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A Case of Decision Making in Monetary Policy

Nixon and the end of the Bretton Woods system

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Abstract

The end of the Bretton Woods international monetary system during the first years of the 1970s represents one of the most important historical event of the 20th century. In fact, with the Camp David conference between the 13th and the 14th of August 1971, the President of the United States Richard Nixon and his administration were not only undertaking a set of measures to relaunch the American economy and international competitiveness, even if these represented the official purposes. With these measures the American government was also dramatically changing many of the rules that since the end of World War II onwards had accompanied the economic and monetary growth of the western world.

The convertibility of the American dollar into gold has been the cornerstone of the U.S. hegemony over the rest of the world during the post-war period. Powerful because of its role conquered during the conflict, the United States enormously contributed to shaping the economic and political global order. The democratic values on which its hegemony was based were those of the modern social welfare and liberal economy, and the belief that the major human errors experienced in the first half of the century were the direct result of their absence.

Besides the second global conflict, the other great catastrophe all nations worldwide still had fresh in mind was the economic shock of 1929. Considered one of the more likely causes of the war, the crises of the 1930s had shown that the economy was not an autonomous and self-regulating mechanism, but it needed a set of limits and controls if such disasters were to be avoided in the future.

The Bretton Woods conference in July 1944 laid the foundations for the post-war international economic system. The American dollar was pegged to gold at the precise value of $35 per ounce, while a set of institutions such as the IMF and the World bank for Reconstruction and Development dealt with the aids to countries hit by the war and their economic recovery.

Over a period of a few years the United States lead of the world spread wealth and prosperity to all western democracies and also beyond them, whilst the American economic power experienced the most rapid growth ever.

Yet, there were many limits to the power of the system. During the 1960s the mechanism at work under the American hegemony began to show the first signs of weakness, which derived from the imperfections that permeated it. The cold war liberalism, namely the model at the basis of the American economy, started to vacillate because of a fundamental disequilibrium between its parts. With the military expenditures exceeding those for all other goods, the huge costs for the Vietnam war, the increasing inflation, the decrease of the Americans trust in their leaders, and the soaring competitiveness from Europe and Japan, the United States started to experience a deep crisis. This was the situation that Richard Nixon found when he was elected at the White House in January 1969.

Regarding the monetary matters, what the new administration had to cope with was the *Triffin dilemma* becoming reality: while the dollar circulating abroad was on the verge of exceeding the domestic reserves, a stop of the U.S. dollar supply internationally would have triggered a market stagnation, while a continuous supply would have lubricated the market, but also diminished the trust the other countries had in the American ability to sustain the convertibility.

The Nixon administration demonstrated from the very beginning to be particularly concerned with the delicate monetary issues of those years and their international implications. A closer look at the way Nixon and his closest collaborators managed the decision and policy making system reveals the great importance they gave to such problems. The institution of the working group directed by Paul Volker, and of many others agencies, committees and subcommittees dealing with international monetary matters under the direct supervision of the National Security Council, are outstanding proof of this.

It was becoming increasingly apparent that the existing monetary order necessitated as never before to be reorganized, and throughout 1969 and 1970 the

American government made a lot of attempts to do it. Its goal was to find a sort of compromise between the challenges coming from abroad and thee need to maintain a strong U.S. position. The first and most important move in this direction was the deregulation of governmental control over American foreign investments, considered by the large influential industries as the major reason for the decreased productivity and hence for unemployment and inflation. Yet, despite these deregulation policies initially appearing to function, it soon become clear that they were inefficient.

Under Nixon and Kissinger U.S. policies were slowly leaving the multilateralism that had so strongly characterized the post-war period. It could be argued that at one point Nixon and his collaborators understood that the crisis affecting the United States required international affairs to be put in second position. That is why, in defining the goals for 1971, they expressly chose to pursue a passive policy in the balance of payments, a decision further ratified that year.

With the appointment of John Connally as Secretary of the treasury in 1971, the United Stated policies became increasingly unilateral. Notwithstanding the warnings from the president of the Federal Reserve Bank, Arthur Burns, and also from Kissinger, the idea that a dramatic and unexpected disruption to the system would have favoured the United States, ultimately affirmed itself. On the 15th of August 1971 Nixon announced via television the suspension of the dollar convertibility into gold, a general surtax on all imports and a freeze of wages and prices for ninety days.

The reasons for the New Economic Policy were both domestic and internationally related. But other variables surely played an important role. Some, for example, have stressed Nixon's apprehension for the 1972 elections while other interpretations consider the measures undertaken on the 15th of August as the starting point for the decline of the American hegemony. Also the organization of the policy making process is quite revealing. In fact another major problem resided in the incoordination between the various departments and committees with regard to international monetary matters. From this standpoint the lack of a unique regulatory entity could be considered a likely cause of disruption. On the other hand, the analysis of the major figures involved in those happenings outlines the human aspect that emerges in any

political process, and permits to evince their personal preoccupations and their interests. This allows one to reject the views of those who depict Nixon and his administration as the mere executors of the Bretton Woods system.

Yet, a decision regarding the global role of the United States had to be made. The reasons for this did not lay in Nixon's politics, but can be traced back to the American policies of the previous years, which left him to cope with an extremely delicate situation. The question remaining is whether the NEP was the only possible solution, i.e. something inscribed in the laws of the market and hence unavoidable, or a revealing element of the conservative shift that the U.S. policies were bound to follow and that initiated with Nixon.

What emerges from this research is the importance of considering all variables when dealing with such far-reaching topics.

Riassunto

La fine del sistema monetario internazionale di Bretton Woods avvenuta nei primi anni ’70 rappresenta uno dei più importanti eventi della storia del XX secolo. Con la conferenza di Camp David del 13-14 agosto 1971 l’allora presidente degli Stati Uniti Richard Nixon e la sua amministrazione non adottarono solo una serie di misure per rilanciare l’economia americana e la sua competitività internazionale, anche se questi costituivano gli obiettivi ufficiali. Con tali misure, infatti, il governo americano stava anche modificando molte delle regole che dalla fine della seconda guerra mondiale in poi avevano accompagnato la crescita economica e monetaria del mondo occidentale.

La diretta convertibilità del dollaro americano in oro fu il cardine dell’egemonia statunitense sul resto del mondo dopo la guerra. Forti del proprio ruolo di principali vincitori del conflitto e del prestigio acquisito durante le ostilità, gli Stati Uniti contribuirono in modo determinante a creare il moderno ordine economico e politico globale. I valori democratici su cui l’egemonia americana si fondava erano il *social welfare* e il liberismo economico di derivazione keynesiana, ma soprattutto la convinzione che i maggiori orrori di cui l’umanità aveva fatto esperienza nella prima metà del secolo erano una diretta conseguenza dell’assenza di tali valori.

Oltre alla seconda guerra mondiale, l’altra grande catastrofe di cui tutte le nazioni conservavano fresca la memoria era lo *shock* economico del 1929, considerato una delle più probabili cause della guerra. La crisi degli anni ’30 che seguì aveva mostrato al mondo che l’economia non era un meccanismo autonomo e autoregolantesi, ma che andavano imposti limiti alle forze del mercato e qualche forma di controllo se disastri del genere volevano essere evitati in futuro.

La conferenza di Bretton Woods nel luglio del 1944 gettò le basi dell’ordine economico postbellico. Il dollaro americano venne legato all’oro al preciso valore di 35$ per oncia, mentre ad alcune istituzioni come il Fondo Monetario Internazionale e la Banca Mondiale venne affidato il compito di gestire gli aiuti ai paesi più duramente colpiti dal conflitto e organizzare la loro ripresa economica.

Nel giro di pochi anni la guida statunitense sul resto del mondo riuscì a diffondere ricchezza e prosperità in tutte le democrazie occidentali e anche oltre, mentre la potenza economica americana viveva il più rapido sviluppo mai conosciuto.

In realtà esistevano parecchi limiti allo sviluppo del sistema, e durante gli anni '60 il meccanismo che sosteneva l'egemonia americana cominciava a mostrare i primi segni di debolezza derivanti dalle imperfezioni che lo permeavano. Il *Cold War Liberalism*, ossia il modello alla base dell'economia occidentale dominata dagli Stati Uniti, cominciò in quegli anni a vacillare per via di un fondamentale disequilibrio tra le sue parti. Con le spese militari che eccedevano quelle per la produzione degli altri beni, gli enormi costi della guerra in Vietnam, l'inflazione incalzante, la diminuzione della fiducia del popolo americano nei suoi leader, e la crescente concorrenza europea e giapponese, gli Stati Uniti cominciarono ad avvertire una profonda crisi. Questa era la situazione che Richard Nixon trovò quando entrò alla Casa Bianca nel gennaio del 1969.

Per quel che riguarda le questioni monetarie, ciò con cui la nuova amministrazione doveva fare i conti era l'avverarsi del *Dilemma di Triffin*: con l'ammontare dei dollari circolanti all'estero sul punto di superare le riserve domestiche, uno stop all'emissione di dollari a livello internazionale avrebbe generato una stagnazione del mercato, mentre continuarla avrebbe al contrario consentito un'espansione, ma allo stesso tempo avrebbe diminuito la fiducia degli altri paesi nella capacità americana di sostenere la convertibilità.

L'amministrazione Nixon dimostrò fin dall'inizio di essere particolarmente impegnata nel gestire le delicate faccende monetarie di quegli anni e le loro implicazioni internazionali. Uno sguardo più attento al modo in cui Nixon e i suoi più stretti collaboratori organizzarono il processo di *decision* e *policy making* rivela infatti la grande importanza attribuita a tale ordine di problemi. L'istituzione del gruppo di lavoro diretto da Paul Volker, e di molte altre agenzie, commissioni e sottocommissioni che si occupavano di questioni monetarie internazionali sotto il diretto controllo del *National Security Council*, ne sono una prova concreta.

Ciò che divenne sempre più evidente era che l'ordine monetario necessitava come non mai di una riforma, e di fatto, durante il 1969 e 1970, il governo americano si impegnò molto in questa direzione. Il suo obiettivo era di trovare una sorta di compromesso tra le sfide provenienti dall'estero e il bisogno di conservare una posizione americana forte. La prima e più importante mossa in questo senso fu la deregolamentazione del controllo governativo sugli investimenti americani all'estero, considerato dall'influente mondo della grande industria statunitense come il principale motivo della diminuita produttività e di conseguenza della disoccupazione e dell'inflazione. Nonostante queste politiche di deregolamentazione in principio sembrassero funzionare, divenne subito chiaro che non erano così efficienti.

Sotto l'amministrazione di Nixon e Kissinger, segretario presidenziale alla sicurezza nazionale, le politiche americane abbandonarono pian piano quel multilateralismo che aveva così fortemente caratterizzato il primo periodo post-bellico. Si potrebbe affermare che a un certo punto Nixon ed i suoi collaboratori capirono che la crisi che stava affliggendo gli Stati Uniti richiedeva che gli affari internazionali venissero posti in secondo piano. E' anche questo il motivo per cui, nel definire gli obiettivi per il 1971, essi optarono apertamente per una politica passiva nella bilancia dei pagamenti, una decisione, questa, riconfermata anche per l'anno successivo.

Con la nomina di John Connally a segretario al Tesoro nel 1971, le politiche americane divennero sempre più unilaterali. Nonostante gli avvertimenti del presidente della Federal Reserve Bank, Arthur Burns, e di Kissinger stesso, l'idea che un sostanziale e improvviso sconvolgimento del sistema avrebbe favorito gli Stati Uniti alla fine prese piede all'interno dell'amministrazione. Il 15 agosto del 1971 Nixon annunciò in diretta televisiva la sospensione della convertibilità del dollaro in oro, l'istituzione una sovrattassa del 10% su tutte le importazioni e un blocco di prezzi e salari per novanta giorni.

Le ragioni per quella che venne chiamata la *New Economic Policy* erano sia domestiche che internazionali, ma le variabili che giocarono un ruolo primario su quella decisione erano molte e complesse. Alcuni storici, per esempio, hanno fatto riferimento al *Political Business Cycle*, ovvero alle preoccupazioni per le elezioni del

1972, mentre altre interpretazioni considerano le misure adottate il 15 Agosto come il punto d'inizio del declino dell'egemonia americana. Anche l'organizzazione del *policy making process* offre un interessante spunto: infatti, un ulteriore elemento di fragilità del sistema risiedeva nella scarsa coordinazione tra i vari dipartimenti e commissioni riguardo a temi monetari internazionali. Sotto questo punto di vista, la mancanza di un'unica entità in grado di regolare la mole di questioni proveniente da quei settori può benissimo essere considerata una delle maggiori cause del definitivo fallimento di Bretton Woods. D'altra parte, un analisi dei principali personaggi coinvolti negli avvenimenti di quegli anni permette di portare alla luce quell'aspetto umano presente in ogni processo politico, e di definire le preoccupazioni e interessi di ciascuno. Ciò consente di rigettare quelle visioni che dipingono Nixon e la sua amministrazione come gli assassini dell'ordine economico postbellico.

In ogni caso, resta il fatto che all'inizio degli anni settanta gli Stati Uniti si trovarono nella posizione di dovere per forza di cose prendere una decisione riguardante il ruolo globale degli Stati Uniti. Le ragioni di ciò non risiedono nelle politiche intraprese da Nixon, bensì in quelle delle amministrazioni precedenti, che gli lasciarono in eredità una situazione estremamente delicata. La questione che rimane da risolvere è se la NEP fosse la sola possibile soluzione, cioè qualcosa di già inscritto nelle leggi del mercato e quindi inevitabile, o il primo passo di quello spostamento in senso conservatore che le politiche statunitensi erano in procinto di attuare e che trovarono in Nixon il loro precursore.

Ciò che emerge dalla ricerca è l'importanza di considerare il maggior numero possibile di variabili nell'affrontare questioni di tale portata.

Introduction

On the 15th of August 1971 the President of the United States Richard Nixon announced via television that the American government had undertaken a new set of measures to relaunch U.S. economic growth and the international competitiveness of American products. These included the establishment of a 10% surtax on all imports, the freeze of wages and prices for ninety days and, above all, the suspension of the convertibility of the American dollar into gold.

This last move officially ratified the end of the international monetary system based on fixed exchange rates between currencies born at the Bretton Woods Conference in July 1944, and initiated the era of the fiat money. The impact of this shift on the international economic and political system has been overwhelming: in fact the introduction of the fluctuating exchange rates triggered a series of processes that still have vast repercussions nowadays.

The work developed over the next pages is an attempt to analyze the mechanisms at work in that precise historical juncture and the dynamics that influenced the decision making process, in order to gain a better understanding of what drove the American administration under Nixon to act that way.

I will start by describing the origins of the post-World-War-Two international monetary system. This task will require an introduction to a set of concepts that belong to diverse fields, from monetary politics to general macroeconomic theory. Then, I will briefly summarize the various phases of American history from the establishment of the Bretton Woods system up until the end of the Johnson Administration in 1969. In this part I will also outline the United States monetary policies and their impact on the international scenario.

Chapter III focuses on the Nixon years, and takes into exam the international context to the events that occurred around 1970. Particular attention will be paid to the evolution of the international monetary system during the Nixon administration and to the consequences of the Nixon Shock at international level. Subsequently, in

chapter IV, I will delve into the two-year period between 1969-1970, depicting more closely the Nixon administration, its main figures, and the way it handled the complicated dynamics and challenges experienced throughout those years.

The remaining part of my work will be a description of the policy making system under Nixon and a more accurate presentation of those who were involved in the decision making process, in order to shed additional light onto the case of August 1971.

I will conclude by summarizing the points that have emerged from my study and, lastly, conveying my personal interpretation of these developments.

The aim of my thesis is to present the widest possible set of variables that come into play in an important decision making process concerning international monetary policy. I have chosen the Nixon case and the end of the Bretton Woods system because of its extreme importance in shaping the modern political and economic world. Besides showing how variegated the political process is, the Nixon shock is, in fact, also an outstanding example of the numerous consequences an action undertaken for domestic gains can trigger world-wide.

The Origins of the Bretton Woods System

The United Nations Monetary and Financial conference which took place at the Mount Washington Hotel in Bretton Woods (New Hampshire) in July 1944 could easily be considered one of the most important chapters of the 19th century's history. All 730 delegates from the 44 allied nations who came together at the small resort in Bretton Woods shared the firm conviction that a new economic and financial global system should be constructed once World War II came to an end. The common view held by the great participating powers (primarily the US, Great Britain and Russia) was that the post-war order had to stand on a more solid foundation, and that many of the major errors experienced in the first half of the century were a direct result of its absence.

Still fresh on the public officials minds were the catastrophic effects of the 1930's depression, and the frightening speed with which the economic and financial crash in the American Stock Market began, spreading in a matter of days to all capitalistic nations, with damaging effects on people in even the most remote countries. Compounding the problem, was that the worst disaster in the history of humanity, World War II, was still smouldering, bringing with it a record number of human deaths, damages and costs to civilian people the world had ever seen.

Even though the members differed in points of view and proposals, all participating governments agreed that such a disaster should never be repeated. It was this firm conviction which drove the conference.

This chapter aims at describing briefly the origins of what has been called "The Bretton Woods System". First of all I will outline the political and diplomatic framework behind the conference, why it took place, and the forces that were involved; then I will focus on the monetary side, illustrating the different ideas, plans and objectives that lead the negotiations.

It could be said that the core of the negotiations at Bretton Woods was monetary.

A major breakthrough occurred during the first quarter of the XIX century which would ultimately alter the entire monetary history. The end of two centuries of gold standard after World War I was that remarkable event, and from that time onward things would never be the same.

The commodity standard, or in other words the operation of tying the currencies with gold, silver or even goods was an extremely old concept, and it had been the constant in monetary history for more than two thousand years. Also periods of suspended convertibility were nothing new: the major currencies such as the Sterling and the Dollar had already known periods "off gold"[1] (The Napoleonic war for Great Britain and the Civil war for the US). But what marked the difference between this period and the previous ones was the fact that once it was attempted to rehabilitate the standard after the war, it no longer functioned.

The entire mechanism of the Gold Standard as it used to operate during the two centuries before 1914 (during the period of sterling supremacy), was based on two main factors : the credibility of the maintenance of the parity, and international cooperation. These alone made the system highly autonomous and stable, assuring that any shift in the balance of payments of a State was soon adjusted by a rapid move of capital that restored the parity.

This basis had been completely mined by the war. What lacked at the end was indeed credibility and cooperation, and hence any sort of attempt at returning to the past soon showed its inadequacy. Nonetheless in 1918 returning to the gold standard seemed to be for more or less all nations the most logical thing to do: "Nothing can contribute more to a speedy recovery from the effects of the war, and to the rehabilitation of the foreign exchanges, than the reestablishment of the currency upon a sound basis"[2].

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[1] I. M. Drummond, *The Gold Standard and the International monetary System 1900-1939*, London, McMillan Education Ltd., 1987

[2] Committee on Currency and Foreign Exchanges after the War, *First Interim Report* (Report of the Cunliffe Committee), Cmd. 9182, HMSO, London [1918], cited in M.D. Bordo, B. Eichengreen, *A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform*, Chicago, University of Chicago Press, 1993, p. 116

As I have already mentioned, another major event that occurred to change the political mind of the time was the Great Crash in 1929.

On October 24 of that year, “Black Thursday” as it has come to be known, the Wall Street Stock Exchange in New York experienced the most devastating financial crash ever. The sustained economic prosperity that had so far characterized the “Roaring Twenties” ended in a matter of days, leading to a chain reaction that dragged the World into the worst and longest depression ever known.

The postwar world saw a dramatic increase in terms of mass production and international trade. The emerging hegemonic power of the 20th century, the United States, strong because of its role acquired during the war as major creditor not only in terms of money, but also of armaments and goods, enabling it to become the leader of a global process of economic growth. The laissez-faire monetary policy of the time contributed to the strengthening of that optimistic faith in the power of the system: the belief that any governmental intrusion into its financial and economic life was something to avoid and that the market was a self-regulatory entity. On the wake of this, the volume of investments grew at a dangerous speed, and with it that of financial speculation, completely free from the burdens of national and international restrictions.

The Crash of 1929 sparked a twelve-year long global depression, devastating unemployment and soaring inflation all over the world. But on top of that it showed that such a self-regulating mechanism could not work. Although many voices in the international debate continued favoring a liberal approach to international trade and finance, virtually all agreed on the need for stronger control over the market and capital movements, if such heavy blows were to be avoided in the future.

The futile attempt by Germany and England to rehabilitate the Gold Standard respectively in 1924 and 1925, followed by 21 countries, ended in ruins. By the middle of the 1930s it was clear that not one of them had the strength to sustain the convertibility. But by that time something had already been set in motion in the academic and also institutional world. The debate about the great depression

flourished in an explosion of ideas and prospects, giving birth to theories and names that would shape and affect the economic thinking up until today.

