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THE LIMITS REACHED: HOW INTERNATIONAL MONETARY POLICY,
DOMESTIC POLICY, EUROPEAN DIPLOMACY, AND THE VIETNAM WAR
CONVERGED IN THE 1960S

Dissertation

Presented in Partial Fulfillment of the Requirements for the
Degree Doctor of Philosophy in the Graduate School
of The Ohio State University

By

Charles H. Rieper, B.A., M.A.

* * * * *

The Ohio State University

1995

Dissertation Committee:
Michael J. Hogan
Peter L. Hahn
David L. Stebenne

Approved by

Adviser
Department of History
To My Parents, Mr. and Mrs. Durward and Beverly Rieper,
My Grandparents, Mr. and Mrs. Henry and Verna Rieper and
Mrs. Dorothy Schiefen,
and the Memory of My Grandfather, Mr. Leonard Schiefen
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VITA

27 April 1963 ................................ Born - Le Mars, Iowa

1985 ...................................... B.A., University of South Dakota, Vermillion, South Dakota

1985-1990 ............................... Bank Examiner, United States Treasury, Comptroller of the Currency, Sioux Falls, South Dakota

1990-1991 ............................... University Fellow, The Ohio State University, Columbus, Ohio

1991-1992 ............................... Graduate Research Associate, Department of History, The Ohio State University

1992-Present ............................ Graduate Teaching Associate, Department of History, The Ohio State University

1993 ...................................... M.A., History, The Ohio State University

Major Field of Study: U.S. Diplomatic History, Michael J. Hogan and Peter L. Hahn, Advisers

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INTRODUCTION

THEMES, TRENDS, AND THE IMPERMANENCE OF LASTING SOLUTIONS
(To 1960)

This dissertation discusses the efforts of successive American administrations to preserve the post-World War II Bretton Woods international monetary system. Its primary focus is on the international policies of the administration of Lyndon B. Johnson. More than any president before him, Johnson faced the need to resolve the conflicting challenges between international and domestic financial policies, as well as other foreign and domestic aspirations.

The argument of the dissertation is that Johnson's international monetary diplomacy aimed to reconcile two different goals: to preserve the Bretton Woods system and to provide for domestic prosperity. Historically, reconciling these two objectives had been difficult, but the legacy of the Great Depression required that this task be done. No American official could ignore the domestic economy. At the same time, American officials during the 1960s thought that preserving a viable international monetary system was an important part of ensuring a healthy domestic economy.
Post-World War II developments, however, made resolving this dilemma more difficult. The most frustrating international financial problem with which the Johnson administration had to contend was a string of worsening American balance of payments deficits that began in the late 1950s. These deficits, originating from various aspects of foreign military and economic policies, increased during the late 1950s but wrought their greatest damage from 1960 onward. The major problem with the deficits was that they threatened a key element of the Bretton Woods system, gold-dollar convertibility. The Democratic administrations of Johnson, and to some extent, his predecessor John F. Kennedy, tried to improve the workings of that system. Unfortunately, they undertook additional domestic and foreign policies that undermined their efforts in international financial diplomacy. The biggest of these burdens, of course, was the Vietnam War, but activist domestic economic policy also did much to complicate the task of preserving international monetary stability. A transformed international financial system added to the difficulties that the Kennedy and the Johnson administrations faced, as did a reinvigorated Western Europe.

The Johnson administration failed to reconcile the competing pressures, although the denouement occurred on the watch of its successor. Still, the catastrophe that many
experts had feared with the collapse of Bretton Woods did not occur. American preeminence in the international monetary system remained limited, but still extant.

The dissertation's argument, then, suggests a number of themes for analysis. The most important themes involve the matters of competing policy assumptions and the tradeoffs involved in fashioning policies that emanated from these assumptions. The reality that follows from this set of contending pressures is that postwar American domestic and international economic, political, and strategic exigencies connected with and sometimes contradicted each other. A secondary theme deals with the issue of how the administrations, particularly the Johnson administration, tried to resolve the policy questions they faced. The importance of this secondary theme is that the decision making procedures of officials did more than establish policy goals. These procedures set priorities on the time and attention that officials could devote to policy questions. A tertiary issue centers on the intellectual underpinnings of American policies and the historical contexts in which they develop. The mindset of those officials responsible for policy did not emerge from a vacuum. Johnson administration personnel brought to the problems they encountered an assortment of common historical experiences. They also relied upon a set of theoretical formulations that derived from experiences and reinforced
them. On a day-to-day basis, then, these experiences and theories became convenient ways to formulate policy goals, strategies, tactics, and responses.

Succinctly put, what happened by the 1960s was that American officials had not thought through the assumptions that had guided the creation and execution of their foreign and domestic policies. That they had not done so eventually made it difficult to pursue forcefully and effectively any one policy. Ultimately, the successor to the Kennedy and Johnson presidencies, the Nixon administration, decided to make certain choices that allowed for the continuation of some objectives while abandoning others.

International monetary questions lie at the very heart of this nexus of dilemmas, which is why this dissertation is studying them in depth. The balance of payments deficits originated from measures that American officials took after the Second World War. Initially, these officials undertook these policies for reasons that they saw as entirely justified. The deficits emerged in a rapidly changing international economic and financial environment that American officials had fostered with the intention of rectifying the damage of the Great Depression of the 1930s. For a period of ten years or so, the deficits did not create any problems.

A series of developments that had largely originated out of other aspects of American policy, though, intersected
with the deficits. Many of these aspects had consequences that American officials had not foreseen. Their allies, now experiencing an economic boom, became reluctant to do American bidding pliantly. The international financial arena had also become more volatile than ever imagined. As a result, the deficits grew in size and the maneuvering room in which American policy makers could operate became sharply reduced.

On the other hand, stopping the deficits posed its own set of problems. For one thing, ending the deficits through conventional means, meaning the inducement of some domestic austerity, would exact high political costs. For another, these officials assumed, cessation of the deficits risked endangering global prosperity. Encouraging global prosperity had been a staple of American foreign economic policy. Since American officials believed that domestic and international prosperity and political stability were intertwined, any resolution might be painful at best.

By 1960, American officials realized, however dimly, that they had to make some painful decisions. They avoided these decisions for about a decade. Had not other developments occurred, American officials would still have had to make some hard choices anyway. What complicated this scenario, though, was how the Kennedy and Johnson administrations defined their missions in both the domestic and foreign policy arenas. Domestically, they committed
themselves to increased activism in several areas of the economy and society. Internationally, they brought the logic of anti-Communist containment to a particular conclusion that they thought justified, based upon their reading of historical experience. Over time, international monetary questions, despite their importance, became relegated to lesser priority.

To be fair to these administrations, however, one must acknowledge that they did attempt to resolve this troublesome situation. Their solution was, initially, to foster prosperity at home with activist economic policies that the theories of John Maynard Keynes inspired. This answer, though, narrowed even more the options that American officials could use to resolve the balance of payments problems. What Johnson officials eventually decided upon, though, was a reform of the international monetary system itself. They hoped that reform might accomplish several objectives. Johnson and his administration wanted to preserve international prosperity. They also worked to reduce the role of gold and the dollar in the international monetary system even as they sought to protect the preeminence of these media. Their specific proposal to reform the international monetary system, the Special Drawing Right, or SDR, sought to accomplish all of these objectives simultaneously.
The Americans ultimately succeeded in pushing this measure, but not without considerable difficulty. Throughout, they had to overcome the skepticism of officials from Europe and elsewhere who thought the SDR to be a dubious thing. In some cases, the policy goals of the Europeans in other areas contributed difficulties to American efforts. One group of Europeans, the French, were adamantly opposed to the American conception of SDRs altogether. Developments in the international monetary system, such as rampant and destabilizing currency speculations, also frustrated the Americans. Of these, the sterling crisis of November 1967 and the French franc and Deutschemark crises of 1968 were the key examples. Naturally, American officials had to make certain compromises, but in the end, they achieved what they sought.

What really made the American SDR negotiations so difficult, though, was the Vietnam War. This sad undertaking frustrated every foreign and domestic measure for which Johnson labored. In purely financial terms, the Vietnam War worsened America's balance of payments and exacerbated inflation. This combination of events subverted one of the foundations of Bretton Woods, much to the irritation of American allies and much to the delight of speculators who wanted to profit from the dollar's demise. On an intangible level, though, the financial mismanagement of the Vietnam War undermined the confidence of foreign
officials and private financiers and speculators alike in the ability of the United States to conduct its fiscal measures responsibly. Moreover, the attention that Johnson and his circle paid to the war in Vietnam forced them to devote less time to other policy matters, including international monetary matters. Perhaps more than anything else, then, this war’s effects ultimately set events in motion that forced certain policy decisions by default. Still, what observers by the late 1960s were describing as financial management had itself resulted from another policy default, mainly a reluctance to compromise on other policy issues. Unfortunately, for Johnson, he could not escape what he had desperately sought to avoid. Evasion forced what he most wanted not to do.

The subject of this dissertation has received considerable scholarly study, but not from historians. The literature that exists falls into two categories: first, those accounts of political scientists and international relations specialists, and second, memoirs and official histories. For the most part, little exists by way of compelling emotionally-laden debate. Many of these studies deal with the technical dimensions of their subjects. The emphases of this literature also vary. Much of it, though, grapples with how American officials coped with maintaining a dominant position while the international financial
environment underwent rapid changes. Some of it is just restricted to describing the power relationships among the various actors involved. To some extent, these scholars see the problems as being almost systemic in nature, meaning that the Bretton Woods system possessed certain flaws from its inception and that its operation simply made them worse. Studies of this genre include the writings of Hal Leary, Fred L. Block, David Calleo, Joanne Gowa, Stephen D. Cohen, Susan L. Strange, and Alfred Grosser.¹ Policy advocacy is a related task of this scholarship. Studies in this vein often build models that try to explain international behavior, using whatever "historical" or current evidence is available. While generally they do a reliable job of assembling the facts, their usefulness for the historian is limited. Gowa's account is one example. It is better than many others because it conscientiously tries to use archival material. What might be said as a general criticism of Gowa's book and the others, though, is that it is difficult

to glean a sophisticated and nuanced treatment of the historical context of ideas, policies, or developments.

