹⁴

Moreover, American presidents had no significant political incentives on the domestic front to attend to the intricacies of the Bretton Woods system, since the role of the United States in the postwar international monetary system remained an apolitical issue in American politics for a long time. While particular balance-of-payments initiatives by the administration on occasion aroused some political controversy, the monetary system itself for the most part escaped the scrutiny of the public and Congress. With the exception of several hearings and reports by a subcommittee of the Joint Economic Committee, little congressional attention was devoted to issues concerning the Bretton Woods system itself: few Representatives and Senators were equipped to ask, for example, whether the Bretton Woods system itself was responsible for the series of U.S. payments deficits; whether the role of the dollar in the postwar

¹³He comments that "until the late 1960s, virtually all sectors of the American elite regarded both the value of the dollar and fixed exchange rates as graven in stone and beyond the tampering of mere mortals" (Krasner, "US Commercial and Monetary Policy: Unravelling the Paradox of External Strength and Internal Weakness," in Katzenstein, *Between Power and Plenty*, pp. 65-66).

¹⁴Strange, *International Monetary Relations*, p. 42.

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monetary system exerted a deleterious effect on domestic industries; or whether the obligation of the United States to convert dollars into gold ought to continue to be U.S. policy. As a result, presidents could afford, at least from a domestic political perspective, to skirt issues related to the monetary system.

Trade issues served as the political surrogate for what might otherwise have become grievances directed at the Bretton Woods system. When special interests lobbied and Congress legislated in the sphere of international economics, they targeted trade much more heavily than they did monetary issues. In part, they were as constrained as the president was from intervening in international monetary issues by the structure of the Bretton Woods system and for a long time they accepted the conventional wisdom that the dollar's exchange rate and its relationship to gold were immutable. Trade issues also proved to be both more susceptible to political influence and more accessible to intuitive understanding than were monetary issues. Every industry that either exported or competed with imported goods knew that reducing foreign trade restrictions or raising U.S. tariff or nontariff barriers directly influenced their balance sheets and, consequently, everyone in Congress knew it too. The history of congressional involvement in the setting of U.S. tariffs, sometimes on an industry-by-industry basis and sometimes by legislating the ground rules for the executive branch's involvement in trade negotiations or adjustment assistance to affected industries, is extensive.¹⁵ Thus, there is a domestic political incentive for presidents to understand and attend to trade issues that does not apply equally to issues in international monetary policy. International trade also involves this political incentive because presidential prestige, at home and abroad, sometimes becomes entangled with the outcome of highly visible international negotiations over tariff levels. The Kennedy Round of negotiations that concluded in 1967, for example, became a symbol of the president's ability to conduct alliance relations while simultaneously promoting his nation's economic interests.

¹⁵For a history and analysis of tariffs and Congress, see E. E. Schattschneider, *Politics, Pressures and the Tariff* (Englewood Cliffs, N.J.: Prentice-Hall, 1935), and Raymond A. Bauer, Ithiel DeSola Pool, and Lewis Anthony Dexter, *American Business and Public Policy: The Politics of Foreign Trade*, 2d ed. (Chicago: Aldine-Atherton, 1972).

During his administration, President Nixon would conform quite closely to this pattern of skewed attention toward trade and away from money. He had pledged in his 1968 campaign to try to alleviate the plight of southern textile workers; as a result, the Japanese for several years after Nixon's election were the unwilling beneficiaries of a great deal of presidential attention to the issue of trade in textiles. When Congress attended to international economic issues during Nixon's first two years in office it focused on trade, threatening to pass restrictive trade measures such as various proposals to levy surcharges on imports. As the balance of payments deteriorated sharply in 1971, the Subcommittee on International Exchange and Payments of the Joint Economic Committee, chaired by Henry S. Reuss, would begin to press for a fundamental change in basic U.S. international monetary policy; but most congressional energy continued to be expended on trade rather than monetary issues.