The most important names which emerged from that debate are those of the famous British economist John Maynard Keynes (1883-1946), the American Secretary of Treasury Harry Dexter White (1892-1948), and the Vice President of the Federal Reserve Bank of New York John Henry Williams (1887-1980), whose work and theories were to have a considerable influence on the Bretton Woods discussions. Many of the institutions that the Conference gave birth to, are also outcomes of their ideas. A full understanding of the Bretton Woods System and its origins requires therefore a focus on the thoughts of these figures and on the negotiations between them. But in doing this the wider field of the monetary theory must be taken into account, the gold standard must be defined, and the mechanisms through which it operated described.

Prewar each country was free to organize the gold-standard according to its own laws and institution, and thus there were some elements of discontinuity between the different States. But in principle all those who were "on Gold"[3] shared many common features: first of all, the national currencies had their own "gold content", in other words they were given a fixed value in terms of gold; secondly not all circulating money was physically made of gold: all nations had a long-term experience with paper currency, and it was commonly assumed (but by no means did this always correspond to reality) that all of this could be converted into gold at a fixed price; lastly, there was no control over the movement of money and gold across borders, or over the transaction and exchange between different currencies. To summarize, there was "the possibility of moving gold, of freely buying and selling all monies, and of converting paper currency freely into gold"[4].

The basic exchange rates were determined by the comparison between the gold content of the particular currencies and were called "par values". Turning paper into gold or moving gold from one state to another were not costless operations, and hence the exchange rates were not totally fixed, but could vary slightly in relation to

[3] Drummond, *The Gold standard and the International Monetary System 1900-1939*, cit.
[4] *Ivi*, p. 11

demand and supply, but always stayed close to the par value. It follows that the most part of the international transactions that took place were in the form of foreign exchange rather than gold. At the same time, "the freedom to move money, gold or bullion, ensured that actual exchange rates could never move very far from par".[5] The "gold import point" and the "gold export point" (namely the exchange rates at which it is more convenient respectively to buy or ship gold rather than foreign exchange) determined the interval of variation. What emerges from this whole process is the utter absence of any element of political intervention: there was no willingness by the policymakers and bankers to interfere in the system, or to modify the exchange rates by adopting inflationary policies to enhance exports and gain competitiveness. To summarize, things worked as if there was a unique international currency.

What precedes simplifies the structure of the System, explaining its main characteristics, but it does not answer the most important question, i.e. how did it work? Or in other words, what did the Gold Standard Countries do to keep the system working?

The collective thinking of that time was that nothing operated behind the system to keep it in motion. It was universally assumed that a sort of automatism was at work, which could maintain the par values within the narrow interval of the gold points and the States on gold. In addition, there was little place in the game for national authorities, and the accommodation of prices and rates was at the mercy of the trends in the gold market.

The underlying principles of this automatism were mostly derived from David Hume's "price-specie-flow mechanism"[6], which still represented the mainstream thinking during the 1920s. According to this approach the parity was sustained by natural adjustments that followed the flows of gold. The decrease in a country's gold reserves, due to a deficit in its balance of payments, provoked a fall in prices, thus in turn creating an improvement to the exports of that country, causing a flow of gold to it from its import countries, and hence restoring the parity. Conversely for a country

[5] Drummond, *The Gold standard and the International Monetary System 1900-1939*, cit., p. 12
[6] See D.Hume, "Of the Balance of Trade" [1752], in E. Rotwein (ed.), *Writings on Economics*, Madison, The University of Wisconsin Press, 1970

that ran an account surplus: a flow of gold towards its reserves increased its prices and caused a decrease in exports due to its low competitiveness.

This exemplification of the working of the Gold-Standard shows its lack of effectiveness: it assumes that prices increase and decrease in a way and at a speed that influence the adjustments; it also implies a certain degree of difference in the balance of payments between the countries, and there was not much a difference ; finally, a change in the gold reserves of a country was not necessarily followed by a revealing change in the domestic money supply.

Another explanation of the "workability of the gold-standard"[7] claims that the system could continue because the banks followed the so called *rules of the game*, namely "expanding the domestic monetary base when gold flowed in and contracting it when gold flowed out"[8]. Also in this case it is important to notice that there was not much cooperation between banks, nor were they concerned whatsoever with rules.

The answer to the question is not in the internal mechanism of the gold-standard; on the contrary, it lays in the structure of the world economy of that time.

The system could accommodate over time real economic growth to soaring (or at least stable) prices, only if the quantity of gold itself was increasing. The States who were always running a current account surplus (the UK, France, Holland, Germany, Belgium and after 1900 also the US), used to export capital, mostly in the form of long-term investments, and consequently helped those who were chronically running an account deficits (Latin America, Russia, South east Europe, and the British Empire). Yet what they exported in terms of capital to those States, was almost always less than their surpluses. The new gold revenues tended then to flow towards them.

In short it could be argued that the system worked well for the capital importing countries, only because the exporters forced capital outside their borders. The system itself "provided for multilateral clearing. That is balances earned or borrowed in one country could be freely used anywhere else".[9]

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[7] Drummond, *The Gold Standard and the International Monetary System 1900-1939*, cit., p. 14
[8] *Ivi*, p. 15
[9] *Ivi*, p. 19

Due to the mechanisms of price-specie flow and income adjustment, the gold standard was expected to produce great variation in terms of prices, loans, employment and prosperity. However it did not. Why? Because the economic booms which would have created the necessary gap between countries normally affected all the wealthiest states simultaneously; at the same time the external reserves and capital flows reduced the effects of automatic adjustment. In any case and taking all of this into account, it could be argued that up until 1914 the gold standard brought with it prosperity and price stability.

What then did go wrong?

"The mechanism of the gold-standard system was very delicately balanced"[10]: on the one hand it was totally dependent on new revenues of gold for monetary expansion, and so if the production of gold diminished, as it was bound to, surely some problems would emerge; troubles may have also arisen if the continuous export of capitals to debtor countries was interrupted, given the extreme importance of such flows to balance international trade (e.g. Argentine and Canada in 1913-14). In other words, the entire system was intrinsically multilateral, and could not survive any disruption to this multilateralism. Another point of fragility threatening the functioning of the gold-standard was the artificial character of many of its channels of surpluses and deficits, which were perilously tied to patterns of trade specialization and tariffs. The growth of new specializations and new tariffs could heavily affect the existing multilateralism and create new patterns of surpluses and deficits that the servo-mechanisms alone would not have been able to face.

In addition to all of this, England, the virtual World Bank, faced another major and invisible risk. During that time London was the sole financer of the bulk of the international trade, and some already thought that England's gold reserves did not correspond to the wealth of its capital around the world. At the same time,

> little attention was paid to Britain's large and growing short-term obligations, which no one was concerned to measure or weight [and that were worsening its

[10] Drummond, *The Gold Standard and the International Monetary System 1900-1939*, cit., p. 27

> liquidity conditions, but] so long as world trade and payments remained centered in London, and so long as the world had confidence in the gold-convertibility and exchange-convertibility of the pound-sterling, this did not matter[11].

The war came to mark the passage of England from a creditor State (the largest) to a mere borrower (especially from the United States). As Sayers has argued, it has too often been said that "London's financial strength before 1914 was due to the gold standard. The truth was rather that the strength of the gold standard was due to London's international financial position"[12]. What became apparent was that the gold-standard system operated so well for such a long period only because Britain was able to sustain it.

The conflict compelled the different countries to engage in independent and un-coordinated actions, consequently of dismantling the gold standard. However, as I have already mentioned, everybody expected that at the end of the conflict, the old system would be resumed, because it was seen as something stable and necessary for the recovery of trade and finance. As Hansen has put it, the main purpose of the policymakers was to "reconstitute as rapidly as possible the automatic forces in economic life"[13].

But by that time the very foundation of the entire system had already been destroyed, and the attempt to rehabilitate the gold-standard soon revealed its lack of effectiveness. In 1931 England again went off the standard because of its impossibility to buttress it. The people did not understand that there had been a change in the rules of the game, that the automatisms at work before the war had ceased to function and the same rules now required stronger monetary control. Instead of being automatic, the system needed political action, to revive the sort of order that once the gold market had governed well alone; in short it became *managed.*[14] Furthermore,

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[11] Drummond, *The Gold Standard and the International Monetary System 1900-1939*, cit., pp. 27-28

[12] R. S. Sayers, "The Return to Gold 1925", cited in G. Arrighi, B.J. Silver, *Chaos and Governance in the Modern World System*, Minneapolis, University of Minnesota Press, 1999, p. 73

[13] A. Hansen, "Stability and Expansion", in P. Homan, F. Machlup (eds), *Financing American Prosperity: A Symposium of Economists*, New York, Twentieth Century Fund, 1945, pp. 199-226, p. 199

[14] F. Cesarano, *Gli Accordi di Bretton Woods. La Costruzione di un Ordine Monetario Internazionale*, Bari, Editori Laterza, 2001, p. 37

governments aimed at particular internal objectives that generally contrasted with any idea of international and multilateral equilibrium. During the gold standard these conflicts between internal and external aims did not exist, being the sole aim of the economic policy of the various States directed towards the preservation of the parity. What came to be added to the framework was a discretionary element, represented by the different choices policymakers could make on financial issues. In addition to this, the crash of 1929 had a catalyst effect, bringing with it widespread protectionism and expansive policies that mined the system and consequently inaugurated the era of the *fiat money*. From then on the objective to create *full employment* would precede the maintenance of the parity.

The rehabilitation of the gold standard by many European countries and by the United States in the mid-twenties did not work. The heavy accumulation of gold in countries like France and the US, combined with the failure of the old adjustment mechanisms, initiated a wave of restrictive and deflationary measures in other countries, prompting Britain to leave the convertibility in 1931, followed directly by all the other States.

The important events described above (the first World War, the end of the two centuries old gold standard system, the futile attempt to rehabilitate it in the twenties, and the shock of 1929) contributed to the development of a transnational debate about the need for a new international order to manage monetary issues. At the same time, the most influential nations were becoming more and more involved with such arguments. They had learnt that mass unemployment, one of the worst problems of modern times, was due to monetary causes, and the best solution would require monetary therapy[15]. Over the few next pages I will analyze this debate, highlighting the main ideas that helped to develop the Bretton Woods Agreement.

The discretionary element here plays a very important role. In fact, an extreme exemplification of this issue brings to the front a basic opposition that could be considered the primum movens of the entire negotiations: the contrast between

[15] Cesarano, *Gli Accordi di Bretton Woods. La Costruzione di un Ordine Monetario Internazionale*, cit., pp. 82-83

laissez-faire and interventionism. On the one hand there was those (in particular the officials of the American State Department) who fostered a free trade position, and on the other those (basically in the British wartime's cabinet) who were more willing to assure full employment and economic stability. In spite of these differences, a general will for stabilization and for finding a new arrangement for international monetary institutions had already manifested itself in the form of the Tripartite Agreement in 1936 between France, the USA and the UK.

The Second World War and the destruction that accompanied it did not stop the discussion about the management of the international economic and financial matters. Henry Morgenthau, Secretary of Treasury during the administration of Franklin D. Roosevelt, wrote in the foreword to the White's Plan that the post-war reconstruction problems had to be addressed before the end of the hostilities[16]. In 1941 both the United Kingdom and the United States were already conceiving a reorganization of the post-war monetary system. Keynes, the father of modern economics, did not yet have an alternative plan to the German desire to substitute the Sterling system with a Mark-based one in which Berlin was to be the financial center. Nonetheless some of the ideas of his later work were already taking shape: at the end of the conflict Germany should have been sustained in its recovery in order to avoid the errors made in Versailles, and in addition to this a European Reconstruction Plan had to be engineered in order to assist the countries hit by the war.

The joint declaration made in August of 1941 between the American president Franklin D. Roosevelt and the British prime minister Winston Churchill, also known as the Atlantic Charter, was drafted on the wake of these developments.

Yet, there were different views on how to shape the post-world war order even within the American and English divisions. The officials of the American State Department represented the voice claiming free trade and multilateralism; they also held the conviction that an open international trading world would have allowed an American-led security global system; on the contrary, the economic planners of the New Deal wanted an increase in the organizational power of the government over the

[16] J.K. Horsefield, *The International Monetary Fund 1945-1965: Twenty Years of International Monetary Cooperation*, III, Documents, International Monetary Fund, Washington (D.C.), 1969, p. 84

institutions, and pushed for policies favoring employment and social welfare. However, they must not be considered isolationists: in fact they never opposed international cooperation.

Among the British the division was even greater: the conservatives were not eager to leave the imperial preferential system created at the Ottawa Conference in 1932, whilst the left saw an open economy as a threat to economic planning and social welfare policies; in the middle stood those who did not want to return to a bilateral and preferential system, but considered it a possible option to save the British post-war interests.

Despite all of this, almost all the "liberal minded international economists"[17] (mainly Keynesian) shared many of the convictions that went on to form the Bretton Woods Agreement.

The consensus pertained three main points: the desire for monetary stability and for the convertibility of currencies through the abolition of controls and restrictions and with exchange adjustments subject to international agreement; the necessity of an international reserve for short-term assistance and for aids for deficits in the payment balance; the need to reconcile free capital movements with policies for full employment and social welfare.

The importance of Keynes goes well beyond this. Thanks to the developments in economic thinking, the policymakers had been provided with modern tools for economic policy. They also had wider freedom in using these tools, and were asked by their citizens to address these new possibilities towards society and its well-being. It is easy to understand how much these new socio-economic objectives (social welfare, distribution of socio-economic goods) were at odds with the deflationary policies of the gold-standard.

If the breakthrough in policymaking contributed so greatly to shaping the new order, another important factor was the change in American foreign policy. By the end of the 1930s it was globally recognized that the post-war world would require a

[17] G.J. Ikenbberry, "The Political Origins of Bretton Woods", in M.D. Bordo, B. Eichengreen (eds.), *A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform*, cit., p. 161

stronger American presence regarding international affairs. This is what was called "internationalism", the idea that "the economic health of every country is a proper matter of concern to all its neighbors, near and distant"[18]. To summarize, with respect to the end of World War I there had been a great turn around, represented by the knowledge that the States had to cooperate if they wanted to survive the cyclical depressions and solve the problem of mass unemployment.

In the summer of 1941 the Anglo-American disagreement manifested itself in the negotiation for the Lend-Lease Act. Keynes went to Washington for that occasion, but he refused to agree to some of the American requirements: in particular the 7th article that claimed a reduction in trade barriers, was at odds with the English imperial preference system. Yet, Keynes during that period was changing his position and shifting to a more multilateral one, where an international institution was given the responsibility of dealing with the balance of payments issues. The idea of an "International Clearing Union", the core of Keynes post-war plan, began to take shape during this time. According to the Keynes project, a global bank should have been created to manage international trade, and the "Bancor", a common currency with fixed exchange rates for national currencies , would have been used for international exchanges. The functioning of this system was simple: every exported good added bancors to the account of the export country, whilst every imported good removed bancors. Every country was encouraged to maintain its bancors balance close to zero, because the International Clearing Union (ICU) took a percentage of the hypothetical surplus and put it in the ICU's Reserve Fund. Countries with a surplus were pushed to buy from deficit ones, while those whose imports were greater than exports would have seen a depreciation of their currency in relation to the Bancor, helping them gain competitiveness by increasing their exports.

Although Keynes could reasonably be considered the father of modern macroeconomics, he was not the sole protagonist of the debate; Another major influence was Harry Dexter White, assistant to the American Secretary of the Treasury

[18] U.S. Department of State, "Proceedings and Documents of United Nations Monetary and Financial Conference", http://fraser.stlouisfed.org/docs/publications/books/1948_state_bwood_v1.pdf

Henry Morgenthau. To some extent White's plan was very similar to Keynes' one: he also recognized the need for the removal of trade controls and restrictive financial policies, and favoured the establishment of rules on the alterations of exchange rates. But taken as a whole it was much more modest. The aids for nations in difficulty were also provided by the plan, but to a much smaller degree than what Keynes suggested, and the role of creditor nations for this relief was much reduced.

The *Joint Statement by experts on the Establishment of an International Monetary Fund* edited in April 1944 contains a large part of the outcomes of the Bretton Woods Conference from July, and although it revealed the superiority of White's position , it did not reproduce it entirely? In identifying what was bound to become the post-war monetary order, a certain importance must also be given to the claims of the then Vice President of the Federal Reserve Bank Of New York, John H. Williams. According to Williams both White's and Keynes' plans showed a "lack of attention to transitional problems"[19]. Their ideas and plans were still largely tied to classical economic models that did not account for factors of change or variability. On the contrary the world's economic systems and processes are not as rigid as these: there are many variables that play an important role in shaping economic life and these must also be considered before developing new theories:

> This is not a world with many countries mutually held in balance through compensatory internal adjustments...(but) a world with one or two key countries and with many peripheral countries which are all subject to profound changes also in their attitudes towards internal adjustment... at least until some decisive steps are made toward common sovereignty[20].

White and Keynes were accused by Williams of carrying forward the errors made in the twenties, which could be summarized in the "immediate establishment of new

[19] P.F. Asso, L. Fiorito, "A scholar in Action in Interwar America. John H. Williams' Contributions to Trade Theory and International Monetary Reform", Siena, *Quaderni del Dipartimento di Economia Politica dell'Università degli Studi di Siena*, July 2004, 430, pp. 1-36, p. 17

[20] J.H. Williams, "International Trade Theory and Policy. Some Current Issues", *The American Economic Review*, 41, 2, Papers and Proceedings of the Sixty-third Annual Meeting of the American Economic Association, May 1951, pp. 418-430

fixed exchange rates"[21]. Williams' proposal came to be known as the "Key currency plan", and in many aspects was the deciding factor for the final shape of the Joint statement. According to his plan the recovery of the post -war world depended greatly on the stability of the key currencies, namely the Sterling and the Dollar. Only at a later stage would the other currencies be given the possibility "to join an international monetary system based on fixed exchange rates and managed by supranational institutions"[22].

After months of negotiations, the English abandoned the idea of the "unlimited Liability" of creditor countries (heart of Keynes Clearing Union), and the agreement emerged in its final shape. Although it was not as cutting edge as Keynes had imagined, the Bretton Wood System,

> embodied a distinctive blend of laissez-faire and interventionism. It allowed the operation of a relatively open System of trade and payments as well as arrangements to support domestic full employment and a social welfare provision[23].

To summarize, it was an "embedded liberalism"[24].

The common international currency did not find a place in the final plan; short-term assistance issues were also excluded from the debate, and would have been discussed bilaterally. The main responsibility in restoring the equilibrium in the balance of payments laid in the hands of the deficits countries, and thus it was not shared with the surplus ones; the nations were enabled to change their exchange rates, according to the British wishes.

The monetary regime was a de facto Gold Exchange Standard, in which the dollar was tied to a precise value in terms of gold (35$ per ounce) and represented the principal currency in the entire global system (with the Sterling on a complementary

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[21] Asso, Fiorito, "A Scholar in Action in Interwar America. John H. Williams' Contributions to Trade Theory and International Monetary Reform", cit., p. 16
[22] *Ivi*, p.21
[23] Ikenberry, *The Political origins of Bretton Woods*, cit., p. 158
[24] For the concept of "Embedded Liberalism" see J. Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order", in S.D. Krasner (ed.), *International Regimes*, New York, Cornell University Press, 1983, pp. 379-415

pillar). The conference also gave birth to the institution controlling the rules that had been laid, the International Monetary Fund, and to the International Bank for Reconstruction and Development which dealt with the recovery of countries hit by the war.

The American Hegemony

The 20th century has commonly become known as the "American Century"[25]. As a matter of fact the world that emerged from the ruins of the war reflected, in its new institutions, the paramount power the United States had acquired during the conflict. Thanks to its new role as the first international creditor and its enormous military power demonstrated during the hostilities, the United States was able to take the lead in establishing a more democratic, stable and peaceful global order: "Only the United States emerged strengthen from the war. Its economy towered over the world like none other. It accounted for fully half of global industrial production. Only its currency was freely traded"[26].

This was not only the result of its economic and military power. The war had been a severe example of the disastrous effects that beggar-thy-neighbour policies could bring about. A new order would therefore require every government to take responsibility for the international consequences of its own actions. The United States, emerging as the most powerful Nation after the war, was asked by the international community to become the warrantor of that entire process. The institutions which were decided upon at Bretton Woods (IMF, GATT, IBRD) were intended to be the subsidiary means to those goals.

If domestically the American administrations after Roosevelt gave precedence to attain full employment, the foreign policy focused on the rehabilitation of the productive capacities of Western Germany and on European reconstruction. The background on which these policies were based was that of a liberal global economic order, with the Dollar as a unique currency for international transactions.

At the basis of these aspirations were the ideas of the New Deal and the theoretic legacy of Keynes.