The second general category of literature of this topic might be expected to include many works designed to defend particular officials or institutions. There are accounts of this type, such as Margaret Garritsen de Vries' official history of the International Monetary Fund (IMF), which is indispensable because IMF archives of this period are not available to researchers. Memoirs of second-tier officials such as Robert Solomon, Charles Coombs, Herbert Stein, and Paul Volcker are also fair and candid accounts. Those of the French adviser Jacques Rueff, might be more egocentric, but are nonetheless more spirited and interesting. The usefulness of top-level elected officials, though, varies. Johnson's memoirs say little about international monetary matters, as do those of Franz-Josef Strauss, a long-time German politician who served as finance minister in the Grand Coalition cabinet of Kurt Georg Kiesinger. Others, such as the memoirs of French foreign minister Maurice Couve de Murville, help to gain a sense of the attitude of their governments. The memoirs of British officials, such as Harold Wilson, the Labour Prime Minister, and his two Chancellors of the Exchequer, James Callaghan

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and Roy Jenkins, are helpful on certain topics, most notably on the sterling devaluation of 1967.3

If a controversy, as such, has actually emerged, it is from some recent writing that comprises what has become termed the "declinist" debate. The declinist issue centers on the question whether or not the United States is in some sort of economic demise, compared to other nations, as measured by such yardsticks as the American share of world production. Yale historian Paul Kennedy's work, particularly his *Rise and Fall of the Great Powers*, has served as the point of departure of commentary on this controversy, although elements of this thinking can also be found in Calleo's work. The declinist notions of Paul Kennedy and Calleo have invited rejoinders, most notably in a 1988 *Foreign Affairs* article by Samuel P. Huntington, and in book-length treatments by Joseph Nye and Henry R. Nau. Nau also takes exception to the earlier point that Bretton

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Woods collapsed because of systemic reasons. Instead, Nau lays the blame on activist domestic policies beginning in the 1960s for sharply reducing the room for maneuver for the United States in the international arena. This dissertation will touch on some of the aspects of this debate, but only in part, and not until the concluding chapter. In brief, I side with those who reject the declinist thesis. I do not go as far as Nau does, though, in saying that the collapse of Bretton Woods was primarily because of domestic activism.4

Historians have not shied from paying attention to the international monetary issues that the United States and the other industrialized countries have faced throughout much of the twentieth century. As various archival collections have become accessible, historians have taken advantage of the wealth that they offer. Scholars have discussed the origins of contemporary American financial diplomacy and how it related to other issues. Persons who have devoted effort to analyzing some of the roots of the contemporary international monetary system include Michael J. Hogan and

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Carole Fink. Barry Eichengreen has investigated the collapse of international monetary order during the Great Depression, while the Bretton Woods agreements receive excellent treatment from Richard N. Gardner, Alfred E. Eckes, and Randall Bennett Woods.5

Historians have also provided excellent treatments of the broader features of postwar economic diplomacy. Much of this literature brings the corporatist relationships between government and business interests that Hogan has revealed in sharp detail. Hogan continues his investigations along these lines in his definitive work on the Marshall Plan. One exception to this corporatist approach is Alan S. Milward's study on the same subject. Milward takes issue with the predominant interpretation that credits American policy for providing the basis for European recovery. Instead, he emphasizes the postwar efforts made by the Europeans themselves. Otherwise, work by Charles S. Maier, Robert Collins, and Kim McQuaid take up similar corporatist themes, whether they be in the domestic or in the

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international spheres. A doctoral dissertation by Amy Elizabeth Davis does not analyze the corporatist relationships *per se*, but is nevertheless an excellent basis for a solid monograph about how the Kennedy administration made domestic economic policy.⁶

With respect to the Johnson administration, though, few historical monographs exist on either the foreign or domestic economic questions that it faced. Major biographies, such as those by Robert Caro, Robert Dallek, and Paul Conkin mention little or nothing about the international monetary questions. International and domestic economic issues occasionally figure in chapter-length treatments or less.⁷ One example to be mentioned is a short chapter that Gabriel Kolko offers in his study of the Vietnam War. Kolko's presentation, astonishing in its brevity given his New Left affiliation, is accurate. Still, his treatment, which is heavily grounded in Marxist economic

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determinism, is open to considerable criticism. Only recently have scholars published works that attempt a comprehensive treatment of the foreign policy of the Johnson years. Lawrence S. Kaplan and Samuel F. Wells, Jr. have contributed articles about the Johnson administration’s relationships with NATO, one of which contains information about the Trilateral negotiations. These negotiations had one critical effect upon American international monetary policy during the 1960s, namely because they caused the Bundesbank, or German central bank, to agree in 1967 not to redeem its dollar balances for gold. H.W. Brands’ recent *The Wages of Globalism* is quite disappointing, though, because it has little discussion of international monetary politics. Besides the Trilateral negotiations, he barely discusses international monetary issues.\(^8\)

The probable reason for this lack of attention to international economic issues is that the necessary archives are just now becoming available for research. A few studies are beginning to appear that analyze the Johnson Administration’s handling of pertinent domestic economic

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issues. James Anderson and Jared Hazelton's study of the techniques that Johnson and his top advisers used to make domestic and international economic policy uses archival holdings extensively, and provides a reliable account of the events. Still, it is primarily concerned with evaluating Johnson and his top advisers as economic managers. Donald F. Kettl has contributed an excellent seminal article on the decision for the 1968 tax surcharge. An article by Burton Kaufmann in the same collection discusses how the balance of payments problems ultimately undermined the Johnson Administration's foreign aid program.9

Thomas W. Zeiler's American Trade and Power in the 1960s, a monograph about the Kennedy Round of trade talks, is a good first step toward gaining an historical understanding of American economic diplomacy of the 1960s. As part of his analysis, Zeiler attempts to analyze Johnson's trade diplomacy in terms of various schools of thought, such as realist-mercantilist, corporatist, and the like. Zeiler concludes that traditional mercantilism, and not corporatist bargaining, animated American trade

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diplomacy. Naturally, though, Zeiler's study devotes little attention to international monetary questions.

The cursory review of the literature that has just been provided suggests that a monograph-length study of international monetary politics is worthy of a historian's consideration. This dissertation will attempt to do this in its five chapters, analyzing the various themes enumerated at the beginning of this introduction.

The first chapter analyzes how the Kennedy and Johnson administrations gradually developed a set of approaches that they thought would resolve the deficits while following the domestic and foreign policy policies that they inherited, as well as new ones they wanted to implement. The second chapter analyzes the SDR negotiations that ultimately evolved from their policy approach, and the problems that these manifested to them as well as their negotiating partners. These problems, of course, were the limits that the other policies established, particularly the Vietnam War and the expanded domestic agenda. The third and fourth chapters explore the constraints that the international monetary environment itself placed before American officials, as well as the difficulties that the Vietnam War continued to pose for domestic and international policy. America found its commitment to Bretton Woods sorely tested

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during the sterling crisis of November 1967. The following year's gold and currency crises caused American officials to begin to alter some of the principles of that system. The fifth and last chapter primarily deals with how the Nixon administration eventually opted to scuttle Bretton Woods. It did so because it found the costs of maintaining it were more than the domestic economy and political climate could sustain. This final chapter will also provide a summary section that will recapitulate the dissertation's findings and answer the questions that the dissertation raises.

The rest of this introduction will sketch the basic historical background to the balance of payments problems that the United States faced by the late 1950s. Its basic theme is that already by this time, certain flaws in the international monetary system, combined with the need to pursue other policy imperatives at home and abroad, limited the extent to which American officials could resolve the payments deficit problems. To understand the situation that Johnson and his economic advisers faced at the beginning of his term in late 1963, it is necessary to review briefly certain economic, political, and intellectual developments that occurred over the previous three decades. The international monetary arrangements that Johnson and his predecessors pledged to defend went by the name of Bretton Woods, after the New Hampshire resort where they were
fashioned in 1944. This system aimed to rectify the damage that the Great Depression had inflicted upon international monetary stability. Great Britain had left the gold standard in 1931, opting a year later to create a closed sterling and trading bloc and then devaluing sterling. In 1933, President Franklin D. Roosevelt and his Treasury Secretary, Henry Morgenthau, followed the British example. They soon reversed their stance in 1935 by restoring the gold-dollar parity at $35 per ounce. Still, they did not resurrect a truly workable international monetary system for the time being. The Tripartite Agreement of 1936, into which the United States, Great Britain, and France entered, only restored international monetary cooperation in part. It took the Second World War to renew full-fledged multilateral international monetary cooperation and prevent another Great Depression from recurring.\footnote{11}

1936 also saw the publication of a seminal tract on economics that would profoundly influence future officials, and complicate international monetary policy at the same time: The General Theory of Employment, Interest, and Money by the noted British economist John Maynard Keynes. This book, Keynes’ \textit{magnum opus}, was not a tome about which people

could be neutral. Its controversial aspects arose from the role Keynes assigned to the public sector in the economy. In so doing, Keynes broke with established economic orthodoxy that prescribed that the public sector's role be passive. Keynes' reputation for heterodoxy, in the eyes of the established economics profession, was well established. Earlier he had attacked the gold standard and had maintained that thrift was irrelevant to investment activity. The General Theory, while backing away from the earlier dismissal of thrift, focused on the importance of demand in the demand-supply relationship. The specific policy prescription that Keynes articulated in The General Theory was that government management of an economy's level of demand was what determined its overall well-being. Since traditional relief efforts were not up to the task of stimulating demand effectively, Keynes recommended that government stimulate consumption with large scale deficit spending. Not surprisingly, then, did economic conservatives react to Keynes with vigorous opposition.12

Where Keynes would have his greatest influence, though, would be with upcoming generations of students, economists, politicians, and journalists. It took the work of academicians such as Alvin Hansen and Paul Samuelson to make

Keynes' ideas acceptable to the general public.\textsuperscript{13} Still, the harrowing experiences of the 1930s served as a reminder to these generations that the public sector could never be passive in the economic life of a nation.\textsuperscript{14}

For the time being, though, Keynes' postulations would have to wait. Despite the enthusiasm of some New Dealers for Keynesian thinking, Roosevelt was hesitant to embrace stimulative deficit spending. Whatever he said about the need to prime the economic pump, Roosevelt never wanted to depart from balanced budgets, at least in principle.\textsuperscript{15}

The economic benefits of that war, though, did not alone make it a watershed for American economic policy. The Second World War also allowed the United States to be preponderantly stronger than other economies, many of which were destroyed. This strength allowed the United States the rare opportunity to try to reshape the postwar future according to its preferences. Thus, it seemed, many American architects of the postwar world acted as if they were rectifying past mistakes for all time, in an almost


Wilsonian manner. Just as Roosevelt labored for the United Nations, his Secretary of State, an old-time Wilsonian named Cordell Hull, visualized a postwar multilateral free trading order. Hull's dream was to promote global prosperity and avoid the trade barriers of the 1930s to which he attributed the Great Depression.¹⁶

The first such economic institution that the Americans built was one to rehabilitate the international monetary system. Reforming international money, these Americans assumed, was a precondition for the success of the other aspects of their ideas for the postwar world. In 1944, the institution was born that became that international monetary order: Bretton Woods. Its fathers were Keynes and Harry Dexter White, an aide to Morgenthau. Its purpose was to use the supposed lessons of the 1930s to prevent another Great Depression from recurring.