On presidents' own foreign-policy agendas, moreover, issues related to the Bretton Woods regime did not rank very highly. Coinciding for the most part with a period of relatively high Soviet-American tensions, the Bretton Woods regime could not compete with, for example, the dispatch of U.S. Marines to Lebanon in 1958, the Congo crisis of 1960, the Cuban missile crisis, Vietnam, or the many other ongoing issues and crises related to the Cold War. In the competition for presidential attention, the appeal of East-West issues was overwhelming; Bretton Woods, while not insignificant, nevertheless achieved nowhere near the salience accorded to traditional security issues by successive American presidents.

As was true of his predecessors then, President Nixon would attend to international monetary issues on an episodic basis. He very plainly did not want to be bothered about the balance of payments: he did not want domestic economic policy restrained by the payments deficit nor did he want the deficit to impinge on his direction of foreign policy.¹⁶ The deficit, he thought, could be best dealt with by forcing the European Community to modify its Com-

¹⁶At an economic policy meeting in his office in November 1970, for example, President Nixon reportedly "exploded" when the balance of payments was "mentioned," stating "I hear all about the balance of payments and nobody worries about 8 percent unemployment!" ("Meeting in Oval Office on Economic Policy," November 30, 1970, document from the files of William Safire, Chevy Chase, Md.)

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mon Agricultural Policy or Japan to open its domestic market to American products. It is true that very early in his administration, President Nixon, to the consternation of top Treasury officials, became aware of press reports of unrest in international financial arrangements and expressed to his aides his interest in doing "something short of a summit meeting . . . to show my concern in that area."¹⁷

But thereafter, until the Camp David meeting in August 1971, Nixon reverted to the more usual pattern of presidential noninvolvement in the conduct of U.S. international monetary policy. Volcker, whose tenure as under secretary coincided with Nixon's presidency, states that "American Presidents . . . have not in my experience wanted to spend much time on the complexities of international finance. But the repeated charge to the negotiators seemed clear, and in a sense ominous: 'I want a system that doesn't have all these crises!'"¹⁸ The fate of H. R. Haldeman's and John Ehrlichman's efforts to engage Nixon's interest in the Italian lira in 1972 is well-known: their attempts evoked the famous, expletive-deleted comment by the president that "I don't give a . . . about the lira."¹⁹ Even before Watergate usurped the president's atten-

¹⁷"Report on Cabinet Committee on Economic Policy," February 13, 1969, p. 7, document from the files of William Safire, Chevy Chase, Md. Charls E. Walker, the under secretary of the Treasury who was sitting in for Secretary Kennedy at the meeting, was clearly nervous about the president's desire, in Walker's words, not "to be viewed as a 'do-nothing' in international monetary reform" and about the president's expression of intent to discuss international monetary issues in his March 1969 trip to Europe. This, Walker stated in a memorandum to Kennedy relating the events that transpired, "shook me a little" (U.S., Department of the Treasury, "Memorandum for the Secretary," February 13, 1969, pp. 2-3, document released by the Department of the Treasury under an FOIA request).

¹⁸Volcker, "Political Economy of the Dollar," p. 22.

¹⁹A larger extract from the June 23, 1972, tape provides further evidence of President Nixon's low-level interest in and understanding of international monetary issues:

Haldeman (H): Did you get the report that the British floated the pound?

President (P): I don't think so.

H: They did.

P: That's devaluation?

H: Yeah. [Peter] Flanigan's got a report on it here.

P: I don't care about it. Nothing we can do about it.

H: You want a run-down?

P: No, I don't.

H: He argues it shows the wisdom of our refusal to consider convertibility until we get a new monetary system

tion, his advisers had trouble getting Nixon to concentrate on the fate of the international monetary system. During the 1971 meeting with French President Georges Pompidou, at which the United States finally conceded that it would devalue the dollar, Treasury officials competed, not altogether successfully, for the president's time with a televised football game.²⁰

The 1969 "Decision": A Presidential Rubber Stamp

In this context of presidential preference for avoiding intimate involvement in issues related to the Bretton Woods regime, it is understandable that President Nixon chose not to deviate from the elaborate rationales and policy recommendations of his experts. His inclination to accept the arguments and options as presented by the Volcker Group was reinforced, moreover, by the fact that, of his cabinet-level aides present at the June 1969 meeting, only one issued a significant dissent. Furthermore, the course of action recommended fitted nicely into his grand scheme of foreign policy.