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[25] Cf. H.R. Luce, "The American Century", reprinted in M.J. Hogan (ed.), *The Ambiguous Legacy*, Cambridge, Cambridge University Press, 1999, pp. 11-29

[26] B. Eichengreen, *Exorbitant Privilege. The Rise and Fall of the Dollar*, New York, Oxford University Press, 2011, p. 39

I will begin this chapter by describing the results of the Bretton Woods Agreement, paying particular attention to its faults and weaknesses; secondly, I will briefly summarize the two decades of American history following the second world War, concentrating on the establishment of the American hegemony throughout different administrations, from Truman to Nixon, and on their monetary policies. Lastly, I will focus on the important changes in 1960s, that brought to an end the system inaugurated at Bretton Woods in 1944.

> The new System was intended to be a realistic compromise between the rigid gold standard of the 19th century and the uncertain floating exchange rates of the 1930s. […]The Bretton Woods Agreement confirmed the importance of the domestic economic objectives of full employment and rising incomes, but rejected the idea that autonomous exchange-rate manipulations should be used as the main instrument to achieve them. In place of this the principle of relative rigidity was accepted. That is, exchange rates were in principle fixed but from time to time, under certain conditions, could be adjusted[27].

To summarize, a certain quantity of gold determined the parity, and the national authorities were allowed to fluctuate the exchange rates to 1 per cent below and above it. In case of a "*fundamental disequilibrium* in the balance of payments"[28] the IMF permitted the parity to fluctuate up to 10 per cent. Moreover, the agreement established that the world economy should be set in a global framework of multilateral and free trade, in which national control on trade aimed to adjust deficits in the balance of payments were banned. A "scarce currency clause" was introduced to face the problem of countries running a continuous current surplus. If the surplus in one country's balance was becoming so high that the IMF was not able to meet the demand for its currency, the other member States were allowed to take discriminatory

[27] H. Van der Wee, *Prosperity and Upheaval. The World Economy 1945-1980*, Berkeley, University of California Press, 1988, p.429
[28] *Ivi*, p 429

measures by limiting the payments in the scarce currency and thus reducing the exports of that country[29].

Since the establishment of such a free and open regime would surely cause difficulties in the balance of payments in some countries, the Bretton Woods system determined a set of short-term and medium-term lending mechanisms, using the monetary and gold amounts that every member State was required to contribute to the IMF, and that varied depending on their GDPs[30]. Yet obtaining a loan was not the easiest thing to do. Besides being asymmetrical (because of the fact that the voting rights of members were directly determined by their quotas) the system was in fact also highly contradictory. The limitation in the fluctuations of the exchange rates foresaw a large availability of foreign currency to help cope with deficits in the balances. But precisely this supply of foreign currency was strongly limited by the Fund. This mechanism had been set in motion by the United States to ensure that the national governments would have attempted every possible measure of national economic policy before resorting to the IMF.

But these internal discrepancies were not the sole challenge of the new System: "Another problem was the enormous gulf between the normative, ideal system worked out in Bretton Woods, and the chaotic situation that existed in the world in 1945"[31]. The general coordinates decided at Bretton Woods (open and multilateral trade, fixed exchange rates, etc.) were manifestly at odds with the disastrous post-war global economic situation, that still relied on the inheritance of the 1930s and on the restrictive policies of those years.

Roosevelt's death in April 1945 was not followed by dramatic changes in American politics. Nor did it pose an end to the full establishment of the New Deal inspired by the new liberal thinking descending from Keynes, as a distinctive feature of the

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[29] For a clear description of the Scarce Currency Clause cf. G. Bird, T.D. Willet, "Multilateral Surveillance. Is the IMF Shooting for the Stars?", *World Economics*, 8, 4, October-December 2007, pp. 167-189; a good definition can be found in: G. Black, N. Hashimzade, G.D. Myles, *Oxford Dictionary of Economics. A Dictionary of Economics*, New York, Oxford University Press, 2008

[30] For an exhaustive explanation of the functioning of the International Monetary Fund see: E.P. McLellan, *The International Monetary Fund. Overview, Issues, Bibliography*, New York, Nova Science Publishers, 2002

[31] H. Van der Wee, *Prosperity and Upheaval. The World Economy 1945-1980,* cit., p. 432

American economic development. The basis of that thinking was that economics is something intrinsically human, and as such it cannot be considered as operating apart from social life (the typical approach of neo-classical economists). On the contrary, it can only be understood once cast into society and seen in relation to all the variables that are at work in every-day life. It follows that every action in economic policy should be directed toward society, the well-being of which directly influences the well-being of the State. This was the very foundation for the modern welfare State: i.e. investing money into society (schools, hospitals, employment, etc.), thus creating public debt, but at the same time broadening the feeling of social security that encouraged people to spend and invest and hence to perpetuate the cycle[32].

The Truman Administration demonstrated from the beginning its preference for the vision of the Department of State and its free trade position. The more liberal tone it gave to the world monetary recovery resulted in an approach that was reminiscent of William's Key Currency Plan. As a consequence, measures were taken to link the Sterling to gold once again, but the huge British debt made it impossible to sustain the convertibility, notwithstanding the cancellation of the Lend-Lease act.

The problem remained. International trade had to be set in motion again. This was a necessity also for the United States: without external buyers, American production was doomed to diminish. On the other hand their allies in Europe and Japan necessitated as never before American products to preserve social stability and "capital goods for economic reconstruction"[33]. Furthermore, the Anglo-American Loan Agreement in 1946 and the United Nations Relief and Reconstruction Administration were only temporary solutions. It was thought that "with reconstruction and the peacetime reconversion of wartime armaments factories, Europe and Japan would immediately regain the capacity to earn the dollars needed to purchase imports"[34], but this was not to be. Reconstruction was not such a quick process, and the exports (to earn the

[32] For an overview of the New Deal see: S.M. Milkis, J.M. Mileur, *The New Deal and the Triumph of Liberalism*, Amherst, University of Massachusetts Press, 2002; about the concept of a Global New Deal, a good explanation can be found in: G. Arrighi, B.J. Silver, *Chaos and Governance in the Modern World System*, cit.
[33] Eichengreen, *Exorbitant Privilege. The Rise and Fall of the Dollar*, cit., p.47
[34] *Ivi*, pp. 47-48

money for purchases) required imports of capital and other goods to start the production. It was like a dog chasing its tail. And that dog awakened the fears for a return to the protectionism of the 1930s: a situation that would have brought countries to "resort to barter"[35]. The Marshall Plan in Europe and the Dodge Plan in Japan were the American responses to that danger, and as such they literally rescued the entire Bretton Woods System[36]. To gain an idea of how ambitious the plans were, one must only observe the first year of the Marshall plan, which absorbed alone 10% of the entire Federal budget[37].

A full understanding of the monetary policies during the period I am focusing on requires at least a brief focus on the particular dynamics at work.

European reconstruction and the rehabilitation of West-Germany should not be considered only acts of charity and kindness from a superior entity (the United States) acting as a good Samaritan. In fact the Truman years formally gave birth to the Cold War, the four-decade-long conflict that opposed the two superpowers emerging from World War II: the United States and Russia[38]. Under this particular light every action in favour of the European allies appeared to be the result of a necessity to contain the expansionary power of the USSR. It also became clear the importance given to West Germany's recovery, especially because of the unique situation in Berlin. In a few words: to sustain their exports, the United States needed a safe, and above all not-communist, Western Europe.

The capitals flowing to Europe through the Marshall plan were not the only aid provided by the United States. Major help came in the form of a strong military presence. Thanks to this enormous support, Europe saw a rapid development and moved toward the process of building a community that still continues. It is important

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[35] Eichengreen, *Exorbitant Privilege. The Rise and Fall of the Dollar*, cit., p. 48

[36] For an understanding of the importance of the Marshall plan for the process of European recovery see: G. Lundestad, *The U.S. and Western Europe since 1945: from "Empire" by Invitation to Transatlantic Drift*, New York, Oxford University Press, 2005

[37] Eichengreen, *Exorbitant Privilege. The Rise and Fall of the Dollar*, cit., p.48

[38] I write about the "formal birth" of the Cold War referring to the Truman Doctrine, officially set forth in march 1947 during a public speech by president Truman, and globally considered as the begin of the Cold War. A general but exhaustive summary of the Cold War is R. McMahon, *Cold War. A Very Short introduction*, New York, Oxford University Press, 2003

to notice that the process of European integration later became one of the most destabilizing elements in the United States, and to some extent a real threat to its hegemony, for example with the Common Agricultural Policy of the early sixties, or with the process of partial opening to the Soviet Union pursued by Brandt's Ostpolitik in the seventies.[39]

As we can see, the establishment of the American hegemony was not a linear process. Problems and real challenges to the working of the "perfect" arrangement decided at Bretton Woods existed since the beginning. On the one hand the Cold War climate contributed to affirming the American economic superiority throughout the world. Its huge costs allowed it to reach a spectacular rate of employment, causing the greatest economic boom ever. In short, it was the catalyst for the propagation of the "American Way" to all the capitalistic Nations, and its establishment as an essential characteristic to the modern world as a whole. The modern models of mass production and distribution, the growing importance of multinational corporations not only in the economic life but also in the political processes of decision making, the rapid development of new forms of financial speculation are all American products and siblings of that economic boom. Indeed, on the other hand the Cold War itself, and the huge expenditure it required laid the foundations for the decline of the American hegemony[40].

As a matter of fact the Cold War had a great impact on the American economy. It influenced it to such an extent that the entire system has been called *Cold War Liberalism.* The working of this mechanism can be summarized as follows: in order to sustain high rates of employment, the US government, through its New Deal policies,

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[39] On the importance of the process of European Integration and some of its manifestations like the Common Agricultural Policy in affecting American politics cf. L. Segreto, "Stati Uniti, Europa e Crisi del Sistema Monetario Internazionale (1968-1973). Verso la Fluttuazione Generale delle Monete", *Rivista di Storia Economica*, 20, 2, August 2004, pp.175-206; Brandt's Ostpolitik has been largely discussed , and represents one of the major point of interest in the study of the 1970s. Among others I suggest G. Niedhart, "U.S. Détente and West German Ostpolitik: Parallels and Frictions", in Schultz M., Schwartz T. (eds.), *The Strained Alliance. US-European Relations from Nixon to Carter*, Cambridge, Cambridge University Press, 2009, pp. 23-44; S. Lorenzini, "Globalising Ostpolitik: Ostpolitik Revisited", *Cold War History*, 1743-7962, 9, 2, 2009, pp. 223-242

[40] The concept of declining hegemony is at the core of: Arrighi, *Chaos and Governance in the Modern World System*, cit.

put money into society creating factories and an elevated number of workers. At the same time, part of the money those workers earned returned back to the government in the form of taxes, and partly were spent by families in consumer goods, the manufacturing of which required the factories, that consequently received their incomes from the high demand of the always wealthier society. Yet the factories did not build only goods for American families, absorbing the military production a large part of Federal expenditure. In addition to all of this, capital was flowing to Europe through the Marshall plan reinforcing the European market and hence creating another important reserve of buyers of American products.

The mechanism described above managed to reach its goal of full employment and soaring wealth, and in the short term it functioned well. The problem was that arms expenditures were bound to grow as the Cold War escalated and as other, always more expansive conflicts started. At a certain point these expenditures were doomed to exceed domestic ones, and this is what occurred[41].

Undoubtedly the privileged role of the Dollar had a great importance in shaping such a mechanism. At the end of the World War,

> for foreign central banks and governments the dollar was as good as gold, since the United States stood ready to sell gold at a fixed price of $ 35 an ounce. […]Central banks still had the option of accumulating gold, but the supply of newly mined gold was limited. There was also the uncomfortable fact that since the Soviet Union and South Africa were the main producers, purchasing gold effectively subsidized two unsavory regimes. These facts placed the dollar and the United States in a unique position. American consumers and investors could acquire foreign goods and companies without their government having to worry that the dollars used in their purchases would be presented for conversion into gold. […]America was able to run a balance-of-payments deficit *without tears*[42].

[41] To give an idea of the huge military commitment of the U.S.: in 1969 American soldiers in south-east Asia were 542.000; 300.000 were in Europe; in the same year American military bases abroad were 2300 while federal military expenditures were $ 4.8 billion, six times more than in 1946. Cf. W. LaFeber, *The American Age. American Foreign Policy since 1750*, New York, Norton, 1994, p. 635

[42] Eichengreen, *Exorbitant Privilege. The Rise and Fall of the Dollar*, cit., pp. 39-40

In reality, the process of establishing a general convertibility took more or less ten years.

Immediately after the war, the discrepancies between the economies of different countries were enormous, in particular between the United States and Europe. Nor were the different currencies subjected to any sort of equilibrium between one another. The link with the dollar decided at Bretton Woods had brought with it a diffused overestimation of the national currencies, however every government was fairly certain that in the short run its own exports would regain momentum and hence the overestimation would disappear. But economic recovery was not such a rapid process, nor was it identical in every State. In some cases the differences in the purchase power increased further. The United States soon realized that the Marshall Plan alone would not be able to achieve full multilateralism without a general realignment of currencies.

This is why in 1950, two years before the official end of the Marshall plan, Western European countries signed the agreement for the European Payments Union (EPU), which operated until December 1958 and represented one of the most important steps toward European integration. The EPU was not that different from a clearing union. Its scope was to finance temporary commercial deficits of the member States, in order to avoid obstacles in the flow of imports and exports. Offsets between the countries of the Union occurred monthly in the form of payment units linked to the dollar. The Bank for International Settlements implemented these compensations. One country's deficit in the balance of payments was covered by the Bank partly in gold and dollar, and partly through credits of the Union. On the other hand, countries with a surplus in their balance credited the Union[43].

It was a success. In a matter of eight years this system reached its objective of general convertibility. In 1959 the last exchange controls on the international payments were finally abolished, and,

[43] Cf. B. Eichengreen, "The European Payments Union: An Efficient Mechanism for Rebuilding Europe's Trade?", in B. Eichengreen (ed.), *Europe's Postwar Recovery*, Cambridge, Cambridge University Press, 1995, pp. 169-195

> the two great monetary zones of the Western World, the hard dollar area and the weaker European one […] merged into one large area for multilateral payments on the basis of liberalized merchandise, trade and general convertibility with fixed exchange rates[44].

Yet, the newly born system was delicately balanced too. Its weakness resided in its dependence on the American capacity to provide two reserve assets at a fixed price (dollars and gold), however one was easily available, whilst the other not. It could be argued that this system continued to work only because its participants did not require the conversion of their dollars into gold. To make matters worse, the American gold reserves were dramatically diminishing during the 1950s, falling from $ 24.4 billion in 1948 to $ 19.5 billion in 1959, while American capital held abroad registered the opposite trend, rising from $ 7.3 to $ 19.4 billion during the same period. In 1960 the dollars circulating abroad finally exceeded American gold reserves[45].

In order to avoid a convertibility crisis such as the one that was bound to happen with the depreciation of the dollar against gold at the London Stock Exchange during 1960, when gold was sold for $ 40 per ounce., initiatives were taken to maintain the fixed price, exhorting other countries not to request the convertibility of their dollars. The opportunistic nature of these tactics, undertaken for the first time during the administrations of Kennedy and Johnson, brought many historians and economists to name them adhocceries[46].

The Gold Pool in 1960 was one of these initiatives. On November 1th of that year the United States and seven European countries agreed to create a reserve of gold (in which the US contributed half) in order to sell or buy gold on the world market to maintain the price at $ 35 per ounce. Yet the rising American debt, and the inflation nourished by the Vietnam war made the system hard to conserve. The lack of trust in the American ability to sustain the parity manifested itself in 1967 as De Gaulle's

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[44] B. Tew, *The International Monetary System*, London, Hutchinson, 1985, p. 107

[45] American gold reserves were on the verge of diminishing further. In 1968, as president Nixon was first elected at the White House, these reserves were $ 10.8 billion: IMF, *International Financial Statistics, Supplement 1972*, Washington DC, IMF, 1973, pp. 2-3, cited in J.E. Spero, J.A. Hart, *The Politics of International Economic Relations*, Boston, Wadsworth, 2010, p. 18

[46] Cf. D. Basosi*, Il Governo del Dollaro: Interdipendenza Economica e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, Firenze, Edizioni Polistampa, 2006, p. 38

France finally abandoned the agreements. The Gold Pool experiment finally failed the following year.

Triffin's predictions were rapidly becoming reality[47]: if the Unites States refused to furnish dollars, trade would stop and no growth would occur. Conversely, if the U.S. supplied dollars unlimitedly lubricating trade and growth, the trust in its ability to convert them into gold would end. This would bring to a run to gold reserves that would destroy the capacity to sustain the $ 35 parity. The unique valid alternative was a preventive withdrawal from the obligation to pay gold at a fixed price. "Either way the gold-dollar system was doomed".[48]

The last attempts to keep the Bretton Woods system alive were made under Johnson administration, and the most famous of them was the plan for the *Special Drawing Rights* (SDR) in 1967. These particular rights were issued for the member States of the IMF in order to gain credits from the other members. Although it had been decided that SDRs were to be a form of loan (because of the fact that their refund was compulsory), they represented in fact a new reserve currency, whose value corresponded directly to the U.S dollar and that were distributed to the IMF members in proportion to their existing quota in the Fund:

> Governments would be obliged to accept these bookkeeping claims from other governments and in transactions with the IMF itself. Through the periodic issuance of SDRs, the IMF could now provide countries with the additional reserves they needed to support their expanding trade and payments without adding to the overhang of dollars[49].

The SDRs were hailed a success. At the end of 1969, 104 countries asked to participate in the plan[50]. Nonetheless, problems were evident. First of all, the use of SDRs was limited to the transactions between governments or with the IMF, not with private parties, and this made them less practical; secondly, under French pressure,

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[47] Cf. R. Triffin, "National Central Banking and the International Economy", *Post-war Economic Sudies 7*, Washington, 1947, pp. 46-81
[48] Eichengreen, *Exorbitant Privilege. The Rise and Fall of the Dollar*, cit., p. 50
[49] *Ivi*, p. 56
[50] Van der Wee, *Prosperity and Upheaval. The World Economy 1945-1980*, cit., p. 467

the issuance of any new tranche of SDR was subjected to European veto, even if Europe accounted only for 15% of the total amount. This was a further move by de Gaulle's to limit American power. In addition to all of this there was widespread concern by those countries, in particular West Germany, who feared a dramatic increase in circulating liquidity and inflation.

In any case, the beginning of the emission of SDRs in 1970 came at the worst possible moment. The terrible slump in which the sterling was as a hard currency, due to British difficulties in recovering its uncompetitive industrial sector, and to the enormous war debt, came to a head in 1967. The Six-Day War in June, the closure of the Suez Canal, the increase in oil price and the Arab abandonment of the pound as the international currency brought the British government to announce in November a devaluation of the pound by 14,3%[51], which was followed by an increase of the gold price that brought the remaining members of the Gold Pool (without France), to sell gold in order to maintain the price stable. In a matter of a few months, 2 billion dollars-worth of gold had been sold. In March of the following year half a billion dollar-worth of gold was sold every day. But London remained the major place for gold trade in the world, and this is why on the 14th of March the U.S. Treasury officially requested England to close the London gold market. A meeting between Belgium, England, Italy, U.S., the Netherland and Germany took place in Washington on the 16th and the 17th of March, 1968, formally ending the Gold Pool and introducing a new organization for the international monetary system: the so called *two tier gold market*.

Conceived by the Governor of the Bank of Italy Guido Carli, who presented it at the conference, the ideas contained in the plan have been defined by president Johnson as "the most significant reforms of the international monetary system since Bretton Woods"[52]. According to Carli's plan, global transactions should take place within two distinct levels: in one of these level the price of gold was free to fluctuate, while in the

[51] Cf. R. Solomon, *The International Monetary System 1945-1981*, New York, Harper & Row, 1982, pp. 89-95

[52] Cited in Eichengreen, *Exorbitant Privilege. The Rise and Fall of the Dollar*, cit., p. 59

other, in which transactions occurred between central banks, it maintained its value of $ 35/oz.[53]

Although it represented a clever solution, not everybody was as enthusiastic as Johnson about the two tier system. The doubts of many concerned the possibility of a run by governments to buy gold from the U.S. at $ 35 in order to sell it at a higher price in the international market. Why then, did this not happen? Because of a "fear of the unknown"[54] affecting governments themselves: nobody knew what would have happened if the U.S. could not manage to sustain the convertibility. Yet, the plan seemed to work well: by the beginning of 1969 the price of gold, after reaching $ 43/oz., returned to $ 35, and the American balance of payments registered a surplus in the two-year period between 1968-69[55]. But the massive expenditures that the Kennedy and Johnson administrations decided on, in order to finance the project of the *Great Society* and the Vietnam war, together with the decision not to raise taxes, soon brought back galloping inflation and an overvaluation of the American currency because of its link to gold. As a result of all of that the balance of payments deteriorated further[56].

This was the situation that Richard Nixon met as he took his place as American president on the 20th of January 1969.