White and Keynes managed to fashion a plan for an international monetary system that only underwent moderate changes during the Bretton Woods deliberations. Nevertheless, the two men had different ideas about how the postwar international monetary system should work, differences that reflected the objectives of their countries. White's plan was designed to benefit a country such as the United States, which enjoyed consistent balance of payments surpluses. Keynes, on the other hand, sought

¹⁶ Eckes, A Search for Solvency, 34-5.
provisions that would give balance of payments deficit countries such as Great Britain an even break. Not surprisingly, though, White’s plan prevailed, because he represented the stronger country.17

The features of the Bretton Woods system, as White laid them down, included, first, a requirement that participating countries become IMF members. The IMF was to ensure that member countries maintained convertible currencies into either gold or gold-convertible currencies such as the dollar at fixed rates. In most cases, member nations had to avoid payments controls, although in practice the IMF relaxed this stipulation for deficit countries reconstructing their economies. On the other hand, under some conditions, member countries could use capital controls if needed. The IMF also provided loans for countries experiencing balance of payments difficulties. Members could qualify for these loans, though, only after they had exhausted other remedies, such as domestic adjustment. Keynes did manage to obtain some deficit country relief in the form of the scarce currency clause, which permitted the IMF to allow chronic deficit nations to conserve their gold reserves or reserves of currencies of large surplus nations, i.e., the dollar. Finally the IMF could allow deficit countries to use trade restrictions to shore up their

17 Eckes, A Search for Solvency, 45-6, 59-80; van der Wee, Prosperity and Upheaval, 426-8; Nau, The Myth of America’s Decline, 81-6.
payments positions. In addition, the IMF would have a complementary organization, the International Bank for Reconstruction and Development (IRBD), or World Bank, to lend money for reconstruction assistance of member nations.\textsuperscript{18}

The intent of White, Keynes, and the other delegates assembled at Bretton Woods during that summer of 1944 was that their institution be fully operable once the Second World War had ended. Bretton Woods never quite worked that way, though, especially in the short term. One reason was the hostility that American conservatives in Congress, in the press, and in certain banking circles had toward it. Consequently, Bretton Woods remained underfunded during its early years.\textsuperscript{19} The United States had to resort to bilateral measures to solve crises, such as a $3.75 billion loan to Great Britain to support sterling after the end of the Second World War.\textsuperscript{20}

What probably hurt Bretton Woods more in the beginning, though, was the fact that White and Keynes had underestimated the wartime damage that the economies of Western Europe had sustained. This weakness became apparent

\textsuperscript{18} Eckes, \textit{A Search for Solvency}, 135-64; van der Wee, \textit{Prosperity and Upheaval}, 428-32.


\textsuperscript{20} Woods, \textit{A Changing of the Guard}, 332-62.
as the tensions of the Cold War began to surface. As a result, Bretton Woods became subordinated to other concerns. In the process, the United States unilaterally made the international monetary system work. The dollar, consequently, became the *de facto* world currency, something that White had not quite intended.\(^\text{21}\)

Moreover, policies that the United States undertook to meet these challenges reversed the heretofore surplus position of its balance of payments. It was the intention of the United States that the deficit effects of these policies benefit the recipients of American assistance. In so doing, the United States, however unwittingly, sowed the seeds of future problems as it rushed to meet two crises at hand.

The first crisis was that Western Europeans could not earn the dollars they needed to pay for critical American imports needed for reconstruction. The second crisis was that Communist parties in these countries were very active, particularly in France and Italy, where they took advantage of the misery of the general population. To resolve both crises, the United States proposed the Marshall Plan, or the European Recovery Plan (ERP). The ERP aimed to meet the dollar scarcity, or dollar gap, as it was called, and blunt the appeal of the Communists. In 1948-9, after a recession

in the United States caused the market demand for Western Europe's exports to shrink, American officials supplemented the ERP with the European Payments Union (EPU). The EPU was a sort of clearinghouse that allowed its participants to settle with each other without having to make actual currency transfers. Over time, however, the Europeans pledged to restore currency convertibility as they recovered.\textsuperscript{22}

What really helped close the dollar gap, however, was military spending. This spending came about because of the formation of NATO in 1949 and the Korean War in 1950.\textsuperscript{23} Although the American balance of payments was now in deficit, this did not concern anyone immediately. Europe was happy to have the dollars, as they aided recovery. The size of the deficits at this point were modest, and did not seem to threaten America's ability to convert dollars into gold. Moreover, the costs of these strategies to the United States were minimal, as they represented a small percentage of GNP.\textsuperscript{24}

In addition to ERP assistance, another factor that contributed to European recovery was a particular policy approach that the United States required the Europeans to

\textsuperscript{22} Hogan, \textit{The Marshall Plan}, 26-134, 238-9, 324, 325, 349-50, 354.

\textsuperscript{23} \textit{Ibid.}, 380-426.

cultivate as a condition to obtaining ERP assistance. The United States induced the Europeans to follow policies that emphasized productivity over income redistribution. The argument behind this approach was that productivity would eventually allow all segments of society to share in the economic gains attained without descending into bitter disputes over how these gains were apportioned.

The origin of this approach could be found in the American experience. While American leaders were promoting productivity abroad, they were moving toward a similar strategy for the domestic economy. American leaders immediately after the Second World War rejected full-blown Keynesianism. They did not want to become involved in aggressive demand management and income redistribution. Instead, they opted for an approach that emphasized productivity and prosperity. Therefore, they did not return to strict laissez-faire, as advocated by refugee Austrian economist Friedrich A. Hayek in his *The Road to Serfdom* and in the conferences of his Mont Pelerin Society.\(^\text{25}\)

The policy approach that emerged in the United States had two components. First, a corporatist-like partnership among business, labor, and government groups coalesced to guarantee continuous prosperity and productivity, so as to avoid messy distributive conflicts. Second, this

partnership favored moderate fiscal and monetary policies that Stein, at the time Research Director for the Committee of Economic Development (CED) called "commercial Keynesianism." Commercial Keynesianism rejected activist fiscal policy. It also eschewed the canon of the balanced budget for its own sake. Instead, commercial Keynesianism proposed to balance the budget, or run surpluses, at high employment and run deficits whenever the economy fell below high employment.\(^{26}\)

The success that American officials had in influencing Europeans to pursue these policies was mixed. American ERP administrators nudged dirigiste bureaucrats in France away from strong central planning and toward the voluntary planning measures of Jean Monnet. In occupied Germany, however, Ludwig Erhard's Sozialmarktwirtschaft remained more free-market and export oriented than what the ERP officials had in mind. Postwar Great Britain, on the other hand, tended toward nationalizations and stronger interventionism than in Germany. Even more protracted were efforts to induce Great Britain to dismantle the network of preferential trade and currency blocs that had accompanied the 1931 decision to retreat from the gold standard.\(^{27}\)

\(^{26}\) Collins, The Business Response to Keynes, 115-41.

Over time, these American policies achieved notable successes. As the 1950s progressed, the recovery of Western Europe and Japan became more evident. Concomitantly, though, American economic and defense policies contained elements that undercut some of their original purposes. These elements became discernable only as the 1950s began to close. These elements, and their implications, will be expounded upon at length throughout this dissertation. By 1960, the conflicts that these policies were engendering required some distasteful choices among popular and domestic policies. Not only did Americans have to face these choices. The Europeans too, because aspects of their politics and economics were evolving along similar lines, confronted these compromises as well. In the end, the entire nexus of relationships binding the United States, Great Britain, and Western Europe was placed under great strain, if not gravely threatened.

One set of factors that caused tensions involved the relative strengths of the American economy compared with those of Western Europe and Japan. Between 1945 and 1960, America’s share of world production dropped, primarily because Western Europe and Japan managed to recover. This recovered strength accorded the formerly war-torn nations

the opportunity to reassert some control over their destinies.28 Increased economic integration, of which the Treaties of Rome of 1957 were the culmination, was one way of reasserting a degree of self mastery. The Treaties of Rome established the European Economic Community (EEC). They required EEC members to assume fully their obligations under the Bretton Woods system, which they did in 1958 with the return to full currency convertibility. Originally, the United States had encouraged this integration trend, and had even tolerated European trade discrimination. As the EEC hurried to erect tariff barriers against American products, though, it became apparent that American and European policies would soon conflict with each other.29

Emerging differences over strategic and diplomatic issues also created tensions between Western Europe and the United States. The ever-contentious Franco-American relationship was the classic example of these trans-Atlantic disputes. French and American officials had always had their quarrels over aspects of strategy and economics, but these became intensified after the return of General Charles de Gaulle to power in 1958. De Gaulle continuously articulated an alternative vision of Europe. Instead of an integrated Europe, de Gaulle spoke of a somewhat vaguely

28 Nye, Bound to Lead, 72-8; Huntington, "The U.S.--Decline or Renewal?" 82-3.

defined "Europe of the Fatherlands." Part of de Gaulle's motivations stemmed from his resentment of how Roosevelt and Churchill had treated him during the Second World War. On the other hand, de Gaulle wanted to project onto the rest of Europe the idealized view he had of his own country. In his thinking, every other European nation, like France, had a certain esprit and destiny. After settling the Algerian crisis in 1962, de Gaulle threw his energies into bringing about his vision. His criticisms of American policy sharpened. He developed an independent nuclear force over American objections, ended French military participation in NATO, and issued public reproofs against American policies in Cuba and Vietnam. With the Soviet Union he began a rapprochement of sorts. De Gaulle's disagreements with the United States over economic issues were just as pointed, whether they be over trade or British membership in the Common Market.30

The American-German relationship was also complex. What made it that way was that the Germans tried to steer the middle course between the Americans and the French. Much of the foreign policy of the postwar German Chancellor, Konrad Adenauer, was aimed at a total repudiation of the Nazi past and Prussian heritage. Whereas historically, German foreign policy had been oriented toward its eastern

neighbors, Adenauer worked to better relations with Western Europe. In addition to cooperating fully with European integrationist schemes, Adenauer labored for a reconciliation with France. De Gaulle was very receptive to Adenauer’s moves and lent him support. On the other hand, Adenauer’s Gaullist inclinations raised a dilemma: his country depended upon the United States for military protection. The delicate position that Adenauer and his successors found themselves in, then, often meant that Germany would either mediate differences between its two other allies or side with one or the other.31

International monetary issues between United States and Western Europe were just as contentious. The American balance of payments deficits, heretofore not a concern, suddenly worsened in 1958.32 These balance of payments deficits reflected and amplified all of the stress points of the trans-Atlantic partnership for the next thirteen years or so. They would defy all attempts at a cure, because they originated in other aspects of American policy that American leaders thought they could not jettison for a variety of domestic and diplomatic reasons.