Among those assembled at the mid-1969 meeting to consider and advise the president on the Volcker Group's recommendations, only Arthur Burns, then serving as counsellor to the president, registered significant dissent.²¹ Burns objected to the report's rejection of an immediate devaluation of the dollar by means of a rise in the price of gold and he vigorously attempted to persuade the president of the advantages of the devaluation that the Volcker Group opposed.

Burns expressed his concerns that the dollar was overvalued and that the U.S. balance of payments would continue to threaten the Bretton Woods system unless and until the overvaluation was corrected. Against the consensus prevailing within the Volcker Group, Burns maintained that other countries would not vitiate a unilateral

P: Good, I think he's right. It's too complicated for me to get into. (Unintelligible)
I understand.

H: Burns expects a 5-day percent (*sic*) devaluation against the dollar.

P: Yeah, O.K. fine.

H: Burns is concerned about speculation about the lira.

P: Well, I don't give a (expletive deleted) about the lira.

(Quoted in Williamson, *The Failure of International Monetary Reform*, p. 175)

²⁰Interview.

²¹The following account of Burns's dissent is based on various interviews.

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devaluation by reacting with corresponding devaluations of their own currencies. He also argued that because a dollar devaluation was inevitable, it would be to the political advantage of the president to proceed with the devaluation as rapidly as possible. If President Nixon sanctioned the move early in his administration, Burns contended, he could attribute its necessity to the policies and practices of his Democratic predecessors and thereby escape some of the political fallout that was likely to ensue.

The disparity in the forecasts of foreign reactions to a dollar devaluation produced by the members of the Volcker Group and by Burns is not immediately explicable. Burns relied on evidence and analysis markedly similar to those of other policy makers. The foreign officials Burns talked with also talked extensively with other administration officials and Burns was not in 1969 on as intimately familiar terms with other central bankers as he would be later, when he assumed the Federal Reserve Board chairmanship. The history of stubborn resistance by other countries to exchange-rate changes was accessible to all on equal terms, and the 1968 Bonn conference had recently provided a vivid reminder of the rigidity of exchange rates.

The disparity in perspectives had little to do with either evidence or analysis. It was instead a consequence of an underlying dispute between Burns and others on a more fundamental point, the nature of the present and future international monetary systems. Agreement was universal on the goal of a depreciated dollar. The argument over the optimal way to accomplish depreciation, however, reflected a latent but basic conflict over the appropriate role of gold in the future Bretton Woods or any other system, as well as sharply disparate images of international economic relations writ large.

Both opponents and proponents of a unilateral devaluation agreed that one of its effects would be to reinforce the role of gold in the system. They disagreed as to that effect's desirability, however; and it was that disagreement which accounted, in part, for divergent estimates of whether a devaluation would be acceptable to other countries, despite the absence of any logical linkage between the two issues. Most members of the Volcker Group wanted gold demonetized and believed in the greater utility of the special drawing right; they also believed that a rise in the gold price in an effort to realize a dollar devaluation would be self-defeating. Burns, on

the other hand, was not particularly enthusiastic about the special drawing right and still believed in gold rather than a paper standard; he believed, accordingly, that a unilateral devaluation would succeed.

Also underlying the disparity in forecasts of foreign countries' reactions to a rise in the dollar price of gold was a disagreement between Burns and most members of the Volcker Group on the nature of the existing international economic system and on the nature of states' participation in that system. As evident in the debate over the closing of the gold window that occurred at the Camp David meeting, Burns did not share the image of the international economic system dominant within the Nixon administration. Unlike most of his colleagues, who themselves accepted and attributed to others a nationalist perspective on the involvement of states in the network of international financial relations, Burns remained convinced that the spirit of internationalism either equaled or exceeded in strength the force of nationalism. He was persuaded, accordingly, that other states would accept a unilateral devaluation of the dollar by the United States and, as a result, he urged President Nixon to raise the price of gold immediately.