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[53] For an explanation of the two tier system cf.: R. Triffin, "International Monetary Collapse and Reconstruction in 1972", in C. Engel, R.W. Staiger (eds.), *Journal of International Economics*, 2, 4, September 1972, pp. 375-400

[54] Eichengreen, *Exorbitant Privilege. The Rise and Fall of the Dollar*, cit., p. 59

[55] R. Solomon, *The International Monetary System, 1945-1976. An Insider's View*, New York, Harper & Row, 1977, pp. 119-124

[56] Cf. Van der Wee, *Prosperity and Upheaval. The World Economy 1945-1980,* cit., p. 475

The Nixon Era

With the election of Nixon as American president the "fear of the unknown was then trumped by fear of the known"[57]. Under his administration American policies became increasingly unilateral and inflationary. Strongly convinced that his defeat in the 1960 presidential election against J.F. Kennedy had largely been due to the economic recession during those years, Nixon's sole preoccupation became the recovery of American prestige, no matter how it was accomplished[58]. What he showed from the beginning was the willingness to modify the system in which the American Hegemony had become jammed, in order to maximize U.S. advantage.

I will not delve into the multiple facets of the Nixon administration here. The discussion about American domestic policy and the responsibility of its main characters deserves a central role in the next part of my thesis. The main purpose now is to provide the international context to the events occurring around 1970.

Nonetheless, the process of separating a domestic and a foreign level is not an easy task when dealing with the United States policies of the 1960s and 70s: for a country of that dimension and political weight, every action of domestic policy was itself an action of foreign policy.[59]

The aim of these next pages is to conclude the brief summary of the international monetary history which I began in the last chapter, and to provide a description of the evolution of the monetary system during the Nixon years, focusing on the decision of the 15th of August 1971, and the consequences it had on the international stage.

The United States that president Nixon found himself leading was in many aspects drastically different from that of the Kennedy leadership almost ten years before. The

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[57] Eichengreen, *Exorbitant Privilege. The Rise and Fall of the Dollar*, cit., p. 59

[58] On the 1960-61 recession, and in general on the recession periods of the last century, I have found notably interesting N. Frumkin*, Recession Prevention Handbook: Eleven Case Studies, 1948-2007*, New York, M.E. Sharpe, 2010

[59] Cf. M. De Cecco, "International Financial Markets and US Domestic Policy since 1945", *International Affairs*, VII, July 1976, 3, p. 25, cited in D. Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, cit., p. 49

growing importance of the Soviet power and its paramount appeal throughout the world manifested itself not only in the birth of a wide range of communist and socialist movements worldwide, but also in an expanding military presence and in the huge amount of nuclear warheads. There was the Vietnam War, with its enormous cost in terms of human lives, military expenditures and its paramount importance in shaping the American public opinion, not only of the new generations, but also of larger layers of a society unhappy with such a useless waste of public money[60]. Another major problem marking the difference between the Nixon era and the former ones was represented by the deteriorating relationship with the European allies, increasingly eager to gain more independence from the United States. The State which tended toward this direction more than any other was De Gaulle's France, who, during the two-year period 1965-66, twice requested the conversion of its dollars and withdrew its troops from NATO's integrated military command. If France's main point of collision with the bigger ally was the unscrupulous use of the seigniorage right of this latter, for West Germany it was the delicate matter of maintaining the American troops on German soil and, from 1966, the revolutionary openness to the Soviet Union pursued by Willy Brandt's *Ostpolitik*. Great Britain, notwithstanding the support to the sterling given by the Americans, was moving closer to the other European countries, and this could have represented a further disturbance to the transatlantic relations given the *special relationship* amidst the two powers[61] . For matters concerning NATO, the most important dispute was the Burden Sharing, that is, a more equal division of the

[60] American deaths in Vietnam had increased year by year during the Kennedy-Johnson administration. In 1967 the number of American soldiers that lost their lives in the war was 11,153; the following year 16,592; 11,616 would die in 1969: Cf. National Archives, "Statistical Information about Casualties of the Vietnam War", http://www.archives.gov/research/military/vietnam-war/casualty-statistics.html#year; American military expenditures abroad had grown six times from 1946: in 1969 they accounted for $ 4.8 billion: US Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Washington DC, Government Printing Office, L, January 1970, 1, pp. S2-S3

[61] On the *special relationship* between England and the United States and in general on the American-European relations during the cold war years see Lundestad, *The United States and Western Europe since 1945: from "Empire" by Invitation to Transatlantic Drift*, cit. See also Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, cit.

expenditures for common defence between the member States[62]. Over and above that, major frictions came from the EEC at the end of the sixties, just as it was starting to operate more and more as a protectionist block, thanks to its privileged position under the *American Umbrella*.

Yet, despite the seriousness of the situation in American international relations, what Nixon was most preoccupied with resided domestically: firstly, the war had nourished a spreading inflation, whilst gold reserves had constantly diminished during the sixties. On the other hand, the *Cold War Consensus*, that particular form of national solidarity which had accompanied the growth of the United States for twenty years after the war, was rapidly fading, pushed from one side by the Vietnam War and from the other by the Détente process with the Soviet Union. In addition to all of this, there was the decline of the American great industry due to the increase of national and international competition.

In short, Nixon had to face the matters the Johnson administration had left unanswered. The first of these matters concerned the difficulties with the balance of payments, the *de facto* inconvertibility of the dollar into gold, and the problems with American-European relations. It is easy to understand how deeply these issues were inextricably connected to the major topic of the reorganization of the international monetary system.

The growing consciousness of the structural faults with the gold-dollar standard brought groups of experts to discuss a monetary reform as early as 1968: the most important were the Deming Group in West-Germany, the Haberler Group in the United States, Robert Solomon and his team from the Federal Reserve, and journals like the Wall Street Journal. Nixon was perfectly aware that monetary matters had to be given particular attention. The National Security Study Memorandum no.7 (NSSM7) gave birth to a permanent working group, also known as the Volker Group taking its name from its then President Paul Volker, which started its activity on the 21st of January

[62] For a brief history of the NATO cf. among others P. Duignan, *NATO: its Past, Present and Future*, Stanford, Hoover Institution Press, 2000

1971 aiming to make "recommendations on U.S. international monetary policy to the NSC[63] and to implement policy decisions"[64].

The pressure for reforms was high both from the internal and from the international front. Although Nixon seemed to back the process of European integration, he was also highly preoccupied with the growing competitiveness that the European and Japanese products were gaining throughout the world. The entourages commissioned to prepare the general analysis in which the political decisions had to be set, highlighted the increasing frictions, the competitive spirit and in some cases a veritable collision course between the two macroeconomic areas[65]. This same new wave of competitiveness also drove the increasingly pressing requests of the American big business world for the instauration of protectionist measures in order to cope with the emerging competitors. The extent of this counter-European and counter-Japanese feeling in the American society was demonstrated by the fact that the trade unions and rural America also advanced such demands, in particular after the failure of the Kennedy Round[66]. Among these requests, those that stood out the most were the ones concerned with the removal of those forms of control over the flow of capitals, introduced by Kennedy and Johnson to preserve the role of the dollar and the Bretton Woods system, namely: the Voluntary Program on Credit restraint (VPCR) and the Foreign Direct Investment Program (FDIP), that blocked the development of the American companies abroad, and the Interest Equalization Tax (IET), that limited American loans[67].

To summarize, the widespread sentiment in the United States was that the Europeans had taken too much advantage of the United States in terms of economic and military aid, and that they had made no attempts to repay it. The American call for

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[63] The National Security Council, the President's principal forum for considering national security and foreign policy matters with his senior national security advisors and cabinet officials. Cf. The White House, "National Security Council", http://www.whitehouse.gov/administration/eop/nsc

[64] Nixon Presidential Library and museum, NSSM7, 21.1.1969, http://nixon.archives.gov/virtuallibrary/documents/nssm/nssm_007.pdf

[65] L. Segreto, "Stati Uniti, Europa e Crisi del Sistema Monetario Internazionale (1968-1973). Verso la Fluttuazione Generale delle Monete", cit., p. 180

[66] The Kennedy Round was the sixth session of the General Agreement on Tariffs and Trade, inaugurated in 1963 and ended on 15th may 1967.

[67] Cf. Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, cit., p. 48

an assumption of responsibility (for example with the proposal of the Burden Sharing) remained unanswered, while the European governments repeatedly denied any American interference in continental politics. It really seemed that they wanted to have their cake and eat it. As the Secretary of Treasury John B. Connally Jr. told the future Secretary of Commerce Peter Peterson in March 1971,

> 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 economic trade. This is no longer the case[68].

Yet, the former governor of Texas John Connally represented an emblematic figure: his passage from the Democratic lines under the administration of Kennedy and Johnson, to the Republicans, showed how much the *Zeitgeist* had changed. What mattered most now was finding a solution to the current problems, however firstly preserving American interests and, only secondly, those of the major West-European and Japanese partners[69].

American behavior toward Western Europe became highly ambiguous under Nixon, in particular with regard to the shared concern about the reform of the international monetary system. Although the first visits of the president to the European leaders in February-March 1969 largely left unquestioned the role that such a reform should have, even in those meetings emerged the American will to reshape the system according to the new needs of the United States[70]. The establishment of a good relationship with Western Europe, which pushed many entourages inside the Nixon administration, found itself in the prospect of an "era of negotiation" that Nixon

[68] Cf. National Security Archives, Fiche 31, doc. 373, Connally to Peterson, 29/3/1971, cited in Segreto, "Stati Uniti, Europa e Crisi del Sistema Monetario Internazionale (1968-1973). Verso la Fluttuazione Generale delle Monete", cit., p. 182
[69] *Ivi*, p. 185
[70] Cf. Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, cit., p. 67

wanted to build shifting from the previous "era of confrontation"[71]. The fall in popularity and the decreased trust that the Europeans had in American capacity to manage international matters required the United States to reassert its role as guarantor of the international order. But what's more, the gravity of the international financial situation made cooperation a more secure choice in view of the American aims.

Furthermore, what Nixon evinced from the trip, was that the Europeans were undoubtedly asking the United States for stronger control over its internal inflation, but on the other hand there was a widespread fear of a contraction of American internal demand that may have caused an international recession. Aware of this, Nixon announced in April 1969 the beginning of the process of foreign investment deregulation. It was a move that made clear that the United States decision-making process would leave little space for consultation with its allies, even if such decisions were to impact the broader international community.

Surely, American decisions had a great influence in shaping European politics, but this influence was highly reciprocal. On the one hand the changes in American policies represented a strong catalyst in the formation of a European front, with the shared conviction that the only way to endure such changes required a higher degree of cooperation and integration. But on the other hand, as I have pointed out previously, this same process of integration was a real challenge for the United States, and gained considerable ascendancy in Washington's decisions.

On the 1th of July 1968 the customs union began among the Six[72]. Despite its extreme importance as one of the first steps toward modern Europe, this event concealed many reserves (e.g. French veto to the admission of Great Britain; the never ending discussion about the CAP; the empty chair crisis of 1965-66 in which France withdrew its representatives from Brussels meetings) that revealed how integration was not a near-at-hand goal for European governments, who often had to resort to a

[71] I am referring to the famous Nixon's quote: "Let us move from the era of confrontation to the era of negotiation", BrainyQuote, "Richard M. Nixon Quotes", http://www.brainyquote.com/quotes/authors/r/richard_m_nixon_3.html

[72] The six founder States of the European Union: Belgium, France, (then-West) Germany, Italy, Luxembourg and the Netherlands

compromise solution. Despite all of this, after the Sterling crisis in 1967 and the end of the gold pool in 1968, in February 1970 negotiations also began for an economic and monetary union, in the form of a working group chaired by Luxembourg's Prime Minister Pierre Werner[73]. The Werner Plan was presented in Venice in March 1971 and reflected the discrepancies of the Six: the project for an economic and monetary union became a mere bargaining chip within a larger set of negotiations including the CAP, the aids to the less developed parts of the community, the harmonization of fiscal policies and the introduction of the value-added tax[74]. Moreover, no major headway had been made in finding a common position towards the United States, nor did a common solution emerge about how to cope with the general crisis of the Bretton Woods system.

However, the Werner Report was doomed to remain unimplemented because of the unrestrained wave of speculation on the international monetary markets in May 1971, that constrained the Bundes-Bank to continually purchase dollars, finally bringing the free fluctuation of the German mark and the Dutch florin on the 10th of May, whilst the Swiss franc and the Austrian schilling were devaluated respectively of 7.1 and 5.05 %[75]. Just two days before, on 8th May, a paper prepared by the department of Treasury named *Contingency* considered the possibility of suspending the gold convertibility as an American tactic to face the current crisis[76].

The final straw was represented by England's demand for the conversion of some of its dollars on the 13th of August: Nixon decided that the situation had gone well over the line. Vis-à-vis the failures in the European front, the deteriorating balance of payment, the growing losses of American reserves[77], and the rising rate of domestic

[73] A brief but exhaustive summary of the history of the European Community, in which its main institution are also described is J. Pinder, *The European Union. A very short Introduction*, New York, Oxford University Press, 2007

[74] Cf. Segreto, "Stati Uniti, Europa e Crisi del Sistema Monetario Internazionale (1968-1973). Verso la Fluttuazione Generale delle Monete", cit., p. 189

[75] *Ivi*, p. 189

[76] Paper prepared in the Department of the Treasury, 8.5.1971, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 152, http://history.state.gov/historicaldocuments/frus1969-76v03/d152

[77] Only in the first six months of 1971, $ 22 billion in assets flew out the United States.

inflation[78], on the 15th of August 1971, after three days of consultations in the summer residence of Camp David with his closest collaborators on economic and financial matters, president Richard Nixon announced via television that he had undertaken a series of important decisions that would form the so called New Economic Policy (NEP). Its main purpose was the temporary suspension of the gold convertibility, the introduction of a 10% import surcharge and the freeze of wages and prices for ninety days. It is easy to imagine the deep impact such moves were to have on the international arrangements. The 10% tax in particular literally "placed other countries over a barrel"[79], especially the Europeans.

At the meeting of the 16th of August between the undersecretary of the Treasury Volker and the French, Italian, English, West-German and Japanese representatives, the United States affirmed their passivity in the current situation: every Government was to decide alone how to address the matters emerging from the American decision. Volker explicity announced that the Americans did not want to organize a new Bretton Woods conference and that "he had no little piece of paper in his pocket about what rate changes were needed" in case of a new parity. With regard to the surcharge, Europe's main concern, it was to remain until the reestablishment of "a strong U.S. position"[80].

Nixon's measures profoundly mined the foundations of the gold dollar standard and the attempt to create an international monetary order. Yet, it did not mean that the U.S. was yielding its global monetary hegemony. The very intent of the Nixon shock was, if anything, to strengthen it. What was at stake was a different interpretation of the origins of the problem: on one side the Americans thought they had paid too great a price to maintain their monetary supremacy. The strain to keep the gold price of the dollar had been converted in a "fundamental external disequilibrium. Since the other countries refused to follow the rules of the system as they did not want to revalue

[78] In 1970 the inflation rate was 5.84%, Inflation Data.com, "Historical Inflation", http://inflationdata.com/inflation/Inflation_Rate/HistoricalInflation.aspx?dsInflation_currentPage=3
[79] Eichengreen, *Exorbitant Privilege. The Rise and Fall of the Dollar*, cit., p. 61
[80] Memorandum of Conversation, 16.8.1971, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 170, http://history.state.gov/historicaldocuments/frus1969-76v03/d170

their currencies in relation to the dollar, the American government was left with just one alternative"[81].

On the other side of the Atlantic the vision was exactly the opposite: the U.S. had up until that time abused its monetary hegemony, using the gold dollars to finance the expanding deficit of the American balance of payments. "The suspension of dollar convertibility in 1971 was regarded as the high point of American misuse of power"[82].

After the shock of August, the British Chancellor of the Exchequer[83] Antony Barber was the first to ask for the instauration of a new monetary order. At the IMF conference in September 1971 he presented the directives for a general reform: according to this program the parities would have remained fixed, but it would have been easier to adjust them; the dollar would have lost its standard position, that would have been maintained by the Special Drawing Right (SDR), an independent unit of account still pegged to gold; central banks would have operated with different currencies, no longer only with dollars; the deficits in the balance of payments would have been periodically adjusted through the transfer of SDRs, while countries with surpluses who denied to take on their part of the adjustment would have been sanctioned; lastly, the IMF would have initiated a program to substitute the credits in dollars with SDRs. Thanks to this right to issue SDRs, the IMF would be able to control the growth of global reserves[84]. Yet, the British proposals remained ignored by the American government, mostly influenced by Connally's strong position.

Despite all of this, during the following months many multilateral meetings took place to discuss the revaluation of currencies against the dollar, for example the summit between Brandt and Pompidou at the beginning of December, in which the common will to find an agreement with the United States emerged. The most important of these meetings was between Nixon and Pompidou in the Azores during 13th-14th December 1971: there the two leaders agreed on a few points, such as the

[81] Van der Wee, *Prosperity and Upheaval. The World Economy 1945-1980,* cit., pp. 479-480
[82] *Ivi*, p. 480
[83] The *Chancellor of the Exchequer* is the British cabinet responsible for financial matters. It corresponds to the American *Secretary of the Treasury*
[84] Cf. B. Tew, *The Evolution of the International Monetary System 1945-1977*, New York, Wiley, 1977, pp. 185-190

increase in the gold price from $35 to $38, the revaluation of some European currencies, the American engagement in a future return to convertibility and the settlement of broader fluctuation margins[85]. This rapprochement to Europe was heavily favoured by Nixon's National Security Advisor Henry Kissinger, concerned with the dangers of a total disruption of U.S.-European relations. The Washington Agreement on 18th December 1971 between the Ten[86], also called the Smithsonian Agreement since it was signed at the Smithsonian Institution, served as ratification of the compromise agreed at the Azores: the 10% surcharge on imports was abolished in exchange for a multilateral realignment of the parities; the currencies of the most industrialized countries appreciated against the dollar and were once again pegged to the American currency[87]; fluctuation was permitted only within 2.25% over and below the official parity; the official price of the gold shifted to $38/oz., but only in the case of a return to the convertibility. The Smithsonian Agreement formally initiated the official Dollar Standard: the currencies of the most industrialized countries were tied to the dollar and converted into dollars, yet without being anchored to gold. Since the SDRs were not yet so diffused, they were not considered a favorable source of global reserves, and "the dollar was thus promoted *de facto* to the main reserve currency of the world, and *de jure* to a universal and dominant key currency"[88].

The Agreement left both sides highly disappointed. Although the system that emerged helped the United States to cope with the exorbitant internal deficit, the appreciations of European currencies were still too low according to the American point of view, and above all it did not bring any increase in incomes. The Europeans conversely, whose currencies had been re-evaluated within reasonable margins, were

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[85] Cf. Segreto, "Stati Uniti, Europa e Crisi del Sistema Monetario Internazionale (1968-1973). Verso la Fluttuazione Generale delle Monete", cit., p. 198

[86] The Group of Ten, also known as G-10, is an international organization that gathers eleven of the major economic powers in the world. The member States at its foundation were Belgium, Canada, France, Italy, Japan, the Netherlands, the United Kingdom, the United States, Germany and Sweden. Switzerland joined the Group as eleventh member in 1964, but the name remained unaltered.

[87] The dollar devalued of 7.9%; sterling and franc had a re-evaluation of 8.57%, the mark of 13.58% in respect to 5th May, Japanese Yen of 16.9%. Cf. Segreto, "Stati Uniti, Europa e Crisi del Sistema Monetario Internazionale (1968-1973). Verso la Fluttuazione Generale delle Monete", p. 199

[88] Van der Wee, *Prosperity and Upheaval. The World Economy 1945-1980, cit., p. 489*

still convinced that the dollar had gained more room for manouvre, because it was still unconvertible.

As a consequence, the European governments accelerated their rush toward a monetary union already presented in October 1970 in the Werner Plan. On 7th March 1972 the six States members of the ECC decided to pose specific limits to the fluctuation capacity of their currency, 50% of the margins decided in Washington (± 1.125% the official parity), hence reducing the total band from 4.5% to 2.25%. It was the beginning of the so called *snake in the tunnel,* "the visual metaphor being a European snake wriggling in the Smithsonian tunnel"[89]. In order to maintain the parities within the limits designed by the snake, the intervention of central banks would occur only in European currencies, without dollars. The dollar was also excluded from the reserve currencies.

Despite the initial success of the snake (on 1th May also Great Britain, Denmark and Ireland joined it), the European governments were swimming upstream against the major international monetary tendencies that moved towards more (rather than less) flexibility.