31 Grosser, Les Occidentaux, 244-5, 246-8.

32 Administrative History of the Treasury Department Under the Administration of Lyndon B. Johnson, (U.S. Treasury Administrative History), Chapter IX, (Frederick, MD, 1984), Reel 6, 1.
A number of factors caused the deficits to widen significantly. The major ones were increased American military outlays, increased tourist expenses, and accelerated investment by American-based multinational corporations. The last category was particularly controversial. American multinationals behaved as they did because they wanted to evade the tariff barriers that the EEC was erecting. The fact that these acquisitions in Europe were made with dollars increasingly bothered Europeans on the Continent. Over time, as inflation from the Vietnam War took its toll, a number of observers became incensed that American corporations were buying European firms with "inflated dollars." 

The European concern over inflation was not unfounded. Both the United States and Western Europe suffered bouts of it right after the Second World War. For the most part, though, it was mild, except in occupied Germany. Economists have thoroughly debated the sources of this inflation. According to Keynesians, it resulted from the fact that most economies by the mid-1950s were operating beyond the point that full employment and capital stock would permit without overheating. Monetarists such as Hayek and his fellow Mont

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33 U.S. Treasury Administrative History, Chapter X, Reel 6, 5.

34 Calleo, The Imperious Economy, 47. For a leading contemporary criticism of this development see Jean-Jacques Servan-Schreiber, The American Challenge (New York, 1969).
Pelerin colleague Milton Friedman attributed it to excess money creation by central banks. Others saw it in the increasing synchronization of business cycles and financial markets. Still others, such as Maier, saw inflation coming from the corporatist bargaining over national income allocations. Whatever its source, officials in the United States and Western Europe took it seriously, either with tight monetary policies or by refusing, as President Dwight D. Eisenhower did during the 1958 recession, to use stimulative fiscal measures.35

Two other developments on the horizon would complicate the situation and set the stage for international monetary crisis. First, most European Bretton Woods members returned to full currency convertibility. This move made it infinitely easier to transfer large volumes of money and capital across borders. This was quite likely to happen whenever interest rate differentials occurred between countries. Second, the American balance of payments deficits helped create the Eurodollar market, largely through the lending activities of American-based multinational banks. The multiplier effects of overseas lending gradually increased the volumes of dollars abroad even more. The Bank of England and the British Treasury

35 Van der Wee, Prosperity and Upheaval, 87-9; Maier, "The Politics of Inflation in the Twentieth Century," in In Search of Stability, 212-3; Stein, The Fiscal Revolution in America (Chicago, 1969), 320.
also helped create the Eurodollar market, mainly by prohibiting sterling's use in export financing. The London financial community then reverted to using dollars and thus preserved its role in world finance.36

By 1960, these overseas dollars exceeded the volume of domestic American gold stocks, a dangerous situation for a country committed to redeeming dollars for gold on demand at a fixed price of $35 per troy ounce.37 Eisenhower undertook some measures to deal with the impending balance of payments crisis, but most of these were small. The biggest step he took, though was to induce other allies to share in the costs of the common defense. He singled out the Germans because of their persistent balance of payments surpluses and because they lacked military clout. In 1961,


37 In 1958, the United States began with $23 billion in gold reserves, roughly two-thirds of the world's total. Over the next six years, to year-end 1963, the United States ran liquidity deficits that totalled roughly $3 billion per year, for a total of $18 billion, compared with the average $1 billion annual deficit figure which had been run up through 1957. The liquidity balance measures the balance on the current and long-term capital accounts (essentially the sum of the trade figures, overseas military expenses, travel outlays, direct transfers abroad, and the net of other services along with government and private long-term capital flows), non-liquid short-term private capital flows, and any errors and omissions. Meanwhile, over the same period, 1958-1963, American gold stocks declined from roughly $23 billion to $16 billion. See U.S. Treasury Administrative History, Chapter XII, Reel 6, 1-2, and the 1974 Economic Report of the President, 350-1.
in response to some American pressures, the Bundesbank agreed to revalue the Deutschemark. The year earlier, Eisenhower dispatched Treasury Secretary Robert Anderson and Treasury Undersecretary for Monetary Affairs C. Douglas Dillon to Bonn to coax Adenauer to ante up more for the American troop presence in Germany. Neither official used much finesse during their meeting with the Germans. At one point in the talks in Bonn, Anderson threatened a wholesale American troop withdrawal. The Germans, angered, eventually agreed to a series of offset payments that the Americans designed not to resemble tribute. Eisenhower, in return, pledged that the United States would not again make such a blatant threat to withdraw troops.38

The balance of payments deficits also prompted Eisenhower to ensure federal budget surpluses. Eisenhower feared losing face to other nations having payments surpluses. His customary concern over fiscal responsibility had always prompted him to restrain federal military and civilian expenses, already higher than prewar levels. After 1958, though, Eisenhower thought that the United States had to reassure foreign creditors as well. If, as Stein points out, foreign officials never really doubted that the United States could meet its fiscal obligations, their intimations to American officials about wanting balanced American

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38 Solomon, The International Monetary System, 34-7; Block, The Origins of International Economic Disorder, 173.
budgets lent added support to Eisenhower's own preferences. Still, Eisenhower seized the connection between the balance of payments and a budget surplus to support his own domestic policy preferences.\textsuperscript{39}

Beyond these measures, though, Eisenhower did little else. Nevertheless, the problems had become systemic and deep-rooted on his watch. It was not for Eisenhower to resolve these problems, though. Resolution was the task of his successors.

The architects of the postwar international monetary system began with the highest of hopes: the desire to create a world where payments and capital could flow to where they would be used most efficiently while each nation could provide prosperity and economic security. This desire, in part inspired by theoretical notions of free trade, also possessed an almost idealistic quality. It was to be the definitive preventative measure to rectify past ills. Just as the League of Nations and collective security were to have prevented the recurrence of another world war, so Bretton Woods was to prevent another Great Depression from happening.

As time progressed, however, subsequent policies in other areas interfered with the smooth functioning of this arrangement. These other economic and military policies

\textsuperscript{39} Stein, \textit{The Fiscal Revolution in America}, 353.
seemed to make sense to their creators at their inception. Nevertheless, by the late 1950s, they were competing over finite resources within the framework of an international monetary system that, over time, proved to be flawed. From the standpoint of three and a half decades later, it appears that Bretton Woods was already incapable of confronting these challenges. Still, could American leaders of any political persuasion renounce any one of the policies pursued and not suffer a loss of prestige or political damage? Could they, in fact, retrench to save the international monetary system? Or would the international monetary system have to be modified or even abandoned?

Kennedy and Johnson had to confront the full implications of these issues, at least implicitly.

What the five chapters of this dissertation will show is that neither President, nor Nixon after them, could successfully evade this question. Moreover, they both embarked upon new, ambitious policy commitments that interfered with the smooth functioning of the international monetary system. To his credit, Johnson did attempt one major rectification, the SDR negotiations discussed in the second chapter. The narrative shows, though, that in the end, neither Kennedy, nor Johnson, nor Nixon, for that matter, could do anything to save Bretton Woods without renouncing policy ambitions in other areas. Since no American official thought that these other policies could be
abandoned, international monetary problems became a troublesome burden. Several half-hearted measures, a protracted series of negotiations, and numerous currency and gold crises later, though, the burden became too heavy. Ultimately, the United States defaulted on its historic role in the international monetary system.
CHAPTER I
SPECIAL DRAWING RIGHTS I: HOW NECESSITY BECAME OPPORTUNITY (1961-1965)

How necessity became an opportunity for Lyndon B. Johnson’s administration to embark on international monetary reform beginning in 1965 is the theme for this first chapter. Chronologically, this chapter covers the events from John F. Kennedy’s election to a critical speech that Johnson’s Treasury Secretary, Henry H. Fowler, gave in 1965 to announce a new American international monetary effort. Thematically, the chapter continues the discussion of the problems that the American balance of payments presented to American policymakers. In essence, the payments deficits reflected how several elements of American foreign and domestic policies clashed with each other. The Kennedy and Johnson administrations assumed that they could not renounce any single foreign or domestic policy they inherited from previous administrations. Had they done so, they would have lost credibility and political support. Their own experiences with history had informed them that the particular policies America was pursuing were necessary for their country’s economic, social, and strategic well being.
What Kennedy and Johnson did instead was to embrace increased activism. In the process, they created a vicious circle of situations demanding remedies that created new situations to be resolved.

Foreign opposition, mainly from America's European allies on the continent, complicated the situation for Kennedy and Johnson. As mentioned previously, they were no longer prostrate from wartime catastrophe, but economically prosperous. Recovery had given the Europeans renewed strength, especially to challenge certain American policy prerogatives. No ally was more dedicated to foiling certain American initiatives than France. The French President, General Charles de Gaulle, and some of his key advisers resented the dominant role that the United States played on the world stage. The payments deficits only increased their ire. Finally, just as he would in other arenas, de Gaulle acted, forcing Johnson officials to respond.

Stopping the payments deficits seemed to be a logical enough response. Nevertheless, a number of theoreticians and American officials were arguing that the deficits had their beneficial effects. If halted, the deficits might create problems reminiscent of previous downturns. A new depression could, of course, not be tolerated. Historical memories were too strong.