The subtleties underlying the dispute over devaluation undoubtedly did not impress Nixon as much as his own conviction that raising the gold price was politically suicidal, to be avoided as long as possible. With the backing of the vast majority of his advisers, therefore, the president decided against an immediate effort to devalue the dollar.

At the same time, the president concurred in the Volcker Group's recommendation that a closing of the gold window ought to be deferred until it appeared that the United States had no alternative but to do so. His concurrence does not appear to have been the result of the Volcker Group's analysis of the impact on the monetary system of an immediate suspension of convertibility but instead seems to have been the product of his own larger foreign-policy design. Intent on gaining Soviet agreement to a strategic arms limitation treaty, stabilizing and expanding Soviet-American detente, and opening contacts with the People's Republic of China, the president had an interest in securing U.S. alliances, in order to bolster his negotiating position with the communist nations and to quell conservative opposition to those moves. To invite conflict

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within the alliances by suspending gold convertibility before the payments situation degenerated seriously and a crisis in the exchange markets forced such action did not fit in with the president's more broadly conceived plan for American foreign policy.

Against the more certain risk that decisive action involved, a decision to lay international monetary issues aside—to temporize—did not threaten important American interests, at least not in the short term. Even if the deficit were to worsen as predicted, the conduct of domestic economic policy would not be significantly affected given the consensus within and outside the administration that it made little sense to key domestic policy to the course of the balance of payments. Nor was the course of the balance of payments likely to influence foreign policy: if the Nixon administration's foreign policy was to be constrained, it was much more likely to be constrained by public and congressional opposition to the war in Vietnam than by the balance-of-payments deficit.

Furthermore, European objections to the Bretton Woods regime were not expected to pose any serious problems. The only fearsome weapon the Europeans possessed was their *de jure* right to convert excess dollars into gold at the U.S. Treasury, but it was apparent to them that doing so would only transform that right into a *de facto* impossibility. When the Nixon administration relaxed capital controls in April 1969, it became unmistakably clear to the Europeans that conversions would precipitate a U.S. float of the dollar. The consequences anticipated from suspension powerfully inhibited European resort to gold, and the Nixon administration knew it. As the Haberler task force ably pointed out, the only viable European responses, were U.S. deficits to reemerge—either appreciation or inflation—would merely provide some relief to the American payments situation. Nothing was to be feared from the European side, therefore, if the president decided to temporize.

That was essentially what the president did when, at the close of the June 1969 meeting, he rejected the options of devaluation and an immediate suspension. Instead, he accepted the Volcker Group's recommendation that the United States adopt a multipronged approach to the problems of the dollar and the Bretton Woods system, an approach that had some small chance of averting their resolution in a suspension of convertibility. Whether he understood the un-

derlying logic of the various components of the policy he sanctioned at that White House meeting is unclear; the president did not modify but simply ratified the strategy favored by the majority of his advisers that had been constructed at the subcabinet level.

It was not until two years later, when he convened his top advisers at Camp David and decided to close the gold window, that the president would again assume a role in determining the course of balance-of-payments strategy and the future of the Bretton Woods system. By that time, however, the president's "choice" would again be largely illusory, decided in advance by a flood of dollars abroad and by the activity and inactivity of those predominantly subcabinet-level officials who had overseen international monetary policy in the interim.

THE IMPLEMENTATION OF POLICY

The Triumph of "Muddle Through"

The multilateral approach that the president approved in 1969 was no more than an agglomeration of various policies to which members of the Volcker Group loaned their support in widely varying degrees. Which components were actually translated into effective policy in the 1969-1971 period, therefore, depended, in the absence of close presidential surveillance, on the distribution of power over the implementation of policy. And since that power belonged largely to Treasury, it was Treasury's preferences rather than the entire multilateral package that became U.S. policy.