In the same month as Great Britain, Ireland and Denmark entered the European monetary snake, on the other shore of the Atlantic John Connally resigned from Secretary of the Treasury. Taking his place at office was the former Secretary of Labor George P. Schultz, who displayed from the beginning his softer position towards an open dialogue with the old European allies, hence inaugurating a new set of negotiations to find a common solution to the more than ever chaotic situation in international finance. In July 1972 he formed a Committee of Twenty, composed of twenty financial ministers and central bank governors, and a Committee of Deputies, whose main tasks were respectively to manage a reform of the international monetary system and to advance proposals for such a reform. Three major positions arose from the negotiations: the American one, which later developed into the Volcker Plan, a European proposal highly influenced by the French positions, and, lastly, the one of the developing countries. The Volcker Plan was very similar to the Barber's plan from the

[89] Eichengreen, *Exorbitan Privilege. The Rise and Fall of the Dollar*, cit., p. 78

previous year. It provided fixed exchange rates for central currencies, while the fluctuation band around the pivotal exchange rates was larger. A set of conditions was settled on for the return to dollar convertibility, such as the considerable reinforcement of the American balance of payments, the establishment of a *primary asset holding limit* (a limit to the amount of dollar each country could request to be converted), and the substitution of gold with SDRs. The clearing and adjustment mechanisms, whose malfunctioning was regarded as the principal reason for the fall of the gold dollar standard, were reorganized in order to distribute more evenly the responsibility of resolving problems in the balance of payments. Each country was assigned a basic level of international reserves: if the reserves of a country differed from that level, it would be forced to make the necessary adjustments. In addition to all of this, "the Volcker Plan proposed a system of multicurrency intervention which would replace the former system of dollar intervention"[90]: a surplus country, whose exchange rate with respect to a deficit country was at the maximal limit provided by the band, would be forced to buy the deficit country's currency, which could be held or otherwise converted into SDRs.

West European and Japanese members did not wholly agree with the American proposal, in particular regarding the adjustment mechanisms: from their standpoint the system needed a greater symmetry between the countries with a pivotal currency and the others. There were three main objections to the Volcker Plan: the first came from France, who was concerned with the excessive flexibility the American proposal would have brought to the monetary system. Also the dollar's role as reserve currency was put into question, given that the American deficit was likely to follow a soaring trend, which may have caused an expansion of global liquidity and inflation. The second objection was held by Germany and Japan, and concerned the automatic mechanism based on the reserves levels: being great exporter countries, they were afraid of the effects a revaluation of their currencies would have caused. Thirdly, there was the shared dissatisfaction with "the continuation of dollar balances"[91]: Italy's proposal to reduce the dollar overhang was to substitute dollars with SDRs through the

[90] Van der Wee, *Prosperity and Upheaval. The World Economy 1945-1980,* cit., p. 483
[91] *Ivi*, p. 483

IMF. The accumulated dollars in the IMF would then have been voluntarily repaid by the U.S. over a long period.

The third position which emerged in the negotiations among the Twenty was that of the developing countries, that discouraged any use of a key currency, which could have rapidly turned into a tool for hegemonic power, fostering on the contrary the development of the SDRs as a source of international reserves. Furthermore, they wanted easier access to these reserves.

The Committee of Deputies gathered in Washington in March 1973 and in Nairobi in September, where a reform program was approved. According to this plan, the SDRs acquired the role of international reserve, while gold remained demonetized (in short, they did not replace the dollar, since they could not be used as national reserve; however they did replace gold); no link was established between SDRs and development aid: special financing programs were however created for developing countries; moreover, it was decided that by the 31st of July 1974 a final decision had to be reached. Yet, as everybody knows, the oil crisis which began in October 1973 brought a new monetary confusion, leading to the failure of the whole project.

Meanwhile, the snake experiment undertaken by the Europeans was rapidly fading. The discrepancy between a rigid monetary policy and the new global tendencies, described above, led some member States to choose more flexible policies, allowing them to sustain internal employment and welfare. In June 1972 Great Britain, Ireland and Denmark left the snake, while Italy and France followed between 1973-74.

The failure of the snake officially marked the end of the sterling area. After Great Britain's exit, fifty-three countries detached their currency from the British. On the 23rd of June Britain also abandoned the Smithsonian Agreement, and hence the sterling became free to fluctuate in respect to the other currencies. What followed was a new set of speculative waves against the dollar that culminated in March 1973, after the lira, the Swiss franc and the yen had also left the parity. The Paris meeting between U.S., France, Great Britain and West-German representatives in February did not bring any relief: although the dollar depreciated further to $42/oz., speculation went on. On the 1st of March the international monetary markets declared a nineteen-day long

closure: it was the end of the dollar-standard and the beginning of the era of managed floating. All the world currencies were now free to fluctuate. However a lot of bilateral and multilateral agreements were reached in order to limit the range of these fluctuations, whilst the dollar maintained its role as major international currency: in 1979, 75% of global transactions were still held in dollars[92].

Why was no definitive agreement reached by the different parts over a new stable organization of the international monetary order? I think the president of the Committee of Deputies Jeremy Morse was right when he spoke about a "lack of political will […] The will to agree and do things together in the common interest even though they may not be precisely what any of the parties would have chosen"[93]. Taking together the different plans examined in the last pages, it becomes apparent their resemblance to the Keynes plan in 1944, where the SDRs substituted the Bancors, and the IMF the clearing union. Yet, the Keynesian approach could no longer work within the new set of economic and political issues of the 1970s[94].

[92] Cf. Van der Wee, *Prosperity and Upheaval. The World Economy 1945-1980,* cit., p. 493
[93] F. Capie, *The Bank of England: 1950s to 1979*, New York, Cambridge University Press, 2010, p. 739
[94] Cf. Van der Wee, *Prosperity and Upheaval. The World Economy 1945-1980*, cit. p. 485

The Road toward a New Economic Policy

The American unilateral decision to suspend the gold-dollar convertibility on 15th August, 1971, represents one of the major watersheds in contemporary history. Its extreme importance resides in the fact that it sanctioned the definitive failure of the project for a new stable monetary order on a global scale initiated at the Bretton Woods conference almost thirty years before.

The reasons and causes for these developments have already been enucleated in the previous chapters. What has emerged in particular from this research is the key role played by American economic policies and the developments in the international scenario contributing to such a conclusion. On the one hand the growing domestic problems in the U.S. balance of payments and the high rate of inflation and unemployment surely concurred in shaping American monetary politics. On the other hand the soaring competitiveness of the U.S. major allies, Western Europe and Japan, together with their protectionist tendencies were surely strong motivating factors.

If the first sections of this work were intended to provide a sort of context to that range of events, the aim now is to gain a better understanding of what exactly drove president Nixon and his administration. The questions this next part attempts to answer are: Who were the main promoters of such policies and who were opponents? What kind of interests were at stake? And: How much did the preoccupation for 1972's elections matter?

In the first part of this chapter I will analyze more intently the two-year period between 1969-1971 underlining the principal steps made by international monetary politics under the presidency of Nixon. At a later stage I will try to describe the various personalities involved in the process, giving a brief presentation of them and their relation to one another. I do not intend to fall into a sort of psychologism giving accounts of political and international events through mere character descriptions[95]. On the contrary, my aim here is to provide an additional lens to look at the case of

[95] A sort of psychological approach to Nixon's personality can be found in V.D. Volkan, N. Itzkowitz, A.W. Dod, *Richard Nixon: A Psychbiography*, New York, Columbia Univesity Press, 1997

August 1971 and thus examining how much those personalities and their interests influenced the actions. Subsequently, in chapter V, I will discuss more generally political theory and the decision-making processes, showing what particular schemes and patterns of policy making were involved in Nixon's decision, in which aspects did they differ from those of the previous administrations and to what degree are they useful in understanding American change in monetary policies at the start of 1970s.

In the months that followed Nixon's approval to start the deregulation of American foreign investment on April 4th, 1969, experts and officials from both sides of the Atlantic literally commuted between U.S. and European capitals searching for a practical solution to the reform of the international monetary order[96]. America's main concern was to verify the European opinion over the possibility of increasing exchange rates flexibility, in order to limit the damages created by the long lasting over/under valuation of certain currencies. The American preoccupation was fuelled by the increasing speed to move capital between States, that was likely to require quick adjustments of exchange rates. According to a paper written by the Volker Group on the 13th of March 1969,

> Unless there are some changes in the international monetary and payments system, cumulative strains could develop over the next few years that could result in increasingly serious disturbances in the framework of international monetary relationships. One aspect of this strain on the monetary system could be heavy reserve losses for the United States, through the conversion of dollars into gold by foreign monetary authorities. The balance of payments on the liquidity basis may well continue at $2-3 billion a year. A strong anti-inflation program, though absolutely necessary, may not be sufficient to shrink our liquidity deficit in a highly competitive world. This prospect would be underlined by a vigorous program of relaxing restraints on capital outflow, in a future situation of relative monetary ease. The present official settlements surplus results from heavy short-term borrowing by United States banks, which pulls money out of foreign official reserves. This is a factor related to credit stringency here, and may prove to be

[96] Cf. Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, cit., p. 76

> temporary. We may face attrition of our reserves, and periodic currency crises can add to our gold losses[97].

In the paper concrete proposals followed for reforms such as the activation of the SDRs, the increase of amounts in the IMF, the appreciation of the mark and a more equal distribution of NATO burdens. Interestingly, besides this open-to-negotiation strategy there also appeared the possibility of a unilateral action, that would have consisted of "suspending the present type of gold convertibility and following this with an attempt to negotiate a new system, in which the United States would undertake a more limited and less exposed form of convertibility of the dollar"[98]. To summarize, Nixon somehow felt justified in pursuing a higher flexibility, which was also perfectly coherent with his political line, expressly oriented toward the free move of capitals and goods within an international framework of liberal trade and finance.

In favor of an increase of the flexibility were Secretary of Labor George P. Shultz and the Chairman of the President's Council of Economic Advisors Paul W. McCracken, but also famous economists like Milton Friedman and Arthur Okun[99]. European governments, conversely, did not favor this solution. As the Assistant to the Secretary of the Treasury George Willis wrote on the 27th of may in a memorandum for the members of the Volker Group about the consultations with the Europeans on exchange rates:

> Prevailing attitude toward greater exchange-rate flexibility: negative, especially if allowance is made for the veil of courtesy and friendliness which lead many to soften their criticisms and doubts; in the second round with the British they wanted to be sure the U.S. was not misled by their willingness to engage in constructive discussion and made clear their attitude was basically negative.

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[97] Volcker Group Paper, 17.3.1969, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 119, http://history.state.gov/historicaldocuments/frus1969-76v03/d119

[98] *Ivi*

[99] See M. Friedman, *Dollars and Deficits : Inflation, Monetary Policy and the Balance of Payments* Prentice Hall, 1968, and A. Okun, *The Political Economy of Prosperity*, New York, Norton, 1970, p. 15

> […]Discipline: widespread concern that greater exchange-rate flexibility would weaken 'disciplinary' pressures on deficit countries[100].

In the meantime some authoritative voices domestically were asking Nixon for a more coherent organization of the decision-making process with regard to international economic and trade policies. These claims came firstly from Kissinger's economic advisor Fred Bergsten, but were expressly shared by Kissinger himself, who wrote a memorandum to Nixon urging him to establish an overall strategy for international economic issues[101]. Following this advice Nixon asked the Secretary of Treasury David Kennedy, with a memorandum dated 15th April, to prepare a unitary document analyzing all the possible options and their respective implications[102].

These requests for a stable organization of American international economic policy clearly became necessary on the 27th of April 1969, as De Gaulle resigned from French presidency, triggering a strong monetary crisis due to speculation. Within the American administration this situation gave life to a basic opposition between two distinct fronts: an interventionist one, whose major supporters were McCracken and Kennedy, with the intention of forcing France and West Germany to change the value of their currencies, and a low-profile one backed by Kissinger, who favored a neutral position in the matter. Nixon showed his preference for the latter's view. Yet, although the monetary chaos progressively lessened until its end in the middle of May, the decision to follow a neutral trend demonstrated U.S unpreparedness to cope with such a crises. In addition to this, during this short period, Kennedy's interventionist line went so far as to propose the closure of the golden window, as a precaution against the risks to U.S. reserves, and was followed by a memorandum of the NSC's economic advisor Richard Cooper, in which this latter considered the possible consequences

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[100] Editorial Note, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 127,
http://history.state.gov/historicaldocuments/frus1969-76v03/d127

[101] NA, NPM, FNSC, NSC Files, SF, Balance of Payments, box 309, mem., H. Kissinger to R. Nixon, "Relaxation of Payments Controls", 11.4.1969, *confidential*, cited in Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, cit., p. 84

[102] *Ivi*, p. 84

originated by the suspension of gold-dollar convertibility[103]. According to this study three possible scenarios would have followed the decision: in the first of these, the demise of any international economic order and of the old political alliances would have created a division of the western World into two distinct economic blocks; the second forecasted a period of uncertainty caused by the fluctuation of currencies, that would in turn have brought reforms to speed up and to increase U.S. bargaining power; the more interesting scenario was the third, in which Cooper foresaw that the end of gold convertibility would have established an out-and-out dollar standard, thus ratifying the situation of the 1960s, but this time without the risks of being contested[104].

On the 6th of June 1969 Kissinger sent Nixon a memorandum in which he asked the President for authorization to "Set up a meeting in about ten days to consider U. S. international monetary policy, both short-term and toward longer run reform of the system"[105]: the need for a common strategy for monetary and economic issues was urgent as never before. As a consequence, on the 26th of June a secret meeting took place between Nixon, the Secretary of State William Rogers, Kissinger, McCracken, Arthur Burns, Volker, Samuels of the Department of State, the director of the United States' Office of Management and Budget (OMB) Robert Mayo and the Chairman of the Federal Reserve Bank William McChesney Martin, giving birth to a document called *Basic Options in International Monetary Negotiations, Annex I*[106], modeled on the Volker Group paper from June 23rd. Initially conceived as a guide for international monetary policy, it came to gather a plurality of themes ranging from Relations with Europe to trade difficulties and to foreign policy strategies. The paper started with a general and sincere description of the existing situation. The Bretton Woods System

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[103] Cf. NA, NPM, FNSC, NSC Files, SF, BP, box 309, mem., R. Cooper to H. Kissinger, "Implications of Gold Suspension and a Floating Pound", 2.5.1969, *secret*

[104] Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, cit., pp. 88-89

[105] Memorandum from Kissinger to Nixon, 6.6.1969, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 129, http://history.state.gov/historicaldocuments/frus1969-76v03/d129

[106] NA, RG 56, Volker Files, FRC 3, PAV-IMR, *paper* of Volker Group, "Basic Options in International Monetary Policy, Annex I", 23.6.1969, *confidential*, *limdis,* cited in Basosi*, Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, cit., p. 91

was recognized as having contributed to the continuous growth of international trade and prosperity, and, with regard to the United States, as having financed 70% of the balance of payments deficit: "The available financing for our deficits has permitted the United States to carry out heavy overseas military expenditure and to undertake other foreign commitments, and to retain substantial flexibility in domestic economic policy"[107].

Yet, repeated crises and the protectionist tendencies in the recent years had substantially mined American ability to carry forward its role as world leader. Moreover, former allies had lost their trust in the dollar and in the U.S. capacity to finance its deficit, perceived as a means to transmit to them American inflation. These circumstances were accused of eroding American bargaining power.

Hence, the objectives for the United States became: maintaining a certain degree of flexibility, both in domestic economic policy and in foreign expense, fostering free trade and free movement of goods and international investments and a non-inflationary growth of international economy, establishing controls against speculations and, lastly, preserving a minimum control position for the United States[108].

The most interesting aspect emerging from the paper was that it reasserted the principle of a gradual approach to the reform of the system, that had already been presented in the Volker Group paper from 17th March: the main points of this approach were the activation of the SDRs, the adjustment of parities, an increase in the quotas to the IMF and the burden sharing in military expenditures. Yet, the unilateral option was not fully excluded: in case of high reserve losses or a failure in negotiations, the U.S. preserved the possibility of a "suspension of the present gold

[107] NA, RG 56, Volker Files, FRC 3, PAV-IMR, *paper* of Volker Group, "Basic Options in International Monetary Policy, Annex I", 23.6.1969, *confidential*, *limdis*, cited in J. Harold, *The International Monetary Cooperation since Bretton Woods*, New York, Oxford University Press, 1996, p. 211

[108] NA, RG 56, Volker Files, FRC 3, PAV-IMR, *paper* of Volker Group, "Basic Options in International Monetary Policy, Annex I", 23.6.1969, *confidential*, *limdis,* cited in Basosi*, Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, cit., p. 92

convertibility at the request of foreigners" and, as an alternative, "a small or large increase in the official gold price"[109] (in other words a devaluation of the dollar).

It leaps out at any observer the discrepancy between the objectives established at the 26th June conference and the effective American policy that followed. The reason for this can be traced back to Kissinger's memorandum to the President from 25th June in which the Assistant to National Security Affairs expressed his reserves over the gradual approach:

> External constraints on the U.S. can be reduced to a safe level only if we get much greater allocation of SDRs than most Europeans want, much more realignment of exchange rates than most Europeans are willing to do, and much faster movement toward greater flexibility of exchange rates than most Europeans are even contemplating at the moment[110].

In this memorandum, in which Kissinger also showed a certain agreement with the suspension of convertibility, he finally stated: "We should pursue a passive balance of payments policy while pursuing the negotiations for monetary reform"[111], meaning that the United States would not have limited their freedom to save the negotiations.

The passive balance of payments strategy became the overall guideline for American policy in the two-year period that ended in August 1971, the period of the triumph of the *Benign Neglet*[112].

However, initially the gradual approach seemed to work well, and in the few weeks after the meeting all the goals of the Basic Options were systematically achieved[113], in so much as the studies for the suspension of the convertibility were temporarily left aside.

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[109] Memorandum from Kennedy to Nixon, 23.6.1969, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 130, http://history.state.gov/historicaldocuments/frus1969-76v03/d130

[110] Memorandum from Kissinger to Nixon, 25.6.1969, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 131, http://history.state.gov/historicaldocuments/frus1969-76v03/d131

[111] *Ivi*

[112] Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, cit., p. 96

[113] *Ivi*, p. 101

On the 26th an agreement was reached within the G-10 about the tranches for the SDRs activation[114] and for the quotas to the IMF. Also the proposals for currencies alignment were hailed as a success: on the 8th of August the French franc depreciated of 11.1%, while on the 24th of October, only three days after Willy Brandt's coalition won the German election, the mark was revaluated of 9.3%[115]. With regard to the increase in exchange rates flexibility, Kennedy advanced some requests for reforms at the joint meeting between the IMF and the World's Bank on the 27th of September 1969. Yet, this was a delicate issue: as a matter of fact any step towards more flexibility could trigger a currency crisis, that would have rapidly shifted into a new wave of speculation against the dollar[116].

Despite this cooperative spirit, in defining the economic and political goals for the following years the American government was bound to follow that passive policy in the balance of payments, so strenuously fostered by Kissinger, that was thought to maximize U.S. autonomy[117]. The first moves in this direction were the deregulation of controls for American investments toward Latin America below $5 million (for the balance of payments this meant a loss of $600 million), and the decision to end the restrictive economic policies descending from Johnson, being that the incomes of American societies were at the minimum point since 1945. This practically meant a request for an expansion of the money supply that brought with it in February 1970 an increase of 5% in the currency issue by the Federal Reserve, soon after Arthur Burns succeeded McChesney Martin as Chairman of the Bank[118].

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[114] The agreement should have been ratified in September at the annual IMF meeting. The agreed tranches were: $3.5 billion for the first year, and 3 billion for the second and third year. NA, NPM, WHSF, CF, FO4-1, box 32, mem., H. Stein a R. Nixon, "Weekly Report on International Finance", 26.7.1969, *confidential*, cited in Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973,)* cit. p. 102

[115] Editorial Note, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 136, http://history.state.gov/historicaldocuments/frus1969-76v03/d136

[116] The reservations over the issue of flexibility was particularly fostered by the Treasury, and was due to the perplexity expressed by Volker after his meetings with the European officials. P. Volker, T. Gyothen, *Changing Fortunes. The World's money and the Threat to American Leadership*, New York, Times Books, 1992, pp. 68-70

[117] Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon (1969-1973)*, cit., p. 105

[118] The change in lead inaugurated also a new relationship between the American central bank and the Government: if up until that time the Federal Reserve was quite autonomous from the Government and

Notwithstanding the first successes in implementing the set points decided on the 26th of June 1969, the developments in the international situation quickly brought back frictions.

On the 1th and the 2nd of December the Six met at The Hague to discuss the Economic and Monetary Union (EMU). The European governments knew they were not yet prepared for a common currency, and hence this did not represent the main topic at the conference. This role was held by Raymond Barre's proposal for freezing exchange rates between the European countries, promoted by the assumption that the international payment problems were not due to the lesser degree of flexibility, but to the high rates of inflation. What mattered most at the conference was that the progress toward the EMU was not conceived only as a tool to reinforce the communitarian relations in view of the British entrance into the Community, but also as a means to increase European economic independence from the United States. Furthermore, flexibility was an American idea and necessity, but eventually those who would have been affected most by it were the Europeans, the dollar still being pegged to gold[119]. Europe's main concern however, as it emerged from the bilateral discussions between Volker, Kennedy and their French counterparts , was the crisis of the American balance of payments, which represented EMU's major catalyst.