This need, then, to remedy the payments situation as it seemed to be improving gave the Americans an opportunity to
create anew, it seemed. The international monetary reform that some in the administration desperately urged could now go forward. A new American initiative in international money could resolve several problems, such as ensuring global prosperity and protecting American gold stocks from abusive conversions. It could also ensure that expansive domestic economic policies could continue. Of course, if the Johnson administration could avoid austerity, it could continue pursuing those domestic social reforms that lay at the core of its soul. As Fowler gave his speech in 1965, then, there could be reasons for optimism, at least from the Johnson administration's point of view. The difficult policy circle, then, could be squared.

Kennedy and Johnson were elected in 1960 on the theme of "getting the country going again." The close results of that election indicated they did not have a mandate per se, however.¹ Nor did activist Democrats crack the hold that conservative southern Democrats and Republicans had in Congress. Still, the notion of rejuvenating the nation with a new sense of purpose had captured the imaginations of many people affiliated with the liberal wing of the Democratic party. These observers called for a renewed national purpose and pointed to a number of areas where they saw

deficiency in the nation's foreign and affairs. When the Democratic liberals had a chance, they would reorder domestic and foreign American priorities by applying a fresh dose of updated activism in the tradition of the New Deal. At his inaugural, Kennedy set the tone for the activism that he and his successor would follow. This activism embraced an unlimited agenda to resolve all of America's ills at home and abroad.²

Kennedy put out a call for "the best and the brightest" to serve his administration as part of the urge to activism. Among those at home who responded to the call were a number of economists who had been inspired by Keynes during their graduate or early professional careers: Walter Heller from the University of Minnesota, who became Kennedy's CEA Chairman; Gardner Ackley from the University of Michigan, who later succeeded Heller; Seymour Harris and Carl Kaysen from Harvard, James Tobin from Yale; and Robert Solow from the Massachusetts Institute of Technology. These men urged Kennedy to stimulate economic growth with deficit spending to reach full employment and provide for the menu of foreign and domestic policies that he wanted. The remedies of these advisers, later collectively termed the New Economics, either recommended increasing spending in relation to tax revenues or cutting taxes while maintaining spending

constant. They had nothing but impatience for Eisenhower’s concerns about inflation or balanced budgets, seeing them as being misplaced when, in their eyes, the American economy had so much potential that was not being reached.⁴

A complimentary shift toward more economic activism also occurred abroad during, although it did not always result from an enthusiasm for Keynes per se. As will be discussed in Chapter Three, British voters returned the Labour party to power. This party had the goal of reimplementing the cradle-to-grave security it had tried after the Second World War. Beginning in the late 1950s, the Germans under Christian Democrats Konrad Adenauer and Ludwig Erhard gradually moved toward an interventionist policy, with increases in social expenditures. By the end of the 1960s, especially under the influence of the Social Democrats, an important stabilization law emerged that mandated extensive government involvement in the economy.⁴

For the time being, the French declined to follow this path, although they continued some dirigisme in their economy. As a rule, though, French policies from the late 1950s into the 1960s would be conservative. The Fourth

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³ Stein, The Fiscal Revolution in America, 379-84.

Republic's maladroit stewardship of French finances required de Gaulle to resort to austerity upon taking office. Two officials drafted the austerity plan: Antoine Pinay, a successful entrepreneur-turned-politician, and Jacques Rueff, a Mont Pelerin associate of Erhart. While Rueff did not enjoy the confidence of all the French financial bureaucracy, de Gaulle still retained him as his top unofficial financial adviser. Rueff's advantage was that his prescriptions seemed to support de Gaulle's anti-Anglo-American inclinations.  

Nevertheless, because of the Keynesian inclinations of his advisers, Kennedy was very reluctant initially to follow their prescriptions. The international financial environment imposed constraints he took very seriously. Once the volume of overseas dollars exceeded domestic gold stocks, currency speculators became eager to challenge America's unconditional dollar redemption policy. In October 1960, thinking a Kennedy victory might mean fiscal irresponsibility, currency speculators launched a major run against the dollar. As a result, the London gold market closed. Kennedy, in turn, was forced to make a public pledge that if elected, he would not suspend the dollar's convertibility. Although order in the gold market was

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5 Pierre Rosanvallon, "The Development of Keynesianism in France," in The Political Power of Economic Ideas; Loriaux, France After Hegemony, 161-8; Rueff, De l'aube au crepuscule, 226-58.
restored with the establishment of the London Gold Pool the following year, Kennedy never forgot the October 1960 run. He recognized the reality that it signified, meaning that going forward, both international and domestic economic policy would be more complicated.6

The reason the balance of payments posed a problem for expansionary domestic policies was that they required relatively low interest rates. On the other hand, in an open global financial marketplace, higher interest rates abroad would draw funds out of American markets. Consequently, the balance of payments deficits would increase, inviting trouble from speculators and others eager to test American mettle over the dollar redemption policy.7

For the first two years of his presidency, then, Kennedy's fiscal policies did not depart too much from Eisenhower's. He kept in place the Long Run International Payments Committee, a Cabinet-level group dating from the Truman presidency. He also established a new Cabinet Committee on the Balance of Payments, to help coordinate international economic policy. Kennedy's appointments generally reflected a cautious attitude. To assuage the business community, he retained the Republican C. Douglas Dillon, now Treasury Secretary. His Treasury Undersecretary

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6 U.S. Treasury Administrative History, Chapter IX, 2 and Chapter XII, 2; Davis, "Politics of Prosperity," 67-8; Calleo, The Imperious Economy, 19.

for Monetary Affairs, Robert V. Roosa, was similarly discreet in his counsel and actions.8

Concrete policy achievements for most of Kennedy's tenure in international monetary policy also remained modest. The London Gold Pool, already mentioned, required the United States and the other major financial powers to feed gold into the open markets whenever the market price threatened to rise significantly above the official $35 per troy ounce price. Another stratagem was Operation Twist, a gimmick of Tobin's. This devise was designed to raise short term rates to discourage the flight of speculative capital. Simultaneously, Operation Twist worked to keep long term rates low for economic expansion. Still another strategy was the Interest Equalization Tax, (IET) a brainchild of Roosa's. The IET sought to discourage foreigners from borrowing in American capital markets by making it prohibitively expensive to do so. Roosa also worked to shift some burdens maintaining the international monetary system onto foreigners. Some of his plans involved negotiating credit lines and swap arrangements with their central banks. Kennedy authorized Dillon and his deputy, Henry H. Fowler, to prod the Europeans into opening and modernizing their capital markets. Because these markets had been insufficient to meet European demand, borrowers had

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made use of American capital markets and had widened the American balance of payments in the process. Finally, Kennedy pushed for passage of the Trade Expansion Act (TEA), which gave him authority to negotiate for reductions in trade barriers with America's European and Japanese partners and boost the trade surplus.  

Two institutional arrangements also emerged to deal with international monetary problems. The first was the Working Party 3 of the Economic Policy Committee of the Organization for Economic Cooperation and Development (OECD). Working Party 3 was a consultative body at which deputy finance ministers from the leading financial powers met every six weeks or so to primarily to discuss balance of payments concerns. Since its meetings were highly confidential, it did not release *communiques* of its deliberations.

The other institution was the creation of the Group of Ten (G-10). The G-10 consisted of those nations party to the General Agreements to Borrow (GAB). This arrangement lent the IMF money whenever it could not finance a member's payments deficits out of its own resources. Its most significant function, though, was to provide a forum for the

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leading financial powers to discuss international monetary reform. Thus, its proceedings were more open than those of Working Party 3. For the rest of the decade, the G-10 was the framework in which most study, deliberation, and haggling over monetary issues occurred. 

Although Kennedy accepted the constraints imposed by the international monetary system, they nevertheless frustrated him. Neither he nor most of his advisers wanted to abandon the any one of the goals that he had set. To do so would alienate a constituency that had supported Kennedy's bid in 1960. Fearing either a loss of prestige abroad, or a slide back into stagnation at home, the Kennedy administration could not do much to tackle the payments deficits head on. Consequently, they continued to stay the course.

The persistence of the deficits, though, had ignited spirited debate over possibilities for international monetary reform at home and abroad. The most strident criticisms of the American payments deficits came from Rueff. The Frenchman insisted that both the United States

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12 Davis, "Politics of Prosperity," 73-6, 87, 89.
and Great Britain, the two major balance of payments offenders, needed to discipline themselves fiscally and monetarily by returning to the classical gold standard. Rueff also proposed an increase in the price of gold because he wanted to see the auric metal restored as the center of the international monetary system. It was not only Rueff's neo-classical outlook, his Mont Pelerin connections, and his position as de Gaulle's unofficial adviser that influenced his thinking. In 1931, Rueff had been the economics attache at the French embassy in London. This post gave him an excellent opportunity to witness what he considered at the time to be British folly. From his observations, he had deduced that it was the departure from what had been a semblance of orthodoxy that had caused the international financial debacle of the 1930s. Rueff, like many Keynesians, always used the Great Depression years as a frame of reference, although he always warned against departing from orthodoxy. If gold's role were lessened, Rueff believed, rigid capital controls would have to stanch the spread of inflation. Unfortunately, these rigid controls would stifle investment, and another global financial catastrophe would result.\(^\text{13}\)

Most other economists and monetary officials generally ignored Rueff. For the time being, persons in positions of

\(^{13}\) U.S. Treasury Administrative History, Chapter XII, 4; Calleo, The Imperious Economy, 48-51.
responsibility also rebuffed another member of the Mont Pelerin circle, Friedman, because he advocated discarding fixed exchange rates. On the other hand, there were many observers who warned about the consequences of stopping the American payments deficits too abruptly. These analysts contended that the deficits were a key source for the liquidity that world trade and payments needed to ensure global prosperity. As the 1950s were ending, many economists and financiers began discussing the possibilities that the world was facing a liquidity shortage. The problem these observers saw was that there appeared to be no alternative sources of liquidity, such as larger accretions to the world's gold supply. Moreover, many analysts thought that the world's two major gold producers, the Soviet Union and South Africa, could not reliably meet the world's demand for liquidity in the form of gold.