That being said, however, it is still difficult to determine what U.S. policy was before the decision of August 1971. It is clear that the desire expressed in the decision paper to activate special drawing rights in sizable amounts was translated into policy; the Treasury did press the Europeans hard on the issue and the first distribution of special drawing rights occurred in 1970. Much of Volcker's energy was expended on this one issue, which proved difficult to consummate because the Europeans were as intent on denying as the United States was on achieving the extra financing for the U.S. deficit that the assets would provide. Volcker was also

preoccupied in 1969 by a dispute between the United States and South Africa, as Washington opposed Pretoria's demands regarding gold sales to the International Monetary Fund and foreign central banks.²²

There was apparent agreement within the Volcker Group that other exchange rates needed revaluation; but whether the United States actually pursued this element of the multilateral approach before it suspended convertibility remains, more than a decade later, a matter of heated controversy. The Johnson administration had begun to move in this direction by late 1968; at the November conference in Bonn of Group of Ten members, for example, Secretary Fowler had urged Germany to revalue the mark. But whether Fowler's successors adhered to the same philosophy is disputed. One vociferous critic of Nixon administration policy, Coombs, charges that the administration never approached Japan, by 1970 one of the two major surplus countries, about its exchange rate. The former Federal Reserve Bank of New York official maintains that "with a sufficiently strong expression of concern, the Japanese government might have been induced [to raise the yen's exchange rate] . . . Yet no Federal Reserve representative attending the BIS meetings in 1970-1971 was ever asked to urge on senior Bank of Japan officials the importance of revaluing the yen. Nor, as far as I could ascertain, were Nixon officials using other channels for negotiation of a yen revaluation. Senior Japanese financial officials have since confirmed to me that there were no American approaches to them at the time for a revaluation of the yen."²³

A senior Treasury official rebuts Coombs's allegation as "inconceivable," pointing out that Coombs also complains that he was never privy to Nixon administration policy discussions. He "would have agreed," the Treasury official admits, "that if you could have gotten, at that stage of the game, a small number of countries to substantially revalue . . . their currencies, you could have avoided the trauma of devaluation of the dollar. The question really became one of possibilities: how much leverage did the United States really have to force revaluation of other currencies? And I think the Fed

²²For a discussion of the South African gold dispute, see Solomon, *The International Monetary System*, pp. 125-26.

²³Coombs, *The Arena of International Finance*, pp. 210-11.

and . . . Coombs felt . . . that the Treasury was not trying hard enough, and if it had only tried a little harder, it could have gotten the job done, and we would have saved ourselves from all this chaos."²⁴ While clearly believing that the resistance to revaluation was too strong to have been susceptible to persuasion even by Coombs, this Treasury official did not directly participate in discussions of exchange rates with representatives of other countries.

Other U.S. government officials did participate, however, and testify they made it clear that revaluations were essential. During meetings between U.S. and Japanese cabinet members in which he participated, an official of the Council of Economic Advisers states, the Japanese were told "in no uncertain terms" that their exchange rate had to be changed. This council official says he does not "have any sympathy for the idea that if they'd only known they would have cooperated. There wasn't the slightest evidence of that."²⁵ Moreover, Philip H. Trezise, the State Department's assistant secretary for economic affairs, who frequently conducted negotiations with the Japanese, actually stated publicly in May 1971 that he thought the yen was undervalued.²⁶ At least one official who himself urged exchange rate changes also believes, however, that the United States did not seriously pressure the Japanese to revalue the yen.²⁷

Neither Coombs's charges nor the various rebuttals are precisely accurate, although both contain fragments of the truth. Foreign officials might well have been justifiably confused as to the desires of the U.S. government regarding exchange-rate changes in this period, although some clearly thought that revaluations were a goal of U.S. policy.²⁸ But many voices spoke in the name of the U.S. government and those voices did not express a consistent, clear-cut policy with regard to exchange-rate changes. Treasury, for example, rebuked Trezise's public call for a revaluation of the yen.²⁹

²⁴Interview.