The low importance Nixon gave to these developments reflects the triumph of the passive policy. Although the Treasury continued to seek a cooperative way to exit the crisis, the diffused feeling was that it had become impossible to save Bretton Woods without completely distorting the system. On the wake of these events, on the 18th of February 1970, during his exposure of the Annual Review of U.S. Foreign Policy, Nixon affirmed that the period of the Truman Doctrine and of the Marshall Plan were well over, and that it was time for the United States to delegate part of their responsibility

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the Treasury, particularly with regard to monetary issues, Nixon began a set of maneuvers to decrease such autonomy from the executive.

[119] Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli anni di Richard Nixon*, cit., p. 114

to the defense of American allies. Moreover major frictions were also due to the protectionist policies that were likely to follow soaring trends on both sides[120].

In the months between April and July 1970 the NSC handled the complex matter of the relation with the E.C.. Even if the aim of the work was to produce a unitary document, it ended in a set of papers from the different departments. The most important among these papers was that of the department of Treasury, Agriculture and Commerce, which stated that the geographical enlargement of the European Community and its move toward a full economic and monetary union were about to bring a fundamental change in the equilibrium of economic and financial power, and that this would have strongly influenced American commercial and agricultural perspectives[121]. Given this situation, the only way to protect American interests was to adopt a "prompt and firm" tactic, thus formally supporting the process of European integration but on the other hand being more rigid in the existing disputes, such as the enlargement to Great Britain, the CAP and the EMU, and the association agreements with Spain and Israel. The NSDM 68 drafted on the 3rd of July 1970 and entitled U.S. Policy toward the European Community reflected these positions and reaffirmed the American will to defend its "economic interests in specific agricultural and industrial products by appropriate means, primarily through notifying the countries involved during the course of the negotiations of our intention of exercising our rights under GATT"[122].

America's attention towards the balance of payments was reinvigorated in the summer of 1970, as inflation rose to 5.8%, unemployment to 5% and the American deficit first exceeded $10 billion[123]. In the United States voices demanding a reduction in military expenditures were dramatically increasing. Also the conservative front was

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[120] President Nixon was actually quite moderate about many protectionist laws that were on the verge to be discussed in the Congress, for example the *Mills Bill*. Yet, in these matters he could not prevail against the Congress.

[121] Records of the National Security Council, "Enlargement of the European Community and Implications for the U.S.", cited in Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon*, cit., p. 124

[122] National Security Decision Memorandum n.68, "U.S. Policy toward the European Community", 3.7.1970, http://nixon.archives.gov/virtuallibrary/documents/nsdm/nsdm_068.pdf

[123] OECD, Economic Outlook. June 1989, Paris, OECD, 1989, pp. 199-201

requesting the government a gradual disengagement from the old imperial duties. The Congress was greatly concerned with the worsening balance of payments condition, whereas Nixon had a relaxed attitude, because the deficit fitted into the program of passive policy that he intended to continue.

But why this relaxed monetary policy? Surely the prospect of the 1972 elections played an important role, but another major contributing factor was the support Nixon found in some individuals inside his administration, such as the Secretary of Labor, Shultz, and the member of the CEA Herbert Stein. According to the two liberalists the deficit was about to grow further in 1971, but this did not have to hinder American decisions, since the free flow of capitals was to be considered the essence of free trade.

Taking all of this into account it could be argued that Nixon's main purpose was to limit the constraints the balance of payments posed to the U.S. freedom to move capital.

With regard to the protectionist claims, these represented a point of friction inside the administration. Nixon himself supported restrictions in some sectors but did not agree with the enlargement of these measures to other areas. McCracken, Kissinger and Bergsten were fairly concerned with the Mills Bill, which between July and November 1970 was constantly adding protectionist clauses. According to them the issue of such a law would have brought considerable damages to the American economy. However, the firm opposition Nixon demonstrated against its approval lasted.

On the 15th and the 16th of October a bilateral conference convened in Washington to discuss the open disputes between the U.S. and the E.C.. The message the United States wanted to convey was firstly, that Europe had to take into account other countries interests if they wanted to extend the E.C. to Great Britain, secondly, that the United States were ready to recur to GATT in order to preserve its interests and lastly, that they were highly disappointed with the association agreements Europe was undertaking outside the GATT. On this occasion Kissinger expressed himself calmly about the Mills Bill: the U.S. was as willing as never before to remain loyal to the

principles of free trade which had been the foundations of its power. The only exception was the textile sector, but also here Kissinger was quite reassuring: it was a matter that should have been solved by negotiation. In this case the United States would have completely ignored the entire Mills Bill.

Yet, Kissinger was becoming increasingly aware that such negotiations and purposes were doomed, and that it had become seemingly impossible to find a solution which entirely safeguarded American interests. As a consequence he pushed his staff to search for valid alternative answers to the Common European Market: a preliminary version of the plan was presented by Bergsten on the 11th of December. Beyond the specific plan, what is worth considering is that the idea of depriving the E.C. of American support had taken root even at the highest levels of the Nixon Administration.

In July 1970 Nixon renewed the requests for further monetary expansion, pushed by the escalating pressures from the business world and its demand for economic recovery. By December inflation had increased to 8%, leaving Mr. Burns alone in sustaining the need for control over the balance of payments[124]. Nevertheless, Nixon asked for another increase in money supply at the end of December. The European countries, still facing the matter of maintaining the Bretton Woods exchange rates, in turn having to expand their money supply, imported American inflation. On the 26th of March 1971the dollar reserves of the German Bundesbank exceeded those of the Federal Reserve Bank[125].

American and European points of view on the problem were completely opposed. If for the latter the only way to avoid the crisis was to compel the U.S. to limit inflation and bring interest rates (drastically diminished after the monetary expansion) under control, Washington was rather firm in defending its own position. But where did this firmness come from? First of all the United States had up until that time proved it was able to confront the crisis, e.g. it had always satisfied the pressing requests for the

[124] A description of the relation between Nixon and Burns and the pressure the former did to enlarge Federal Reserve money supply is in B. A. Abrams, "How Richard Nixon pressured Arthur Burns: Evidence from the Nixon Tapes", *Journal of Economic Perspectives*, 20, 4, Fall 2006, pp. 177-188

[125] D. Kunz, *Butter and Guns: America's Cold War Economic Diplomacy*, New York, Free Press, 1997, pp. 197-198

conversion of dollars into gold from France, Britain and other European countries. But moreover, the gradual process of disengagement from the Bretton Woods system had already been set in motion on the wake of the continuous failures of the negotiations. Since July 1970 the American government was secretly associating the passive policy with contingency plans to manage the U.S. exit from the system, keeping in line its objectives in order to reduce the possible runaway consequences of the closure of the *gold window*[126].

The first of these plans was drafted by the U.S. Executive Director by the IMF William B. Dale for the Volker Group between July 1970 and January 1971, and provided the different *scenarios* for the suspension of the convertibility[127]. Two main considerations emerged from these papers: firstly, that all political officials knew the time for action was near; secondly, that the only issue was to decide how to accomodate the end of convertibility: waiting for a coverage crisis or acting suddenly without informing the IMF members?

Apart from the contingency plans, other factors also highlighted America's will for a drastic change in international economic policy: the creation of new institutions with precise tasks of managing the new international economic challenges. In particular the Council on International Economic Policy (CIEP) was thought to increase the role of coordinating the international economic issues to higher echelons of the State (Treasury, Commerce and Agricultural departments, OMB, CEA, NSC), and the Commission on International Trade and Investment (CITI), aimed at drafting a survey over the new tendencies of international economy to provide the administration with a conceptual framework that should have been the basis for concrete decisions[128].

In the meantime, on the 3rd of January 1971 a new reduction in foreign investment controls further increased the dollar exits, and hence also the preoccupation of the

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[126] Basosi, *Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon*, cit., p. 139

[127] *Scenario n. 2* and *n. 3* were in fact the names of these papers. In particular the 2nd, presented by Dale in November 1970, examined the legal conformity of the plans to American laws. Cf. Memorandum from Dale to Volcker, 23.11.1970, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 150, http://history.state.gov/historicaldocuments/frus1969-76v03/d150

[128] The CITI demonstrated to be less practical. The work which emerged was a too long discussion of economic theory, and above all it took too much time to be prepared.

Federal Reserve. Yet, the first memorandum of the CIEP, dated 8th March, and the consequent memorandum from Volker to Peterson from 1th April, showed that the trend towards financial deregulation was by that time unstoppable[129].

With the appointment of John Connally as the head of the Treasury in January 1971 the manoeuvers of disengagement from the Bretton Woods system were hastened.

On the 22nd of March 1971 the European Community started the implementation of the Werner Plan, which was intended to realize the monetary union over a ten year period. This development gave birth to a debate inside the administration on whether to support or to oppose Europe in this process of integration[130]. For Connally the answer was obvious: the Europeans were not motivated to cooperate on their road toward integration. On the contrary, what they were pursuing was the construction of a rival economic block, whose main purpose was to decrease American influence on the rest of the world[131]. The visit to Washington the President of the European Commission Franco Maria Malfatti made on the 14th of April did not help smooth ruffled feathers. Although the march to European integration was not free from obstacles (as we have seen in the previous chapter), nevertheless the U.S. wanted be ready for action. As a matter of fact, in a memorandum from the Federal reserve dated 21th March, emerged the consciousness that a strong unilateral decision undertaken by the United States before the strengthening of the EMU, would have left the Americans with a higher bargaining power for the following negotiations.

Burns remained the only one advocating caution in this complicated matter: as leader of the central bank he understood the reaction the Europeans experienced

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[129] CIEP Study Memorandum no.1, 8.3.1971, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 55, http://history.state.gov/historicaldocuments/frus1969-76v03/d55; Memorandum from Volker to Peterson, 1.4.1971, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 60, http://history.state.gov/historicaldocuments/frus1969-76v03/d60

[130] In a Memorandum from Peterson dated 30th March 1971 he questioned: "What should be our policy toward monetary integration in the Common Market? Do we favor it or oppose it? How can we influence its substance and its timing so that it will fit into a satisfactory worldwide monetary framework?", Memorandum from Peterson, 30.3.1971, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 59, http://history.state.gov/historicaldocuments/frus1969-76v03/d59

[131] Memorandum from Connally to Nixon, 8.6.1971, cited in F. Logevall, A. Preston, *Nixon in the World. American Foreign Relations, 1969-1977*, New York, Oxford University Press, 2008, pp. 299-300

when only getting wind of flexibility and floating exchange rates. On the 19th of May 1971 he wrote a letter to Nixon in which he advised the President that if the closing of the gold window was to be undertaken by the American government, then it had to be presented in a way that forced the Europeans to believe that they were responsible for it[132].

Nonetheless Nixon had no intention of acting only in the case of necessity. This emerged not only by the government's disregard over the currency crisis in May, in which it did not listen to Burns call for an intervention to save Bretton Woods, but also by Connally's incessant ascent[133].

The strategy this latter proposed to Nixon was to give the Europeans an ultimatum: by July the negotiations for a fundamental reform of the international monetary system should have taken off; at the same time the expenditures for the common defense should have been equally divided and the parities realigned[134].

Although the discussion with the European governments took place within the IMF international forum, the United States referred solely to West Germany and France, given the influence Bonn and Paris was thought to have on the other European capitals. This, however, did not meet the initial expectations, and hence Connally somehow felt justified in pursuing the goals his department had already began to work at, namely the end of gold-dollar convertibility and the institution of trade restrictions. On the 27th of July he informed the administration's economic departments about its plan, whose main purposes were the immediate suspension of dollar convertibility, the institution of a temporary 10% surtax on all imports, and a freeze of prices and wages in order to present a government engaged as never before in fighting inflation, hence

[132] Letter of Burns to Nixon, 19.5.1971, cited in M. Trachtenberg, *Between Empire and Alliance. America and Europe during the Cold War*, Lanham, Rowman and Littlefield, 2003, pp. 142-143

[133] On the 28th of June 1971 Connally became the sole spokesman in the administration for economic issues.

[134] Paper prepared in the Department of the Treasury, 8.5.1971, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 152, http://history.state.gov/historicaldocuments/frus1969-76v03/d152

avoiding the risk of isolationist fallouts in all other countries[135]. Nixon agreed to the plan, preserving for himself only the right to decide when to act.

The time came soon: on the 6th of August 1971 the Reuss Commission published its final report over international payments, which identified that the devaluation of the dollar with respect to gold was the only feasible way to save the Bretton Woods system[136]. This fact triggered major chaos on the global markets between 9th and 12th August, that brought the price of gold to 43 dollars/oz.. Although central banks managed to keep the situation under control (absorbing the dollar in order to sustain its price), Connally pushed Nixon to take advantage of the existing disorder and finally attained Nixon's approval for the plan on the 12th of July[137]. The day after about 15 people from the economic departments, Nixon's collaborators, members of the CEA and the governor of the Central Bank met at Camp David to discuss a new economic policy[138].

Neither Kissinger nor the Secretary of State William P. Rogers took part in the two-day long conference at the presidential summer residence. The main team members were Connally, Burns, Shultz, McCracken, Stein and Volker: apart from Connally and Nixon, all of them were important and recognized economists.

The introduction was held by Nixon, who spoke for fifteen minutes highlighting the aim of the meeting:

> We are here to find solutions. We have to test ideas as to whether they will work. We have to test the cosmetic effect – to limit the consequences. It is easy to take spectacular actions – and this will be the more significant economic action since

[135] Connally's plan had already been presented in the contingency paper on the 8th of May, *Ivi*. See also Editorial Note, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 164, http://history.state.gov/historicaldocuments/frus1969-76v03/d164

[136] The Reuss Commission was the Congress subcommittee for international payments and exchange rates.

[137] Editorial Note, FRUS, 1969-1976, III, Foreign Economic Policy; International Monetary Policy, 1969-1972, 165, http://history.state.gov/historicaldocuments/frus1969-76v03/d165

[138] The members had been told to keep the lid on the meeting, also to their families. Nixon began the conference explaining: "One of the reasons we are holding this meeting at Camp David is for security. There are to be absolutely no calls made out of here….Between now and Monday night, everyone here is to button his lip." Cf. R. Reeves, *President Nixon: Alone in the White House*, New York, Simon and Shuster, 2001, pp. 355-356

> World War II – the question is, how do we get out from under if it doesn't work?[139]

Connally began the conference by explaining his plan: the closure of the gold window, a temporary surtax over all imports aimed at discouraging the other countries to devaluate their currencies in order to increase exports, incentives for bank loans to avoid a recession, and the freeze of wages and prices to limit inflation. Critical was the way the existing situation had to be presented. That is why he, with the consent of Nixon, exaggerated the status of the crisis and also brought to light the case of a new British request for a conversion of $3 billion. Nobody cared to know if the information was true or false: it was enough to convince everyone[140]. Yet, everyone apart from Burns.

Previously, in his letter to Nixon on the 19th of May, he had warned the President about the risks of unilaterally ending the convertibility. On the 27th of June during a meeting with Nixon and Connally at the White House he expressed his aversion to the wage and price freeze, advising: "Let us first see if a milder medicine will work"[141]. On the 12th of July he noted in his secret diary: "My efforts to prevent the closing of the gold window-working through Connally, Volcker, and Shultz do not seem to have succeeded. The gold window may have to be closed tomorrow because we now have a government that seems incapable, not only of constructive leadership, but of any action at all. What a tragedy for mankind!"[142]. In Burns opinion the other measures alone would have been enough to stop the deficit and also the outflow of dollars. To strengthen his position he tried to focus the attention on the broader international consequences of certain decisions, admonishing that "*Pravda* would write that this

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[139] Nixon's introductory speech at the Camp David meeting, 13.8.1971, cited in Reeves, *Richard Nixon: Alone in the White House*, cit., p. 356

[140] Both Nixon and Connally in their own biographies refer to the British request. Yet, Volker and Coombs later demonstrated its falsity: according to them Connally took cue from a simple warranty request made by the British Bank over $750 million. Cf Basosi*, Il Governo del Dollaro. Interdipendenza e Potere Statunitense negli Anni di Richard Nixon*, cit., p. 163 notes

[141] R. H. Ferrel, *Inside the Nixon Administration. The secret Diary of Arthur Burns, 1969-1974*, Lawrence, University Press of Kansas, 2010, p. 45

[142] *Ivi*, p. 49

was a sign of the collapse of the capitalism"[143]. Nonetheless its point of view remained unheeded.

On the 14th of August Nixon and his speechwriter Bill Safire began to work on the speech. In the President's opinion this had to reach two types of audiences and hence it needed to convey two different messages: the Americans had to feel that the measures were undertaken for their sake, while the international audience had to be convinced that the American government had been pushed by necessity, but on the other hand without inducing the other countries to think the U.S. was weak. Naturally Nixon omitted the role played by his administration passive policy in creating the crisis.

Given the extreme importance of this text for this work, I prefer to quote entirely the television speech that Nixon gave on the evening of Sunday the 15th of August 1971, which was titled "The Challenges of Peace":

> Good evening:
>
> I have addressed the Nation a number of times over the past 2 years on the problems of ending a war. Because of the progress we have made toward achieving that goal, this Sunday evening is an appropriate time for us to turn our attention to the challenges of peace.
>
> America today has the best opportunity in this century to achieve two of its greatest ideals: to bring about a full generation of peace, and to create a new prosperity without war.
>
> This not only requires bold leadership ready to take bold action – it calls forth the greatness in a great people.
>
> Prosperity without war requires action on three fronts: We must create more and better jobs; we must stop the rise in the cost of living; we must protect the dollar from the attacks of international money speculators.
>
> We are going to take that action – not timidly, not half-heartedly, and not in piecemeal fashion. We are going to move forward to the new prosperity without war as befits a great people – all together, and along a broad front.

[143] R. Nixon, *The Memoirs of Richard Nixon*, cited in J.H. Wood, *A History of Central Banking in Great Britain and the United States*, New York, Cambridge University Press, 2005, p. 368

The time has come for a new economic policy for the United States. Its targets are unemployment, inflation, and international speculation. And this is how we are going to attack those targets.

First, on the subject of jobs. We all know why we have an unemployment problem. Two million workers have been released from the Armed Forces and defense plants because of our success in winding down the war in Vietnam. Putting those people back to work is one of the challenges of peace, and we have begun to make progress. Our unemployment rate today is below the average of the 4 peacetime years of the 1960's.

But we can and we must do better than that.

The time has come for American industry, which has produced more jobs at higher real wages than any other industrial system in history, to embark on a bold program of new investment in production for peace.

To give that system a powerful new stimulus, I shall ask the Congress, when it reconvenes after its summer recess, to consider as its first priority the enactment of the Job Development Act of 1971.

I will propose to provide the strongest short-term incentive in our history to invest in new machinery and equipment that will create new jobs for Americans: a 10 % Job Development Credit for 1 year, effective as of today, with a 5 % credit after August 15, 1972. This tax credit for investment in new equipment will not only generate new jobs; it will raise productivity; it will make our goods more competitive in the years ahead.

Second, I will propose to repeal the 7 % excise tax on automobiles, effective today. This will mean a reduction in price of about $200 per car. I shall insist that the American auto industry pass this tax reduction on to the nearly 8 million customers who are buying automobiles this year. Lower prices will mean that more people will be able to afford new cars, and every additional 100,000 cars sold means 25,000 new jobs.

Third, I propose to speed up the personal income tax exemptions scheduled for January 1, 1973, to January 1, 1972 – so that taxpayers can deduct an extra $50 for each exemption 1 year earlier than planned. This increase in consumer spending power will provide a strong boost to the economy in general and to employment in particular.

The tax reductions I am recommending, together with this broad upturn of the economy which has taken place in the first half of this year, will move us strongly forward toward a goal this Nation has not reached since 1956, 15 years ago: prosperity with full employment in peacetime.

Looking to the future, I have directed the Secretary of the Treasury to recommend to the Congress in January new tax proposals for stimulating research and development of new industries and new techniques to help provide the 20 million new jobs that America needs for the young people who will be coming into the job market in the next decade.

To offset the loss of revenue from these tax cuts which directly stimulate new jobs, I have ordered today a $4.7 billion cut in Federal spending.

Tax cuts to stimulate employment must be matched by spending cuts to restrain inflation. To check the rise in the cost of Government, I have ordered a postponement of pay raises and a 5 & cut in Government personnel.

I have ordered a 10 % cut in foreign economic aid.

In addition, since the Congress has already delayed action on two of the great initiatives of this Administration, I will ask Congress to amend my proposals to postpone the implementation of revenue sharing for 3 months and welfare reform for 1 year.

In this way, I am reordering our budget priorities so as to concentrate more on achieving our goal of full employment.

The second indispensable element of the new prosperity is to stop the rise in the cost of living.

One of the cruelest legacies of the artificial prosperity produced by war is inflation. Inflation robs every American, every one of you. The 20 million who are retired and living on fixed incomes – they are particularly hard hit. Homemakers find it harder than ever to balance the family budget. And 80 million American wage earners have been on a treadmill. For example, in the 4 war years between 1965 and 1969, your wage increases were completely eaten up by price increases. Your paychecks were higher, but you were no better off.

We have made progress against the rise in the cost of living. From the high point of 6 % a year in 1969, the rise in consumer prices has been cut to 4 % in the

first half of 1971. But just as is the case in our fight against unemployment, we can and must do better than that.