Either way it appeared as if the United States could not decide in the right. Before long, this "dilemma" that

14 Milton Friedman had consistently advocated abolishing the fixed exchange rates of Bretton Woods since the early 1950s. See, for instance, his "The Case for Flexible Exchange Rates," in Essays in Positive Economics, (Chicago, 1966), 157-203.

the United States faced acquired the name "Triffin Paradox." The source of this name was the Belgian economist Robert Triffin, a professor at Yale who later developed ties with the Kennedy administration. Although Triffin sympathized with concerns that the American payments deficits were potentially inflationary, his Keynesian inclinations made him consider the deficits' liquidity effects. What Triffin did not want to see were austerity measures just to balance payments positions. His proposed solution was to transform the IMF into a global central bank, an idea that much resembled elements of Keynes' proposal for Bretton Woods some fifteen years before.\textsuperscript{16}

Other proposals appeared in addition to Triffin's, many of which were not as ambitious. Edward M. Bernstein, formerly White's assistant at Bretton Woods and later the IMF's Director of Research and Statistics, offered a plan. His idea would have broadened the gold exchange standard to include other reserve currencies in addition to the dollar and the pound. Later, Bernstein expanded his suggestions to involve the creation of a synthetic monetary unit backed by a basket of individual currencies strongly linked to gold.

\textsuperscript{16} U.S. Treasury Administrative History, Chapter XII, 4; Robert Triffin, Gold and the Dollar Crisis (New Haven, 1960), 38-58. The characterization of Triffin as a Keynesian can be found in Nau, The Myth of America's Economic Decline, 137. While Triffin was an international monetary specialist rather than a domestic macroeconomist, his concern to preserve full employment at home would make him at least Keynesian in his inspiration, if not in his actual policy analysis.
A related plan, the mutual currency account idea of the Conservative Chancellor of the Exchequer, Reginald Maudling, reflected Britain’s desire to induce surplus countries to help shore up sterling. Essentially, Maudling’s scheme would have permitted central banks to use dollars, pounds, or any other currencies of deficit countries to put claims on an account made up of other currencies. Despite Maudling’s persistence, though, his foreign peers understandably ignored his proposal.17

A number of monetary officials, including such G-10 members as France, were eager to entertain reform proposals. The French, though, wanted to see a restoration of gold to prominence in the international monetary system. Kennedy declined to initiate international monetary reform, however, despite support for it from Heller and George Ball, the Assistant Secretary of State for European affairs. The President deferred to the counsel of Dillon, Roosa, and the Chairman of the Federal Reserve, William McChesney Martin. These three men argued that if the United States negotiated from a position of weakness, such as continually running payments deficits, it risked having to accept constraints on

its freedom of action in either domestic or foreign policy. For the time being, then passivity was the American stance on international monetary issues, although American officials continued to participate in discussions in such organs as the G-10.¹⁸

Nevertheless, Kennedy was about to make a critical policy decision that would make resolving international monetary measures even more difficult for the United States. In 1962, he finally accepted the Keynesian-inspired notions of his CEA, mainly because he feared that the stock market crash of that year would be the catalyst for a serious recession. More importantly, though, the Republican Dillon also converted. The Treasury Secretary's change of heart was very important, because he shaped the form that the Keynesian-influenced measures that the Administration pushed. Orthodox Keynesians and advisers such as John Kenneth Galbraith had offered a plan for tax increases and increased deficit spending. To the dismay of Galbraith, who sought to achieve income redistribution, Dillon advised Kennedy and the CEA to reject that plan. As Dillon rightly noted, the CED and other members of the business community would never go along with it. Instead, Dillon persuaded the president and the CEA to push for a tax cut. Combined with slight increases in spending, or none at all, this scheme would create the stimulation that everyone wanted. To

persuade conservative legislators, the CED, and other segments of the business community, Kennedy and Dillon mounted a public relations campaign. Over the next year and a half, the campaign built momentum, eventually winning over the amount of public support required for the tax cut’s passage.\(^{19}\)

Of course, Kennedy did not live to see many of his initiatives in domestic and economic international policy come to fruition. It would be his successor’s responsibility to shepherd them through the legislative process and then administer them once they became law. Nevertheless, Johnson could not escape the conflicts embedded in the particular choice of policies that Kennedy had made. He too, had to contend with the difficulties of running simultaneously an activist fiscal policy and an open international monetary policy.

Nobody knew what Johnson’s opinions were on any of the economic issues bequeathed to him when he assumed office. Although a New Dealer in his early career as an aspiring Texas politician, Johnson’s postwar voting record in the Senate revealed his predilection for a moderate course.

between the liberal and conservative wings of his party.\textsuperscript{20} As Vice-President, Johnson was excluded from many policy discussions, including the economic issues. Almost as soon as he had been sworn in, Dillon and Heller caught him up on his homework with briefings about domestic and foreign economic issues. Johnson first turned his attention to the tax cut that Kennedy had proposed. He marshalled all of his legendary legislative skills on its behalf and signed it into law as the Revenue Act of 1964.\textsuperscript{21}

More than any piece of legislation, this measure signified the triumph of the New Economics, as it was often called, in the United States. In the process of pushing for its passage, Johnson experienced an epiphany: he became a votary of the New Economics, embracing it with all of the enthusiasm of the newly-converted. He and his CEA inherited a healthy working relationship grounded in mutual respect. Thus, he left untouched the domestic and foreign economic policy apparatus of his predecessor. Moreover, Johnson, who lacked formal economic training but possessed tremendous natural intelligence, probably felt comfortable working with the CEA on an equal intellectual footing. Many of the CEA officials were not part of Kennedy's coterie of Eastern

\textsuperscript{20} Johnson, The Vantage Point, 104, 327; Paul K. Conkin, Big Daddy from the Pedernales: Lyndon Baines Johnson, (Boston, 1986), 81, 82, 84, 91, 92, 101-2, 104, 105, 124-47.

\textsuperscript{21} Kettl, "The Economic Education of Lyndon Johnson," 55-7.
Establishment advisers. Instead, they were Midwesterners. Heller and Ackley reciprocated the admiration. Later, Ackley reflected with pride that he and Heller could write succinct memoranda that distilled requisite information simply.  

The Revenue Act of 1964 also seemed to work immediately. Within a short while, Heller could proudly inform his chief that the economy was thriving from the auspiciously-timed tax cut. The boom in 1964 helped Johnson defeat his opponent, Barry Goldwater, in the presidential contest that year. The reputations of the New Economists waxed even more. Keynes himself was commemorated as Time magazine's Man of the Year, although Friedman was quick to infer that the New Economics was not exactly Keynesian orthodoxy per se, but rather a simplification of it.  

In 1964, then, the domestic economic objectives of the Johnson administration had fallen into place: full employment, economic growth to fund an array of domestic and foreign problems, and price stability guaranteed by voluntary wage and price guidelines. Johnson sought to avoid at all cost the sharp downturns of the 1930s, and the

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24 Ibid., 55-7; Matusow, The Unraveling of America, 57.
milder fluctuations of the 1950s. To the New Economists, these objectives appeared quite attainable. They thought that they could make the business cycle obsolete.\textsuperscript{25}

Of course, this set of priorities had to account for certain problems. One was their relationship with domestic monetary policy. The wage and price guidelines did not always work, which endangered the stimulative growth policies. In December 1965, this is exactly what happened. Martin, ever on the lookout for inflation, increased interest rates by half of a percent, in December, much to Johnson's ire. Moreover, an easy monetary policy could very well exacerbate the balance of payments deficit, especially if American rates were lower than those elsewhere.\textsuperscript{26}

The balance of payments question, however, discomforted Johnson. Although he understood the problem, he probably would have preferred not to deal with it. Perhaps this was because he was aware of his lack of formal economic training, as some observers have noted about him in foreign affairs.\textsuperscript{27} His forte was domestic policy and he wanted above all else to bequeath a generous domestic legacy to the

\textsuperscript{25} Anderson and Hazelton, \textit{Managing Macroeconomic Policy}, 5-6.

\textsuperscript{26} Matusow, \textit{The Unraveling of America}, 164-5.

\textsuperscript{27} Frederick L. Deming, \textit{Oral History}, Tape 2, 45, LBJ Library. Nevertheless, some observers noted that he had an inferiority complex based upon an inadequate formal education. See, for example George McGhee, \textit{At the Creation of a New Germany: From Adenauer to Brandt, An Ambassador's Account} (New Haven, 1989), 116, 130-1.
American people. Later, the Vietnam War absorbed all of his attention. As a rule, then, the daily operational responsibility for the financial questions became the province of the responsible Cabinet secretaries, particularly the Treasury Secretary, and specifically designated aides.\(^{28}\) As Nau has stated, and as the rest of this dissertation will show, Johnson intervened only to resolve intractable bureaucratic disputes or disagreements with foreign governments.\(^{29}\) He expected his deputies to keep him updated on the international monetary situation, but he still remained passive on international monetary policy.

Unfortunately, for Johnson, the balance of payments problem would not go away. Since it tended to improve in 1964, he could freely ignore it. Beginning in November, however, the situation deteriorated, forcing Johnson to attend to it after the election. By year’s end, the deficit would be worse than that of 1963. Again, the primary source of the widening was private capital that foreign borrowers and American corporations used to expanding abroad. Also,

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\(^{28}\) Anderson and Hazelton, *Managing Macroeconomic Policy*, 180-6, 190.

\(^{29}\) Nau, *The Myth of America’s Decline*, 149.
expenditures of American tourists contributed their share.³⁰

The situation worsened in 1965. First, an American dock strike hurt the trade figures, which of course aggravated the payments deficits. Shortly afterward, a sterling crisis loomed. Any American attempt to defend the pound would also cost in terms of deficits and destabilize the international monetary system.³¹

What finally moved Johnson to action on the balance of payments was a stunning announcement that de Gaulle made on 5 February. From now on, *Le General* proclaimed, the French central bank, the *Banque de France*, would redeem all dollar balances for gold save those needed for working balances.³²

De Gaulle's announcement represented an intensification of his anti-American policies. Observers then and since have attributed de Gaulle's pronouncement to Rueff's triumph over French officialdom and Finance Minister Valery Giscard

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d'Estaing. Giscard d'Estaing was not as enthusiastic about gold as was Rueff.\footnote{Gardner Ackley, "Memorandum for the President: Jacques Rueff and Gold," 17 April 1965, FI 9 Monetary Systems, Box 44, C.F., LBJ Library; Loriaux, France After Hegemony, 87-8.}

Johnson acted a few days later. On 10 February 1965, he announced a voluntary balance of payments program for American businesses and banks. His advisers had rejected a tourist tax, however.\footnote{U.S. Treasury Administrative History, Chapter X, 14, 17; Chapter XII, 17-8.} The program urged American corporations and banks not to make any overseas investments in 1965 from domestic sources. Administration of the program for businesses was left to the Commerce Department, while the Federal Reserve would oversee the program for banks.