²⁵Interview.

²⁶*New York Times*, May 26, 1971.

²⁷Interview.

²⁸By late 1969 some European countries, for example, began to ask that swap agreements carry a guarantee of exchange-rate value in case of a revaluation as well as a devaluation (*Minutes of the FOMC*, November 25, 1969).

²⁹In May 1971 then Secretary of the Treasury John B. Connally also criticized the upward float of the deutsche mark (see Odell's discussion in *U.S. International Monetary Policy*, chap. 4).

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While this might reasonably be attributed to bureaucratic pique or concern for market stability, it instead appears to be consistent with actual policy, at least as Volcker conducted it.

“Appreciation of other currencies,” explained Volcker later, “never seemed (to me at least) to provide an answer. It was expecting too much to think then, before inflationary concerns had become so great a consideration in exchange rate policy, that individual countries would voluntarily take the political and economic risks of seeming to write off exports, jobs, and profits so long as they had another alternative.”³⁰ Volcker also apparently adhered to the view that whatever exchange-rate changes might have resulted from American pressure would not have been sufficient to restore global payments equilibrium; but they might have been sufficient to cause the collapse of the entire Bretton Woods system. In this view, any relaxation of exchange-rate rigidity would have created an incentive for holders of dollars to convert their stocks into currencies that they saw as likely candidates for revaluation. As the discarded dollars began to pile up in foreign central banks, pressures to convert those dollars into gold at the U.S. Treasury would have increased, compelling the United States to close the gold window either immediately or when its gold stock had been depleted. The revaluations that some members of the U.S. government were urging as a solution to the problems of the Bretton Woods system appeared instead to the under secretary to threaten its demise.

Whether the option of persuading other countries to revalue their rates actually was adopted as U.S. policy is, therefore, a more complex question than it appears at first glance. The answer depends, in part, on which official of which department the observer perceives to have represented the U.S. government. Volcker, as a representative of the most influential department in U.S. international monetary policy and as the country’s chief negotiator abroad, wielded an authority at least equal to that of cabinet officials carrying different messages. To complicate matters further, many subcabinet-level officials in a variety of agencies who had contact with their counterparts in foreign governments plainly thought that U.S. policy was to encourage other countries to revalue in order

³⁰Volcker, “Political Economy of the Dollar,” p. 15.

to alleviate pressure on the U.S. balance of payments. To observers in finance ministries and central banks abroad, American policy undoubtedly appeared ambivalent and thus justified either revaluing an exchange rate or maintaining a parity unchanged.

Nor was systemic reform in practice a clear priority of the U.S. government, reflecting Treasury's fear that serious discussions of change could cause the collapse of the existing system without providing any reliable replacement. For its part, the Volcker Group apparently never reached a conclusion as to which system of limited flexibility, if any, was most desirable. The Treasury did undertake bilateral discussions with officials of the British Treasury on the technical feasibility of particular limited flexibility systems.³¹ Volcker did inform Canadian authorities that the U.S. government intended to study proposals for such systems to determine their feasibility.³² Furthermore, in the person of William Dale the United States participated in a secret study by the executive directors of the International Monetary Fund that examined limited flexibility in the context of a larger study of the exchange-rate mechanism.³³

Members of the Volcker Group and other U.S. officials maintain, however, that there was no serious U.S. commitment to reform the existing exchange-rate mechanism. Volcker, said one official of the Council of Economic Advisers, "really wanted no part of any reform, and he just played along . . . but he never had his heart in it."³⁴ In the opinion of a Federal Reserve official, Volcker's attitude toward reform was "schizophrenic. . . . He could never quite make up his mind what he thought about it until very late in the game. . . . Some days he would lean one way and some days another. . . ." As a consequence, "the government never really put their heart into [achieving systemic reform]. . . . They didn't take it half as seriously as they would have had to . . . to prevent the situation that we got into in 1971. . . ." ³⁵

³¹Interview.