The time has come for decisive action – action that will break the vicious circle of spiraling prices and costs.

I am today ordering a freeze on all prices and wages throughout the United States for a period of 90 days. In addition, I call upon corporations to extend the wage-price freeze to all dividends.

I have today appointed a Cost of Living Council within the Government. I have directed this Council to work with leaders of labor and business to set up the proper mechanism for achieving continued price and wage stability after the 90-day freeze is over.

Let me emphasize two characteristics of this action: First, it is temporary. To put the strong, vigorous American economy into a permanent straitjacket would lock in unfairness; it would stifle the expansion of our free enterprise system. And second, while the wage-price freeze will be backed by Government sanctions, if necessary, it will not be accompanied by the establishment of a huge price control bureaucracy. I am relying on the voluntary cooperation of all Americans – each one of you: workers, employers, consumers – to make this freeze work.

Working together, we will break the back of inflation, and we will do it without the mandatory wage and price controls that crush economic and personal freedom.

The third indispensable element in building the new prosperity is closely related to creating new jobs and halting inflation. We must protect the position of the American dollar as a pillar of monetary stability around the world.

In the past 7 years, there has been an average of one international monetary crisis every year. Now who gains from these crises? Not the workingman; not the investor; not the real producers of wealth. The gainers are the international money speculators. Because they thrive on crises, they help to create them.

In recent weeks, the speculators have been waging an all-out war on the American dollar. The strength of a nation's currency is based on the strength of that nation's economy – and the American economy is by far the strongest in the world. Accordingly, I have directed the Secretary of the Treasury to take the action necessary to defend the dollar against the speculators.

I have directed Secretary Connally to suspend temporarily the convertibility of the American dollar except in amounts and conditions determined to be in the interest of monetary stability and in the best interests of the United States.

Now, what is this action – which is very technical – what does it mean for you?

Let me lay to rest the bugaboo of what is called devaluation.

If you want to buy a foreign car or take a trip abroad, market conditions may cause your dollar to buy slightly less. But if you are among the overwhelming majority of Americans who buy American-made products in America, your dollar will be worth just as much tomorrow as it is today.

The effect of this action, in other words, will be to stabilize the dollar.

Now, this action will not win us any friends among the international money traders. But our primary concern is with the American workers, and with fair competition around the world.

To our friends abroad, including the many responsible members of the international banking community who are dedicated to stability and the flow of trade, I give this assurance: The United States has always been, and will continue to be, a forward-looking and trustworthy trading partner. In full cooperation with the International Monetary Fund and those who trade with us, we will press for the necessary reforms to set up an urgently needed new international monetary system. Stability and equal treatment is in everybody's best interest. I am determined that the American dollar must never again be a hostage in the hands of international speculators.

I am taking one further step to protect the dollar, to improve our balance of payments, and to increase jobs for Americans. As a temporary measure, I am today imposing an additional tax of 10 % on goods imported into the United States. This is a better solution for international trade than direct controls on the amount of imports.

This import tax is a temporary action. It isn't directed against any other country. It is an action to make certain that American products will not be at a disadvantage because of unfair exchange rates. When the unfair treatment is ended, the import tax will end as well.

As a result of these actions, the product of American labor will be more competitive, and the unfair edge that some of our foreign competition has will be

removed. This is a major reason why our trade balance has eroded over the past 15 years.

At the end of World War II the economies of the major industrial nations of Europe and Asia were shattered. To help them get on their feet and to protect their freedom, the United States has provided over the past 25 years $143 billion in foreign aid. That was the right thing for us to do.

Today, largely with our help, they have regained their vitality. They have become our strong competitors, and we welcome their success. But now that other nations are economically strong, the time has come for them to bear their fair share of the burden of defending freedom around the world. The time has come for exchange rates to be set straight and for the major nations to compete as equals. There is no longer any need for the United States to compete with one hand tied beyond her back.

The range of actions I have taken and proposed tonight – on the job front, on the inflation front, on the monetary front – is the most comprehensive new economic policy to be undertaken in this Nation in four decades.

We are fortunate to live in a nation with an economic system capable of producing for its people the highest standard of living in the world; a system flexible enough to change its ways dramatically when circumstances call for change; and, most important, a system resourceful enough to produce prosperity with freedom and opportunity unmatched in the history of nations.

The purposes of the Government actions I have announced tonight are to lay the basis for renewed confidence, to make it possible for us to compete fairly with the rest of the world, to open the door to new prosperity.

But government, with all of its powers, does not hold the key to the success of a people. That key, my fellow Americans, is in your hands.

A nation, like a person, has to have a certain inner drive in order to succeed. In economic affairs, that inner drive is called the competitive spirit.

Every action I have taken tonight is designed to nurture and stimulate that competitive spirit, to help us snap out of the self-doubt, the self-disparagement that saps our energy and erodes our confidence in ourselves.

Whether this Nation stays number one in the world's economy or resigns itself to second, third, or fourth place; whether we as a people have faith in ourselves,

or lose that faith; whether we hold fast to the strength that makes peace and freedom possible in this world, or lose our grip – all that depends on you, on your competitive spirit, your sense of personal destiny, your pride in your country and in yourself.

We can be certain of this: As the threat of war recedes, the challenge of peaceful competition in the world will greatly increase.

We welcome competition, because America is at her greatest when she is called on to compete.

As there always have been in our history, there will be voices urging us to shrink from that challenge of competition, to build a protective wall around ourselves, to crawl into a shell as the rest of the world moves ahead.

Two hundred years ago a man wrote in his diary these words: "Many thinking people believe America has seen its best days." That was written in 1775, just before the American Revolution – the dawn of the most exciting era in the history of man. And today we hear the echoes of those voices, preaching a gospel of gloom and defeat, saying the same thing: "We have seen our best days."

I say, let Americans reply: "Our best days lie ahead."

As we move into a generation of peace, as we blaze the trail toward the new prosperity, I say to every American: Let us raise our spirits. Let us raise our sights. Let all of us contribute all we can to this great and good country that has contributed so much to the progress of mankind.

Let us invest in our Nation's future, and let us revitalize that faith in ourselves that built a great nation in the past and that will shape the world of the future.

Thank you and good evening.

Richard Nixon

August 15, 1971[144]

[144] "The Challanges of Peace", Public Papers of the Presidents of the United States, Richard Nixon, 15.8.1971, http://www.24hgold.com/english/contributor.aspx?article=803452874G10020&contributor=History+of+Gold

A Pattern of Policy Making

The work developed over these last pages has been an attempt to clearly outline the political importance of the American unilateral decision to suspend the gold-dollar convertibility on the 15th of August 1971. In particular during the last chapter I have analyzed the two-year period between 1969-1971 in order to explain who was primarily responsible for those happenings and what forces were involved in that complicated issue. The reasons that gradually pushed Nixon and his administration to initiate a new economic policy in the United States have been clearly described, and also the importance of the international scenario has been widely taken into account. What's more, Richard Nixon and John Connally have been identified as the major advocates of the 1971's shock.

Some questions, however, remain unanswered. As we have already seen, the newly elected President Nixon found himself leading a very different country with respect to Kennedy and Johnson only a few years before, and furthermore, the international situation was completely altered. Hence, the policies enacted by Nixon could be considered a logical consequence of such changes. However, up until now, what has been excluded from the debate is the intrinsic importance that other non-strictly political or international-related factors played in shaping the American monetary policy during the early 1970s. I am referring to the human aspect involved in any process of decision making. This enables one to consider the effective policies implemented by an administration not only as outcomes of external agents, but also as inextricably tied to the governing figures, their interests and their way to react to political challenges. This chapter endeavors to explore these issues in order to gain a wider comprehension of the policy making processes at work in the United States during the Nixon years.

This task requires at least a basic knowledge of the American policy making system. That is why I will follow on from the brief biography of Nixon with a description of the United States distribution of power to legislate, in particular concerning monetary and

fiscal policies. Subsequently, I will explain what in particular Nixon did to modify the system for his own advantage, who helped him, how he pressured others, and why he did so. My aim is not to answer the question of what drove American policies during that particular historical juncture, preferring to leave this topic for the conclusion. Nor is it my intention to make any personal judgment over the 37th President of the United States or his closest men. On the contrary, the objective of these next pages is to focus on the workings of the policy making mechanism.

Richard Nixon

Richard Milhous Nixon was born on the 9th of January 1913, on the Nixon family lemons ranch in Yorba Linda, a small village in southern California which has now been completely encompassed by Los Angeles urban area . As he later wrote in his *Memoirs*: "Yorba Linda was a farming community of 200 people about thirty miles from Los Angeles, surrounded by avocado and citrus groves and barley, alfalfa, and bean fields"[145]. The second of five brothers, his youth was marked by family financial problems. In 1922 the ranch failed and the Nixons moved to Whittier to open a gas station and a grocery store where all the family members once worked. The young Nixon attended the Whittier College and won a scholarship for the Duke University's Law School in 1934, where he graduated in 1937. Back in Whittier he worked in the law firm Wingert & Bewley and in 1940 he married a school teacher, Thelma Catherin Ryan[146].

On January 1942 Richard moved to Washington DC with "Pat"[147] to work at the Office of Price Administration. But on the 17th of August he entered the Navy and went to fight in the south Pacific.

Nixon's political career started when he came back from the war, in 1946, when some eminent politicians within the republican party in Whittier pushed Nixon as a candidate for the Congress. Once elected, he worked under the Education and Labor

[145] R.M. Nixon, *The Memoirs of Richard Nixon*, cit., p. 3
[146] Cf. "Biography of Richard Milhous Nixon", *Richard Nixon Presidential Library and Museum*, http://nixon.archives.gov/thelife/nixonbio.pdf
[147] Catherin Ryan was universally known as "Pat", *Ivi*, p.3

Committee and the Herter Committee, where he contributed to the first preliminary report of the Marshall Plan. He became nationally recognized in 1948 when he led the commission investigating the former State Department Official Alger Hiss, who was accused of having been a communist spy for the Soviet Union prior to World War II[148]. After having been re-elected to Congress in 1948 he won the vacant Senate seat for the State of California in 1950. At the Senate his fame grew, criticizing Truman's behavior in Korea and presenting himself as an ardent anti-communist. In 1952 the Republican candidate at the presidential election Dwight D. Eisenhower selected him as running Vice-President. His fortune and popularity were bound to increase further thanks to the way he handled the accusation (made by the New York Post) of secretly accepting money from companies eager to buy influence and for personal uses. Nixon's televised self-defense on that occasion has become universally famous: in front of the largest audience ever he clearly demonstrated his superiority when it came to speeches and his ability to capture people's imagination. After having summarized his life and the financial troubles of his youth, and given a precise list of what he and his wife owned, he ended confessing that,

> we did get something a gift after the election. A man down in Texas heard Pat on the radio mention the fact that our two youngsters would like to have a dog. And, believe it or not, the day before we left on this campaign trip we got a message from Union Station in Baltimore saying they had a package for us. We went down to get it. You know what it was[149].

Eisenhower won the presidential elections in 1952 by seven million votes[150]. Under Nixon the vice-presidency acquired a lot of prestige: he frequently held the NSC's meetings when Eisenhower was absent and travelled abroad with the President and in his place in order to find support for American policies during the Cold War years. In 1959 he went to Moscow to represent the United States at the American National Exhibition, where he attended the tour with Nikita Khrushchev, USSR first minister at

[148] Nixon talks at length about the role he covered in the Hiss Case in R. Nixon, *Six Crises*, New York, Doubleday, 1962
[149] Senator Nixon Television Speech, 23.9.1952, http://watergate.info/nixon/checkers-speech.shtml
[150] Cf. "Biography of Richard Milhous Nixon", cit., p.2

that time. That circumstance became legendary: while they were admiring an American kitchen exposed at the exhibition the two politicians started an intense discussion about the wealth and the strength of their respective societies and governments. The popularity attained with the "Kitchen Debate"[151]urged Nixon to present himself as a running candidate at the presidential election in 1960 against the democrat J.F. Kennedy, where he was defeated by a meager majority[152].

Straight away Nixon returned to southern California. There some important republicans wanted him to concur for governor of the State. Yet his disinterest in such a position and the oppositions from the extreme right wing of his party brought him a further defeat against the democratic candidate Edmund G. Brown. He personally considered that loss the end of his political career. The very same night of the election he told the journalists: "You won't have Nixon to kick around anymore because, gentlemen, this is my last press conference"[153].

The Nixons moved to New York, where Richard worked as a lawyer and continued to be politically active, although remaining outside the political arena. He was in high repute among the republicans nationwide for his support to the electoral campaigns, his comments to Kennedy and Johnson's policies and his deep knowledge of politics and international relations, in particular after the publication of his article *Asia after Vietnam* in 1967[154].

Finally, in January 1968, he re-entered the public scene presenting himself once again as republican candidate to the presidency, promising stability in time of heavy upheavals. The confusion within the democrats helped him a lot on his road toward the White House: in March 1968 President Lyndon Johnson announced that he would not participate as candidate for the next elections. Only a few months later the newly-elected Governor of California Robert Kennedy was murdered in Los Angeles, and the Democratic National Convention held in Chicago ended in mass protests and violence, crushing the Vice President Hubert Humphrey's campaign. Nixon, on the contrary,

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[151] This is the name the anecdote with Khrushchev has come to be known

[152] The electoral campaign witnessed a massive use of the modern mass media. The first television debate among aspiring presidents took place on that occasion

[153] The New York Magazine, 1.5.1972, p.46

[154] R.M. Nixon, "Asia after Vietnam", *Foreign Affairs*, 46, 1, Oct. 1967, pp. 111-125

seemed to represent a calmer and more constructive society, and won the election by 500,000 votes.

Nixon's years at the White House are famous for the engagement in the "Vietnamization" of American politics[155], his efforts to renew ties with old enemies such as the Soviet Union and China through the Détente process[156], and support to families with an assistance plan aimed at incomes for all Americans.

Despite the doubtful success of each of these policies he was re-elected in 1972 by the widest margin ever[157].

The Policy Making under Nixon

To understand the effective changes enforced by the Nixon administration to maximize presidential control over the decision making processes, a quick look at the structural organization of the American political system is extremely useful. In short, the question here is: who makes the decisions in monetary policy?

As G.L. Bach has summarized,

> The Constitution allocates the Congress the power to legislate, and the president and the executive branch the power to execute this legislation. Thus, in a fundamental sense, Congress holds the power to make macroeconomic policy, through broad directives or through detailed specifications, to be implemented by the executive branch. In some areas, such as monetary policy, Congress has seen fit to delegate its powers almost entirely to an "independent" agency or commission like the Federal Reserve. In others, such as tax policy, it clings firmly to the power to legislate in detail. But even where Congress delegates its legislative power, it can at any time revoke this delegation and undertake directly the policymaking involved[158].

[155] Namely doing whatever was possible to gradually disengage the U.S. from Vietnam

[156] Nixon went to China in 1972, where he met Mao Zedong after twenty years of no-dialogue between the two powers, and to Moscow, where he concluded the SALT (Security Arms Limitation Treaty) accord with Leonid Brezhnev.

[157] The Family Assistance Plan was not approved by the Congress, while the withdrawal from Vietnam took many years to be completed: the cease fire was reached only in 1973, but in fact the fight protracted till 1975.

[158] G.L. Bach, *Making Monetary and Fiscal Policy*, Washington D.C., Brookings Institution, 1971, p. 25

Even though the Congress on certain topics of major interest and gravity is well informed and effectively makes the law, given the extreme variety of issues it has to cope with, a great part of these matters are handled by committees and sub-committees composed of specialists in those particular areas. The recommendations coming from these committees are mostly accepted by both houses in the Congress, although the latter ultimately has the power to modify them.

The President has great power, mainly being responsible for the implementation of the laws decided by the Congress: "he heads the executive branch of the government – a sprawling hierarchy of departments and agencies, many of which are given broad powers and responsibilities by law"[159]. Moreover, as leader of the governing party he also plays the major role in "proposing and pressing for legislation" and hence, in particular with regard to macroeconomic policies, he and his office "have become the nation's principal analyst of the need for fiscal expansion or for restraint in the economy and its foremost proponent of legislation to meet these needs"[160]. The Office of Management and Budget (OMB) represents the most important organism for expenditure policy[161]. Its job consists of coordinating the government's spending, which is presented by the President to the Congress. The overwhelming importance of the OMB resides in the fact that every governmental body can only attain funds through it.

The Treasury Department is commissioned to provide the funds the Congress has approved, through taxes enacted by the Congress and through borrowing. The Secretary of the Treasury has a central position not only in administering tax issues, but also in the important field of the U.S. international monetary policy, where, although working closely with the CEA, the Federal Reserve Board and the State Department, he has the last word and speaks on behalf of the government. The - Council of Economic Advisors "for macroeconomic policy is […] the President's most important single advisory group". It is not a department but part of the President Executive Office which,

[159] Bach, *Making Monetary and Fiscal Policy*, cit., pp. 28-29
[160] *Ivi*, p. 29
[161] The OMB exists since 1970 as an enlargement of the former Bureau of the Budget

> is responsible for overseeing the state of the economy, for continually checking on the appropriateness of government policies for stable economic growth, and for working intimately with the President and other parts of the executive branch in developing legislative policy in the economic field[162].

There are also many assistants and agencies in the executive branch which held little formal power but are extremely influential on the President. These include the Secretaries of Labor and Commerce for wage and price policies, the Federal Housing Administration and the Farm Administration for credits and lending, but also departments like State, Defense and Agriculture.

Even though the presidential power is prominent, it is still limited. In fact each department affirms its own goals, and these can often collide with the President's ones. The power of the leader is thus proportional to his ability to marshal,

> the powers of his office – by leading and coalescing public opinion, by influencing important congressman, and by leading his own executive officers. […] Fundamentally, the President is the leader of the government and the nation, but he can exercise that leadership only through persuasion[163].

Beside the institutions listed above, the Congress delegates the power to regulate specific issues to a series of independent commissions headed by multimember boards, who do not answer directly to the President. The chairmen of these commissions normally remain at the office for long periods, "to remove them from the day-to-day pressures of the political process that bear on Congress, the President, and the rest of the executive branch"[164]. For my research the most important of these committees is the Federal Reserve System, established in 1913 as a divided entity in order to separate political processes and the responsibility of monetary control and expansion.

The Federal Reserve is one of the main protagonists in American macroeconomic policymaking, maintaining "the responsibility for controlling the amount of money

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[162] Bach, *Making Monetary and Fiscal Policy*, cit., p. 30
[163] *Ivi*, p. 32
[164] *Ivi*, p. 33

(currency and bank deposits) in the United States and for regulating the behavior of member commercial banks"[165].

Notwithstanding the impressive subdivision of the decision making power, in the American presidential system "the President is much more than primus inter pares. The Constitution grants [him] powers that allow him to be the key actor in foreign policy – if he wants to be"[166]. This means that a newly elected President can define his own role in foreign affairs and, thus, freely organize the decision making system: he set the goals for his administration and personally hires his officials and ministers hence creating a frame of reference. Surely the various cabinet officers hold great autonomy and decisional power, however they are mainly technicians and experts selected by the President for their knowledge in specific matters and their loyalty to him, and therefore they share his convictions and ideas. Yet, not every American President chooses to partake actively in the field of international politics. Nixon did.

He appointed Henry Kissinger as National Security Advisor, assigning him the task of re-organizing the decision making process taking the cue from the Eisenhower's model, that is, substantially increasing the power of the NSC[167]: "The purpose of the Nixon-Kissinger NSC system was to centralize decision making in the White House on key issues of foreign policy and to prevent decision making through bureaucratic politics"[168].

As Nixon himself stated,

> The new NSC system is designed to make certain that clear policy choices reach the top, so that the various positions can be fully debated in the meeting of the council […]. I refuse to be confronted with a bureaucratic consensus that leaves

[165] Bach, *Making Monetary and Fiscal Policy*, cit., p. 34
[166] W.L. Kohl, "The Nixon-Kissinger Foreign Policy System and U.S.-European Relations: Patterns of Policy Making", *World Politics*, 28, 1, Oct. 1975, pp. 1-43
[167] During the Johnson administration the role of the National Security Council had been considerably reduced
[168] Kohl, "The Nixon-Kissinger Foreign Policy System and U.S.-European Relations: Patterns of Policy Making", cit., p. 7

me no options but acceptance or rejection, and that gives me no way of knowing what alternative exist[169]

The system Nixon imagined required the partition of tasks into a wide series of interagency committees and subcommittees which operated separately from the Secretary level, all headed by Kissinger. The principal committees were the Senior Review Group for general foreign policy issues, the Verification Panel for arms control issues and the Washington Special Action Group for crisis management[170]. These were important in forcing the foreign policy agencies to produce the NSSMs for the President, which consisted of a thoroughly explained series of options from which Nixon had to only choose the best one after consultation with Kissinger. The final decision emerging from the consultation was the NSDM[171].