The program itself had been some months in the making. In November 1964, the Cabinet Committee on the Balance of Payments, under Dillon's chairmanship, began discussions on measures to limit capital outflows. Commerce Secretary John T. Connor favored a voluntary program, arguing that the administration could set up a voluntary program more quickly than a mandatory one. A mandatory one would have required time-consuming congressional deliberation. Besides saving time, a voluntary program would also encourage more willing cooperation from businesses and banks by appealing to their patriotism. Connor was a persuasive advocate. After a few
months of discussion, the Cabinet Committee recommended the program just in time for Johnson's February announcement.\textsuperscript{35} 

The 1965 program proved to be quite successful, despite some initial skepticism from certain quarters such as the CEA. Over the year the balance of payments deficit dropped significantly. The program generated results as early as the spring.\textsuperscript{36} 

Ultimately, however, these events that began in February 1965 prompted the Johnson administration to reverse previous American passivity. Once the balance of payments began to improve, fears among Johnson's advisers over the Triffin Paradox began to resurface.\textsuperscript{37} Also, Johnson officials wanted to find ways of minimizing the declines in American gold stocks that resulted from de Gaulle's policy. 

As with other fundamental changes in economic policy, international monetary questions required considerable intellectual effort and preparation. This preparation had been going on for some time. Since 1962, American officials 


\textsuperscript{36} The 1966 \textit{Economic Report of the President}, 160, 162-3, attributed the improvement in the balance of payments, largely to the February 1965 program, because it effectively reduced the outflows of capital. The 1974 \textit{Economic Report of the President}, 350-1, shows the net liquidity balance at $2.7 billion in 1964, $2.5 billion in 1965, and $2.2 billion in 1966. 

\textsuperscript{37} U.S. Treasury, \textit{Administrative History}, Chapter XII, 18-9.
had participated in studies among themselves, with their foreign counterparts, and with outside experts, largely within the G-10. Until 1965, though, it had been the French who provided the leadership for international monetary reform. They had pushed a gold-based composite reserve unit (CRU) to supplant the dollar.\(^{38}\) Officially, the Americans had remained devoted to the status quo, of course, because of the split among top Cabinet advisers about initiating active negotiations. As has been mentioned, Treasury and Federal Reserve officials had prevailed in this intra-Cabinet debate.

Still, those State Department and CEA officials who desired to see the United States take the lead in making reform proposals continued to maneuver. More than likely it was Heller and Ackley who were worried lest a delay on an American reform initiative might jeopardize domestic growth policies.\(^{39}\) In 1962, the CEA had commissioned the Brookings Institution to prepare a study of the American payments deficits over the next several years. This study, under the direction of economists Walter S. Salant and Emile Despres forecast that by 1968, the United States would bring its payments deficits into equilibrium. The implication of

\(^{38}\) U.S. Treasury Administrative History, Chapter XII, 4, 13.

\(^{39}\) Ibid., 5-6. Unfortunately, the names of the officials involved are not given, but the context suggests that they were Heller and Ackley.
this conclusion was that the G-10, or some other appropriate group, had to find an alternative source of monetary reserves to fund increasing levels of trade. Although the study's findings did not sway all informed observers, it did provide justification for those administration officials who wanted to see the United States take greater action in the ongoing liquidity debate.40

Another study followed in 1964, this time by the deputy finance ministers of the G-10 under the chairmanship of the Americans Roosa and Federal Reserve Governor J. Dewey Daane. The purpose of this 1964 study, commissioned by the G-10 ministers a year earlier, was to clarify the issues and synthesize current reform proposals into acceptable options. It refined the terms of the liquidity debate but did not recommend any one course of action. The essential conclusion was that world liquidity was currently adequate but potentially in need of supplementation in the future. Included in the study was an American recommendation for an immediate 25 percent increase in IMF quotas. An idea commonly labeled "multilateral surveillance" was also introduced. This idea meant that all of the G-10 nations would monitor each other's payments positions and possible

needs for reserves. Finally, the study recommended a followup study to further clarify the issues.41

Dillon, Roosa, and Heller reviewed this study and Heller passed their observations on to Johnson. Their feelings were mixed. They did not like multilateral surveillance because, in their words, it would put a straightjacket on liquidity and growth. So too would the French CRU scheme, because it had strong ties to gold. On the other hand, expanding the IMF's role by increasing quotas and vesting it with the responsibility to create liquidity appealed to the three men.42 This latter proposal would actually shift some of the costs of maintaining the IMF onto other members, such as the Europeans.

The September 1964 IMF annual meeting in Tokyo approved the American proposal to increase IMF quotas by 25 percent. Debate on the proposal was lively. The French and the other Europeans feared that the United States was trying to make the IMF a debtors' club. Dillon had to reassure the delegates that the United States was taking every available step to bring its payments deficits into line before a vote

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could occur. Aside from the vote, the G-10 finance ministers requested a second study from their deputies. This study, under the chairmanship of Bank of Italy official Rinaldo Ossola, completed its recommendations by the following summer.\textsuperscript{43}

Study efforts occurred among Johnson's advisers as well. In early July 1964, Johnson authorized a task force to review American foreign economic policies, with emphasis upon the foreign aid program. He most likely wanted this review to help him in future battles with Congress over foreign aid, which in the past had been contentious. National Security Adviser McGeorge Bundy and his deputy, Francis M. Bator, had primary responsibility for the study. Former Kennedy official Kaysen actually headed the task force. Prominent academic economists such as Tobin and Despres also participated. So too did prominent officials such as Roosa.

The task force completed its report in late November 1964. Despite its focus on foreign aid, it also looked carefully at international monetary reform. The task force recommended American leadership on reform in order to have the monetary resources for other policy objectives and to protect American gold reserves. It also insisted that the deficits somehow be ended for the sake of preserving

\textsuperscript{43} De Vries, \textit{The International Monetary Fund}, 39-42; Solomon, \textit{The International Monetary System}, 71-2.
American credibility. One possible solution the study mentioned was to obtain long-term loans from the creditor Continental Europeans or the IMF. Another was to develop an orderly system of creating reserves once the balance of payments deficits ended. These new reserves had to be independent of gold. To achieve many of these goals, the task force stressed working within the G-10, if possible. If cooperation eluded the United States, the task force recommended splitting the creditors, particularly the Germans and the more sympathetic Italians from the French and their Benelux allies.44

What one can deduce from the above information is as follows. By late 1964, those people inside and outside the American government favoring international monetary reform had reached an intellectual consensus. Importantly, the United States would have to preserve its Bretton Woods responsibilities, or bear the responsibility for a possible catastrophe. It would also have to provide for two contingencies: an end to the payments deficits and the continuation of supplying liquidity. The creation of synthetic monetary units would address both. Moreover, the American proposal would have to continue providing a smoothly running international monetary system that would not entail domestic sacrifices. Of course this would

44 Report of the President's Task Force on Foreign Economic Policy, C.F. Oversize, Box 156, LBJ Library.
require the Europeans to pick up more of the burdens of managing the system. Obviously, the Americans saw no problems with this. Unlike the immediate postwar years, when they were destitute, the Continental Europeans were now prospering.

Key personnel changes also changed the American attitude on international monetary reform. In the spring of 1965, both Dillon and Roosa left the Johnson administration to pursue business interests. Shortly after leaving public office, however, both men abandoned their caution and forcefully reflected the more activist stance developing within the administration. Roosa publically proposed the creation of a synthetic reserve unit similar to the Bernstein proposal. Dillon urged the need to make further progress on international monetary reform. The influence of these two men, though, was not limited to public speechmaking. They always remained available to provide advice for American policy.45

Their successors were experienced, capable, and eager to take action. Johnson tapped Dillon's former deputy, Fowler, who had left public service in 1964. In contrast to

Dillon, Fowler possessed better Democratic credentials. He was born in 1908 in Roanoke, Virginia, took his law degree from Yale, and in 1934 was admitted to the Virginia bar. He then became a New Dealer, accepting a number of legal appointments that began with service as counsel for the Tennessee Valley Authority. Bad eyesight kept him out of wartime military service, but he did hold several civilian appointments, including a stint on the War Production Board. During the Korean War, he occupied similar war mobilization positions, eventually heading the Defense Production Administration. Fowler returned to private law practice during the Eisenhower years, but he remained active in Democratic politics. In 1961, he reemerged in public life to become a deputy Cabinet official, but went back to private practice three years later.

Now, in the spring of 1965, Johnson was asking Fowler to head the Treasury. Fowler's demeanor did not suggest that he would lend himself easily to Johnson's celebrated "treatment." By all accounts, he was quiet and punctilious. Widely respected for his integrity, Fowler would not hesitate to register disagreement when he thought it necessary. Still, he possessed many assets that commended him to Johnson. An important one was that he was generally a team player, something that mattered tremendously to a President who insisted upon loyalty. Moreover, Fowler possessed critical links to the business community.
Johnson delegated the administration of international monetary policy to Fowler. Fowler had to see to it, of course, that it harmonized with other administration objectives. Thus, during his tenure, Fowler had considerable latitude and authority. Given Johnson's informal but intimate involvement in all aspects of his administration, Fowler reported quite frequently to his chief.46

Frederick L. Deming, Roosa's successor, lacked his predecessor's reputation as an international monetary expert, but did have a solid record as a devoted public servant. A careerist with the Federal Reserve, Deming eventually became president of its Minneapolis branch. He was serving in that capacity when Johnson asked him to become Treasury Undersecretary for Monetary Affairs. Like Fowler, Deming was skilled, for the most part, at carrying out the administration's directives on international monetary policy.47

The appointments of Fowler and Deming arrived in time to lend support to a bolder American stance in international monetary affairs. Two officials who were especially pleased

46 Robert Vexler, Vice Presidents and Cabinet Members, Volume II, Robert Sobel, ed. (Dobbs Ferry, NY, 1975), 742-3; Biographical Directory of the United States Executive Branch 1774-1977 (Westport, CT, 1977), 123-4; Solomon, The International Monetary System, 80, McQuaid, Big Business and Presidential Power, 234.