³²"Memorandum of Conversation," p. 13.

³³The resulting International Monetary Fund study was published in 1970 (see "The Role of Exchange Rates in the Adjustment of International Payments," in J. Keith Horsefield, ed., *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Cooperation*, 3 vols. [Washington D.C.: International Monetary Fund, 1969], vol. 3: *Documents*).

³⁴Interview.

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Indeed, it apparently was the case that systemic reform did not receive high-priority attention from the U.S. Treasury between 1969 and 1971. As a State Department official commented wryly, "during those years when we had those marvelously interesting discussions of how to reform the system . . . the fact is that the action that was taken always went along the traditional line. . . ." ³⁶ "The hope was," a Treasury official confirmed, "that the system could be saved by people accumulating dollars and that the balance of payments of other countries would be reduced, always on the assumption that United States domestic economic policy would be tolerable. . . . The implicit assumption or hope was that we could muddle through." ³⁷

Volcker's enthusiasm for systemic reform in the direction of more flexible exchange rates proved, in practice, to be limited. He appeared to doubt that such reform would resolve the dollar's problems and to believe that too much experimentation in that direction might precipitate crises. His outlook on the U.S. balance of payments and the monetary system as of 1969 seemed to be that the situation was difficult but perhaps not untenable. If both domestic and international economic trends moved in a favorable direction, it might prove possible to sustain both the dollar and the system via reliance on traditional methods. Reliance on options other than the traditional ones, Volcker feared, would precipitate a run on the dollar and force the closing of the gold window, which he, like other members of the Volcker Group, regarded with some trepidation. ³⁸

The Treasury also gave apparent credence to the arguments of those who contended that the contemplated reforms would not, in fact, prove acceptable to other governments or workable even if implemented. Most governments were demonstrably antipathetic to more flexible rates; most would not accept a crawling peg system in which the dollar did not flex; and the exchange-rate changes envisioned in the limited flexibility proposals would not suffice to alleviate the U.S. balance-of-payments deficit. Combined with the

³⁵Interview.

³⁶Interview.

³⁷Interview.

³⁸Based on various interviews.

fear that vigorous pursuit of any reform initiatives would itself destabilize exchange markets, these arguments apparently persuaded the Treasury to expend relatively little energy on the issue of systemic reform. "Muddle through" remained dominant.

The End of "Muddle Through"

The Treasury, the U.S. government, and the Bretton Woods system were able to muddle through successfully for two years as, contrary to the expectations of the Haberler report, the Nixon administration's first years in office turned out to be placid ones for the dollar. Exchange markets focused on the mark and the franc, which the 1968 Bonn conference had indicated were likely candidates for parity changes. The stringent monetary policy pursued by the Federal Reserve to combat domestic inflation raised interest rates to levels that attracted large inflows of Eurodollars, draining foreign central banks of their dollar reserves, relieving pressures on the U.S. gold stock, and raising European interest rates. In contrast to their earlier complaints about excess dollars, the Europeans began to complain about the dollar drain and the effects of the Federal Reserve's tight money policy on their interest rates. In response to these complaints, and also in an attempt to equalize the competitive positions of domestic banks with foreign branches and those without, the Federal Reserve imposed marginal reserve requirements on Eurodollar deposits, thus raising the cost of borrowing abroad.

In 1970, the tight money policy began to have its intended effect. The domestic economy began to slide into recession, boosting the current account position of the United States but by a perceptibly smaller amount than would have prevailed in the absence of an overvalued dollar. Despite the strains its actions would be likely to impose on the Bretton Woods regime but in accord with its long-standing tradition of awarding precedence to domestic economic policy, the Federal Reserve began to relax monetary policy as the pace of the domestic economy slowed. Interest rates in the United States began to decline and, by early 1971, the flows of funds that had concerned the Europeans in 1969 reversed direction. Massive outflows of funds from the United States moved both the Treasury and the Federal Reserve to distinctly marginal efforts to stem the