The NSC was designated a large number of tasks, from monitoring the agencies to the organization of work-teams, the analysis of the NSSMs, and recommendations for Nixon and Kissinger: "The NSC staff became Kissinger's, and through him, the President's right arm which monitored and frequently directed the work of the departments and agencies, ensuring central control on a host of issues"[172].

Nonetheless, after the first year at the White House the discussions with the President and the NSC staff became increasingly rare, as he preferred to consult directly with Kissinger on the NSSMs. In addition to all of this, Kissinger often used to add a personal comment to the agencies memoranda in order to further influence the President. Under those circumstances one is able to understand the power the National Security Advisor had in affecting the foreign policy decisions, even considering Kissinger's mania for secrecy. As a matter of fact, the departments were often uninformed about the results of Nixon and his Advisor's meetings with foreign officials, nor were the agencies particularly involved in bilateral issues: this represented a strong

[169] R.M. Nixon, "First Annual Report to the Congress on United States Foreign Policy for the 1970's", 18.2.1970, http://www.presidency.ucsb.edu/ws/?pid=2835#axzz1uet7oJA5
[170] Kohl, "The Nixon-Kissinger Foreign Policy System and U.S.-European Relations: Patterns of Policy Making", cit., p. 7
[171] National Security Decision Memorandum
[172] Kohl, "The Nixon-Kissinger Foreign Policy System and U.S.-European Relations: Patterns of Policy Making", cit., p. 8

demoralizing factor for the bureaucracy and consequently rendered it quite ineffective[173].

In terms of who were the decision makers, a distinction must be made between three different orders: high policy issues were directly handled by Kissinger, while NSC's inherent issues were dealt within the Council but under Kissinger's strict supervision and hence often personally managed by him. Secondary matters, lastly, were entirely administered by the NSC. In this scheme the bureaucracy entered the game at a later stage, namely during the phase of policy implementation: "The NSC System was designed primarily for decision making, not for implementation, a task formally assigned to the Under Secretaries Committee, staffed by state"[174]. This fact must be seriously taken into account, especially in light of the monetary and economic policies, undertaken by Nixon since the beginning of his administration, which have largely been described in this study. In fact, one of the major problems with the political process under Nixon had been indicated by Bergsten and Kissinger early in 1969, when they accused the administration of lacking a unitary strategy concerning economic and monetary issues[175]. To summarize, the NSC staff were so busy with the responsibility of preparing the NSSMs and with the operational duties for Nixon and Kissinger, that it was unable to simultaneously monitor the process of policy implementation. What's more, the Decision Memoranda were frequently handled too quickly by the NSC, and often without consulting the various departments, and thus these often ended misinterpreted or cast into bureaucratic bargaining.

The New Economic Policy introduced on the 15th of August 1971 could be considered an outstanding example of the malfunctioning of the American decision making system. The case showed that "the American government lacked an effective mechanism to analyze and integrate the political and economic aspects of an international problem"[176], and the newly created CIEP was not yet fully operational.

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[173] Kohl, "The Nixon-Kissinger Foreign Policy System and U.S.-European Relations: Patterns of Policy Making", cit., p. 10

[174] *Ivi*, pp. 10-11. With *bureaucracy* I mean the intra-agencies bargainig process

[175] See chapter 4, p. 3, notes 7-8

[176] Kohl, "The Nixon-Kissinger Foreign Policy System and U.S.-European Relations: Patterns of Policy Making", cit., p. 20

The importance of Connally in the evolution of the 1971 crises should not be underestimated. Under his influence a problem with important international implications was only handled as an internal American problem. Nor should it be left out of the discussion the overwhelming importance of Nixon's apprehension for the 1972 elections. Undoubtedly, one of the main concerns of every democratically elected President is to arrive at the next elections with a long list of achieved goals, in order to reinforce the credibility of the electorate. This is globally known as the Political Business Cycle, namely the fact that "self-interested politicians manipulate the economy for political gain"[177], and it must not only be seen in a negative light, because this same self-interest represents a potential catalyst for political reforms and economic goals. Yet, the specific situation analyzed in this thesis reveals the enormous impact internal economic policies had on the international order as a whole. This arguably placed great responsibility on Nixon: the threats to his re-election were gradually increasing, together with the constant growth of the deficit in the balance of payments and the soaring economic hostilities from Europe and Japan. To say the least, domestically, something had to be done by the President in order to satisfy the electorate, but at the same time, every political action undertaken by the United States during that particular historical juncture would have affected the broader international community. I do not wish to asses Nixon's ability to manage that complicated situation, but at this point, it is perhaps worth noting that if his conduct was largely due to the intricate frames of national and international related matters, a major role has also been played by these kind of electoral interests and personal apprehensions.

Considering this brings to light the other important figure from the story, John Connally, and the reasons why Nixon chose him as Secretary of the Treasury in 1971: he was the man who could better than anyone else play "bullyboy on the manicured playing field of international finance"[178]. As he personally said before the International Banking Conference in May 1971 when discussing the international financial situation:

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[177] R.R. Keller, A.M. May, "The Presidential Political Business Cycle of 1972", *The Journal of Economic History*, 44, 2, The Task of Economic History, June 1984, pp. 265-271, p. 266

[178] Connally's own words. Cf. Eichengreen, *Exorbitant Privilege. The Rise and Fall of the Dollar*, cit., p. 59

"No longer does the United States economy dominate the free world. No longer can considerations of friendship, or need, or capacity justify the United States carrying so heavy a share of the common burdens"[179].

If the allies would not have assumed a greater part of the responsibilities for the common defense, or opened their economies to U.S. exports, then they could have been subjected to whatever policies the U.S. chose to enact[180]. What Nixon especially loved about Connally was the fact that he was not an academic but a pragmatist exceptionally skilled in doing the dirty work, namely taking the responsibility for difficult decisions[181].

Taking all of this into consideration one can understand why the British political economist Susan Strange referred to the Nixon shock by saying that "the main parameters of [that] policy were therefore ideological or political rather than narrowly financial or economic"[182]. To summarize, that something which had to be done to reinforce the domestic economy in view of the 1972 elections finally prevailed over international political objectives. Some months later, Burns noted in his diary: "The President's preoccupation with the election frightens me. Is there anything that he would not do to further his reelection? I am losing faith in him, and my heart is sick and sad"[183]. Other supporting evidence of this theory can be found in Kissinger's absence from the Camp David meeting on the 13th and the 14th of August, meaning that international interests had somehow been pushed into second place giving domestic policy issues the number one priority.

The months that followed the August crisis demonstrated how much importance Connally had gained within the administration and how his actions were expressly oriented toward national interests to the detriment of multilateralism and international cooperation. A closer look at the American international economic policy

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[179] Federal Reserve Bank of New York, "Remarks of the Honorable John B. Connally Secretary of the Treasury", International Banking Conference of the American Bankers Association, Munich, 28.5.1971, http://www.newyorkfed.org/research/monthly_review/1971_pdf/07_1_71.pdf
[180] *Ivi*
[181] Also Connally wrote his own autobiography: J.B. Connally, M. Herskowitz, *In History's Shadow: An American Odyssey*, New York, Hyperion Books, 1994
[182] S. Strange, "The Dollar Crisis 1971", *International Affairs*, 48, 2, April 1972, pp. 191-216, p. 204
[183] Ferrell, *Inside the Nixon Administration. The Secret Diary of Arthur Burns*, cit., p. 63

making in the Autumn of 1971 reveals the emergence of a sort of alliance between Burns, Kissinger and the Under Secretary of State for Economic Affairs Nathaniel Samuels, who together started a quick succession of attempts aimed at limiting Connally's measures. Their main concern obviously was the confrontation with the allies, the floating exchange rates and the surtax on imports were bound to cause. The three, moreover, agreed not to act as a united front against Connally, but chose to confront him separately in the hope of reaching Nixon. Starting with Burns, who warned the President about the risk of a recession if a solution to the flexibility of exchange rates was not found, the final word was however from Kissinger, who had little confidence with economic matters, but was extremely sensitive in forecasting crises. Early in November Nixon seemed to move increasingly closer to the trio's view. The summits with the Western leaders helped consolidate his position[184].

In writing about a specific historical case of policy making I have expressly decided to leave space for a description of the human aspect involved in any political decision, and assumed that the political business cycle had a certain importance in defining Nixon's choices. However, I reject the idea that President Nixon did not fully understand the overwhelming importance and the international implications of closing the gold window. As I have attempted to outline in my work it emerges that the decisions made throughout that period were not undertaken chaotically, considering only American interests. Conversely, Nixon was compelled to make an important choice, even if this would have changed the world position of the United States, and the reasons for this were not only international, but were primarily derived from the bad domestic situation that the war in Vietnam and its related problems had fostered. It is hence understandable why Nixon's policy making gave elemental importance to those matters that mostly involved the American power position (or that were supposed to do so), delegating the management of international monetary matters to

[184] On the 20th of December 1971 Nixon finally removed the surtax

others. Outstanding proof of his position arose from the Memorandum Nixon wrote to Kissinger, Ehrlichman and Harry Robbins Haldeman[185] on the 2nd of March 1970:

> I want to take personal responsibility in […] economic matters, but only where the decisions affect either recession or inflation. I do not want to be bothered with international monetary matters. This, incidentally, Kissinger should note also, and I will not need to see the reports on international monetary matters in the future. Problems should be farmed out, I would hope to Arthur Burns if he is willing to assume it on a confidential basis, and if not Burns to Houthakker[186] who is very capable in this field. […]I feel that we need a new international monetary system[187].

The other interpretation I have decided not to give credence to is the one which depicts Nixon as the executioner of the Bretton Woods system, or as a president completely ignorant about economics who undertook a series of awkward policies without taking into consideration the possible consequences[188]. I think such positions are highly misleading, as they do not account for all the complex issues involved in the policy making process.

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[185] Haldeman was Nixon's first White House Chief of Staff

[186] Hendrik S. Houthakker, member of the Council of Economic Advisers

[187] Memorandum from Nixon to Haldeman, Ehrlichman and Kissinger, 2.3.1970, FRUS, 1969-1976, I, Foundations of Foreign Policy, 1969-1972, 61, http://history.state.gov/historicaldocuments/frus1969-76v01/d61#fn2

[188] Examples of this position are in J. Gowa, *Closing the Gold Window: Domestic Politics and the End of Bretton Woods*, Ithaca, Cornell University Press, 1983, and Kunz, *Butter and Guns. America's Cold War Economic Diplomacy*, cit.
However, Nixon's spontaneity probably contributed to the development of many of the judgment that have been made on him and his disinterest for monetary matters. E.g., when talking about the Italian lira with Haldeman he stated: "I don't give a shit about the lira", Transcript of a Recording of a Meeting between the President and H.R. Haldeman in the Oval Office, 23.6.1972, http://www.nixonlibrary.gov/forresearchers/find/tapes/watergate/wspf/741-002.pdf

Conclusion

The analysis conducted over the previous chapters has outlined the diverse variables that came into play when the American government unilaterally decided to suspend the gold-dollar convertibility in August 1971. Hence, the core of my research has been the study of a specific case of decision making in international monetary policy, whose origins have been identified to be both international and domestic. In the last chapter I have tried to describe the mechanism at work, on a policy making level, inside the Nixon administration. The conclusion I have drawn is that there is not a unique variable that can alone explain the happenings described above.

This last part aims at summarizing the points that have emerged and will permit me to finally characterize the Nixon actions. Taking into account the whole set of dynamics described during my work, the question now is whether the decision made on the 15th of August should be considered the logical and unavoidable outcome of the deterioration process the American hegemony had been witnessing since the 1960s, or as a revealing element of the conservative shift that the U.S. policies were bound to follow. One of these options does not necessarily exclude the other, but a thorough analysis of the points previously examined should now help to decide which one is to be preferred.

As we have seen, the end of World War II initiated a radical reorganization of the political and economic global order by the victorious countries. But the major innovation was the emergence on the international scenario of a new hegemonic entity, the United States, that definitely shifted the center of global power away from Europe. The events that followed the end of the hostilities contributed to the circulating of the American way of life all over the world. It was not only a matter of new tendencies and traditions, but rather the affirmation of an economic, political and social structure that for many reasons contrasted with the old European-derived models. The founding values of European culture had proved their uselessness in

avoiding the war, and the United States felt it had the right to take the lead toward a more equal and just world, thanks to the strongest economy ever, the privileged condition it experienced after being minorly affected by the war, and the most powerful military force in the world. With the Bretton Woods Conference in 1944 the post war global order was intentionally decided to be modeled on America: the New Deal policies that accompanied the United States during the 1930s spread to the Western World, together with the modern Keynesian values of social welfare, equality and full employment. A framework of fixed exchange rates between the different currencies was one of the most distinctive elements of the system, the working of which was assured by the dollar, pegged to gold by a fixed value. These elements characterized the consolidation of the American hegemony during the 1950s and 60s of the last century.

When Richard Nixon was elected President in January 1969 the system described above had already started to show the first signs of weakness. What the United States was witnessing was the Triffin paradox becoming reality: a stop of the U.S. dollar supply internationally would have triggered a market stagnation, while a continuous supply would have lubricated it, but also diminished the trust the other countries had in the American ability to sustain the convertibility.

The situation with the American economy in the years between 1969-1971 has been presented in detail, and also its role in contributing to the suspension of gold dollar convertibility. But the Triffin Dilemma highlights a further question, namely if that event was something indissolubly inscribed in the laws of market and hence unavoidable, and also what specific aspect sanctioned the failure of the system born in Bretton Woods in 1944.

A closer look at the period between the end of World War II and the 1970s reveals the overwhelming preponderance of Keynes' macroeconomic theories. Leading economist at the time of Bretton Woods, his plan for an international clearing union was totally left out of the conference, whose result we have seen was a scheme that reflected White's position with a strong influence from Williams' Key Currency Plan. Nonetheless, Keynes' contributions to the economic theory was tremendous. The

ideas emerging from his thoughts have been the model for all democracies in the 20th century, and can be encapsulated with the image of the State pouring richness into society, in turn assuring economic growth.

This model started showing the first cracks during the Nixon years. Hence, from my standpoint it is accurate the opinion of those who consider the American decisions made in 1971 the starting point for the neoliberal policies commonly ascribed to Ronald Reagan and Margaret Thatcher in the 1980s[189]. Nonetheless, one must pay close attention when considering Nixon the first political exponent of the neoliberal approach to economics[190]. If on the one hand the measures of investment deregulation and, subsequently, the suspension of the gold-dollar tie were undoubtedly cornerstones of that shift toward a laissez-faire economic system which established itself worldwide during the 80s and 90s, it is also true that Nixon still worked within the Keynesian structures. The family assistance plan, the policies for full employment, the passive policy in the balance of payments are outstanding proof of this.

Taking all of this into account, what eventually made the difference was the context in which the Keynesian rules found themselves operating. At this point I do not wish to discuss the validity and the weaknesses of Keynesianism. But it could be argued that its thirty years success after the war was mostly due to the U.S. privileged position described above, and that it operated so well thanks to the huge American military expenditure during those years. To summarize, the limits of the Keynesian approach became clear with the failure of the Cold War liberalism, which was the most solid foundation of the American hegemony.

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[189] D. Basosi, "Alle Radici della Rivoluzione Neoliberista. Nixon e l'Abbandono di Bretton Woods", *Italia Contemporanea*, June-September 2005, 239-240

[190] The core of neoliberal economic and political thought was the absolute trust in free trade and market and hence in the private sector. Financial deregulation was also one of its major goals, that is why neoliberal policies have often been ascribed the fault of modern financial crises and economic shocks. Politically neoliberal ideas sharply contrasted with Keynes's, stating that by pouring richness into the higher classes and into big industries, these grow and create wealth for the whole society. The most important economist of Neoliberalism was Milton Friedman.

Throughout my thesis, when referring to the term *hegemony*, I was using a concept that has been well explained by Fernand Braudel and, later, by Giovanni Arrighi[191]. The idea emerging from their work is that the entire modern history can be subdivided into big macro-periods or hegemonic cycles, and that most of the characteristics which accompany the life, development and decline of a hegemony are constant in every hegemonic cycle. In this way a sort of parallelism can be drawn between the period of Dutch hegemony in the 17th century, the British one in the 18th-19th and the American one in the 20th century. According to this view, the end of each cycle coincides with a period of heavy financial expansion and with the shift of the investment from the productive sectors of the economy to finance and related activities. Here I have decided not to take into account this approach to history. Nor will I argue here that the end of the Bretton Woods system represented the starting point for the decline of American hegemony. Also other theories which try to explain the unsustainability of the American monetary regime by applying economic models to the U.S. economic policy have intentionally been left out of this discussion[192]. If on the one hand all these interpretations certainly offer valid instruments for analyzing some aspects of the development of the modern world, on the other hand they tend to be highly deterministic and hence not always affordable when the question at issue is a specific topic that involves monetary policies, macroeconomic theory and political matters. But what's more, this kind of analysis falls outside the purpose of this study, which was intended to analyze a case of policy making.

However, it is an historical fact that in the 1970s the American economic force began to vacillate, and that, from that time on, finance has become the leading sector of a stagnating economy.

The crisis that affected the United States during the Nixon years was mostly derived from the increasing deficit in the balance of payments and from soaring inflation and

[191] Cf. F. Braudel, *Capitalism and Material Life, 1400-1800*, New York, Harpercollins, 1973; Arrighi, *Chaos and Governance in the Modern World System*, cit.

[192] I am referring to the Mundell-Fleming model, which states that an economy cannot simultaneously sustain a regime of fixed exchange rates, free movement of capitals and an independent monetary policy.

unemployment[193]. Adding to this the overall decrease in industrial productivity and the unruly growth of foreign competition, the scene was not optimistic. This was particularly true for large American corporation, which sharply criticized the set of rules that from the New Deal onwards hindered international finance and foreign investments, considered as the elements that would have relaunched profits and weakened social claims[194]. From this standpoint, it appears that Nixon's decisions were highly affected by the expectations of these influential sectors[195]. This further confirms the point of view I expressed in chapter five, as I rejected the interpretations that depict Nixon as the ignorant executor of the Bretton Woods system. In fact, also the benign neglet should not be considered a loss of control over economy, but a voluntary abstention from control[196]. To summarize: since the establishment of the Nixon administration, the American government knew it was operating in a situation of general crisis, and it worked from the very first weeks to reorganize the system, e.g. through the formation of the Volker Group, the various study memoranda and the specific organization of the decisional power inside the administration.

Also the importance of the political business cycle related to the 1972 elections should not been overestimated. From my point of view it represents a good element for analysis since it "reflects Nixon's ideology, personality, operating environment, and macroeconomic policies"[197], but personally I do not think it wholly grasps the complexity of the Nixon shock.

However, a glimpse at Nixon's character is quite revealing. What in particular has emerged is that he progressively changed the American course toward international monetary issues: despite the gradual approach of the first years, Nixon's policies became increasingly unilateral. I have pinpointed the election of John Connally as

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[193] In 1971 the American unemployment rate was 5%, an incredibly small percentage if compared with the current situation in almost all the well developed countries. But for the United States in those years it was very unusual

[194] Basosi, "Alle Radici della Rivoluzione Neoliberista. Nixon e l'Abbandono di Bretton Woods", cit., pp. 283-284

[195] Interesting for the explanation of the role of expectation in Nixon's policies is R.J. Morrison, *Expectation and Inflation. Nixon, Politics and Economics*, Lexington, Lexington Books, 1973

[196] Basosi, "Alle Radici della Rivoluzione Neoliberista. Nixon e l'Abbandono di Bretton Woods", cit., p. 284

[197] Keller, May, "The Presidential Business Cycle of 1972", cit., p. 267

Secretary of the Treasury in 1971 as a sort of turning point. It is emblematic the fact that the ascent of this latter coincided with the partial disengagement of Henry Kissinger from monetary matters. Besides being proof that Nixon finally gave precedence to the domestic situation over foreign affairs, it also showed that he had become much less willing to rescue the existing order. He understood that the reforms had to firstly safeguard the American freedom of action, and, consequently, he started to look at the unilateral action as something desirable. That is why he ultimately did not listen to those, like Burns and Kissinger, who called for caution. In this respect, the fact that the National Security Advisor consistently changed his position with regard to unilateralism is notably interesting, because it disclosed the worry of the branches within the administration that handled foreign matters. Their main concern was the closure of the gold window, because nobody knew exactly what kind of new challenges this provision would have brought to the United States from the international setting. Yet, neither Kissinger or Burns were able to propose a valid alternative.

To conclude, in my opinion any assessment of Nixon's monetary policy requires the study of all the variables that I have attempted to outline during my thesis: from the inheritance of the 1950-60s, to the international monetary situation, from the new economic challenges to the dynamics of the Cold War, from the organization of the American policy making system to Nixon's apprehension for the 1972 elections. The analysis of the National Security Memoranda during those years and other recent studies on this topic have shown how concerned the Nixon administration was with the sustainability of the Bretton Woods system, and the way in which it endeavoured to keep it functioning up until 1971.

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