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tide.³⁹ The probable effects of domestic recovery and capital outflows on the U.S. balance of payments led market participants to anticipate a change in the dollar's value. By spring 1971, outflows of funds from the United States began to appear not only as a response to interest-rate differentials but also as speculation on a dollar devaluation. Currency flows expanded massively early in May, as four West German research institutes recommended a revaluation of the deutsche mark. After absorbing \$1 billion in one hour on May 5, Germany closed its exchange markets. Several days later it let the mark float; the Netherlands followed; and Austria and Switzerland revalued. The current-account position of the United States weakened and in May the United States announced trade figures for April demonstrating that, as Solomon put it, the "now small export surplus had given way to an import surplus. . . ."⁴⁰

Sometime in the spring of 1971, intense contingency planning began within the U.S. government in anticipation of a suspension. Unknown to most Volcker Group members, their earlier deliberations about the desirability of a suspension in the event of a crisis were being translated into reality. Volcker and John R. Petty, the Treasury's assistant secretary for international affairs, began to assemble a "game plan" for the suspension.⁴¹ In their planning, Volcker and Petty considered whether foreign governments ought to be alerted in advance of the suspension, whether Volcker ought to be on his way to Europe as the suspension was being announced, whether the Group of Ten would be an appropriate forum in which to discuss exchange-rate changes after the suspension, and whether a three-day weekend should be the target date for the announcement.

Petty and Volcker were also convinced that a domestic anti-inflationary program had to accompany the suspension, to persuade foreign governments that they were not to bear alone the full burden of correcting the dollar's overvaluation. They recommended wage and price controls and an across-the-board budget cut, which

³⁹The Treasury issued several billion dollars' worth of securities abroad to absorb dollars that otherwise might have ended up in foreign central banks and the Federal Reserve decreased the reserve-free base of member banks.

⁴⁰Solomon, *The International Monetary System*, p. 181.

⁴¹Interview.

then Secretary of the Treasury John B. Connally pressed on the president and George P. Shultz, director of the Office of Management and Budget, and Paul McCracken opposed. Sometime in July the president accepted Connally's recommendation on the domestic economy and possibly on the gold window as well. It was in mid-July, one official of the Council of Economic Advisers recalls, that Volcker confided to him that "'we were coming to the end of the road [vis-à-vis gold convertibility].' He [Volcker] said, 'we can get through this weekend. I think we can get through next weekend. We might even get through the next. But not much further.'"⁴²

In August, pressure on the dollar intensified. Belgium and the Netherlands demanded that the United States pay off their swap obligations, pushing the United States uncomfortably close to the exhaustion of its automatic borrowing rights in the International Monetary Fund. Britain and France converted \$800 million into gold at the U.S. Treasury to repay their drawings on the Fund and the U.S. gold stock dropped below the crucial \$10 billion mark.⁴³

On August 6, 1971, Reuss's Subcommittee on International Exchange and Payments of the Joint Economic Committee issued a report urging that the United States suspend gold payments if it could not otherwise obtain a depreciation of the dollar.⁴⁴ On August 13, the British government requested that the United States guarantee a portion of its dollar holdings at the prevailing sterling-dollar parity.⁴⁵ Secretary Connally was called back from his Texas vacation and a meeting of the president and his top advisers was convened at Camp David to decide whether the time had come for the U.S. government to close the gold window. "Muddle through" was at an end.

⁴²Interview.

⁴³Susan Strange, "The Dollar Crisis, 1971," *International Affairs*, 48 (April 1972), p. 203; the Treasury reported on July 26, 1971, that its gold stock stood at \$10.507 billion, but that included priority claims against that stock by the International Monetary Fund that reduced its value to \$9.979 billion (*New York Times*, July 27, 1971).

⁴⁴*Action Now to Strengthen the U.S. Dollar*.

⁴⁵Exactly what and how much the British requested remains a matter of some controversy (see, for example, Solomon, *The International Monetary System*, p. 185).