47 Deming, Oral History, Tape 1, 1-2.
were Bator and Ackley. Bator had been responsible for providing the wording in Johnson's February 1965 balance of payments message calling for a more urgent international monetary reform. Ackley, who had just succeeded Heller as CEA Chairman, had agreed with Bator. He was concerned about resistance from Treasury and the Federal Reserve, however. With Fowler's support, though, Bator and Ackley began to persuade Johnson to take action.48

Johnson accepted this advice. He sent a seminal memorandum to Fowler on 16 June 1965 that contained the essence of Bator and Ackley's recommendations. This memorandum became the guiding policy statement for all the administration's subsequent activities in international monetary matters. Johnson authorized Fowler to prepare for international monetary negotiations within the G-10, following the guidelines of the now-emerging American policy. The President requested that the Treasury Secretary establish two task forces to develop a negotiating strategy designed to improve the international monetary system. Johnson expressly stipulated that one task force be intragovernmental and consist of Treasury, State Department, Federal Reserve, CEA, and other White House officials. A second task force, consisting of outside consultants, was to

include persons such as Dillon, Roosa, former Budget Director Kermit Gordon, and other sympathetic officials and experts. These two study groups were not to supplant the work of other groups, Johnson continued, but to complement them.

Johnson was also explicit in his instructions as to the issues he wanted the two study groups to tackle. These issues were based upon what had evolved intellectually over the past three years. Johnson's first specific concern dealt with French policy. He wanted Fowler and the other study groups to devise possible ways to deflect any coercion to convert large dollar balances into gold. He also wanted to know if the United States could obtain, if needed, a large, long term loan. Such a loan would prevent the need to devalue or deflate. The former would make America's overseas obligations more expensive, while the latter would cause domestic recession.

Johnson's third request not only reinforced the concerns behind his first one. It also authorized creating a new reserve asset. The new asset would have to provide for full employment, stable prices, and expanded world trade. All three, of course, were elements required to avoid another massive economic slowdown that had occurred over thirty years earlier. Moreover, Johnson was concerned that the asset would eventually have to stand by itself. He stated that he did not want the new asset to be as unstable
as the dual-reserve gold exchange standard. A dual-reserve standard might tempt massive conversions from one medium into another. That instability, of course, would prevent the ultimate objectives of a secure international monetary system from being attained.

Johnson's memorandum also contained instructions about another pressing and related issue that will receive more thorough analysis in subsequent chapters: the persistent difficulties with sterling and the problems that they posed for other aspects of American policy. The President labeled this issue a "major foreign policy concern." He requested that the intragovernmental study group come up with ideas to relieve speculative pressure on sterling. Great Britain needed a "four- or five-year breathing space" to rehabilitate its economy. It could not resort to avoid another devaluation, exchange controls, or disengagement from East of Suez or the Rhine.49

As the preceding paragraphs show, Johnson's instructions to Fowler thus represented a culmination of American thinking that had been occurring for the past three years. The strategy that he had been outlining since February acknowledged American responsibility for correcting its payments deficits. It also remained consistent with other policy goals: preserving the Bretton Woods system,

49 This memorandum is reproduced in full in Johnson, The Vantage Point, 597-8.
although in a modified form, while allowing the United States the latitude to realize other policy goals. The strategy entailed considerable risk, as it sought to pursue objectives that increasingly worked at cross-purposes with each other. It also assumed, implicitly, that the United States could control the process of reconciling these goals. In a dynamic world, where not only America's allies but also the emerging developing nations were beginning to assert themselves, this task would be daunting.

Fowler began acting upon Johnson's instructions. As requested, he soon established the two groups. He placed his deputy Deming as chairman of the intragovernmental study group, which then bore his name. The Deming Group met after that in the greatest secrecy on a very frequent basis to formulate strategy. Besides Deming, its membership included Bator, Daane, Okun, the American IMF Executive Director William B. Dale, Assistant Secretary of State for Economic Affairs Anthony Solomon, and Assistant Secretary of the Treasury Merlyn N. Trued. Fowler tapped his predecessor to chair the outside consulting body, which became known as the Dillon Committee. Besides Dillon, the membership included Roosa and Gordon. Outside members included Bernstein, whom the Johnson Administration retained as a consultant; Andre Meyer of Lazard Freres; Charles P. Kindleberger, a noted economist and economic historian at the Massachusetts Institute of Technology; and David Rockefeller of Chase
Manhattan Bank. Paul A. Volcker, who was still in the Treasury as an undersecretary, would soon leave to work at Chase Manhattan but would frequently accompany Rockefeller to committee sessions. The Dillon Committee met less frequently than the Deming Group, usually monthly. While the Deming Group was the senior body, the fact that Fowler and Deming sat in on Dillon Committee meetings ensured a cross-fertilization of ideas.\(^5^0\)

Soon after these committee appointments, Fowler began preparing a speech he was to give before the Virginia State Bar Association’s summer convention. The purpose of the speech was to publicize the change in administration policy regarding international monetary reform. Fowler then retreated to his summer home on Cape Cod to collect his thoughts. When he returned to Washington, Fowler briefly conferred with Volcker, who had not left the administration, and the British Chancellor of the Exchequer, James Callaghan. Callaghan was in Washington seeking assistance for a prospective sterling crisis. Nevertheless, the two men also exchanged ideas about international monetary reform.\(^5^1\)

Fowler gave the speech as scheduled on 10 July 1965, which articulated many of the themes this chapter has


\(^{51}\) Volcker and Gyohten, *Changing Fortunes*, 44.
already discussed. After emphasizing the connection between sound money and security, Fowler explained the importance of international monetary reform. Then, he argued that the United States had to help create another source of liquidity. Fowler was thinking that February's voluntary program might generate a balance of surplus by the end of the second quarter. The biggest revelation he made, though, was that Johnson had authorized him to reveal that the United States was ready to participate in an international monetary conference. This conference, akin to the one at Bretton Woods twenty-one years earlier, was to come up with solutions based upon existing reform proposals.52

One American official, McGeorge Bundy, accurately observed how Fowler's proposals embodied the President's activism. Bundy termed them "highly Johnsonian." In his eyes, they carried an implicit aim of establishing a firm monetary base for global, and hence domestic American, economic growth. Support from many quarters was positive. Shortly after Fowler delivered his speech in Hot Springs, the G-10 deputies working under Ossola finished their recommendations, which further narrowed the options for reform. In August 1965, Reuss' Joint Committee released a

report based on testimony that they had been gathering over the previous years. The committee’s findings supported the broad objectives of the administration’s international monetary reform efforts. The Managing Director of the IMF, Pierre-Paul Schweitzer, likewise expressed support.\(^5\)

It might be argued that Fowler’s speech reflected the optimistic hopes that had been building in other areas of policy. The tax cut was working its stimulative effects without, it seemed, any sign of problems. So far, in other areas also the Johnson administration had enjoyed successes, especially in the areas of social reform. Looking from the vantage point of midsummer 1965, then, Fowler’s speech seemed well in tenor with other policy developments.

The Hot Springs address marked a turning point in American attitudes towards international monetary reform. Previous passivity, the result of a sense of frustration, if hopelessness, had given away to a willingness to exert leadership. The groundwork was well prepared intellectually and psychologically. Developments elsewhere only served to act as the catalyst for the Johnson administration to move

\(^5\) Telegram, McGeorge Bundy to Bill Moyers, 11 July 1965, Francis M. Bator Chron File (Bator Chron File), 1 July-31 August 1965, Box 2, National Security Council Chron File (NSC Chron File), LBJ Library; U.S. Congress, Subcommittee on International Exchange and Payments, Joint Economic Committee, Guidelines for Improving the International Monetary System; U.S. Treasury Administrative History, Chapter XII, 23; de Vries, The International Monetary Fund, 64-8.
in the direction where it seemed headed anyway. It certainly looked as if the administration was finally able to square a difficult policy circle. The United States could reassert financial leadership while avoiding austerity.

As the next chapter will show, however, the administration’s challenges were only beginning. Negotiating reform would not be easy, as the United States had credibility problems to overcome. Developments in other areas and the need to preserve the international monetary system from other shocks complicated the Americans’ task. The administration could perhaps have reason to foresee these events, as these had their roots in ongoing developments. Still, the most intractable development had yet to manifest its ramifications. The Vietnam War was only beginning just as Fowler was speaking. Nobody could know what its results might bring. In the end, of course this conflict intruded onto every aspect of American policy. International monetary policy was no exception.
This second chapter focuses on the negotiations among the G-10 and IMF officials that resulted in the creation of the Special Drawing Rights, or SDR’s, in the early spring of 1968. These negotiations reflected the fundamental problems that afflicted the alliance binding the United States, Great Britain, and Western Europe. The most salient problem, though, that the negotiations revealed was how the costs of supporting the international monetary system would be allocated. This vexing issue pervaded the SDR negotiations on all of the major points of disagreement, since the negotiations were no less than a major alteration of the postwar Bretton Woods system.

The fundamental difficulty that remained, of course, was the American balance of payments deficits. The previous chapter has fully explored the dilemmas that they posed for American policymakers, whether they continued or were ended. Until 1966, American officials actually worried about the effects of stopping the balance of payments deficits rather than letting them run without ceasing. The goals for
American international monetary diplomacy for the next three years, then, were to carry out the directives that President Lyndon B. Johnson had sent to Secretary of State Henry H. Fowler in June 1965: protecting American gold stocks from abusive conversions and ensuring adequate liquidity for the world economy. Avoiding domestic austerity was likewise a goal.¹ Fowler clearly enunciated the reasons driving these goals in his Hot Springs speech. The reasons comprised the gamut of domestic and international imperatives that the Johnson administration considered indispensable.

Nevertheless, the negotiations were prolonged and contentious. The primary reasons why were the misgivings of the Continental Europeans in general and the French in particular.² As has been mentioned, the French position in the international monetary talks reflected their opposition to American leadership in other areas. In general, though, the Europeans, who were running surpluses, did not think that the Americans were serious about putting their payments in order and following the appropriate domestic policies required of deficit nations. Moreover, the Germans, who were steering the course between the Americans and the French, became more resistant to American wishes as the negotiations continued. Part of this resistance came from a

¹ U.S. Treasury Administrative History, Chapter XII, 26-27A.
change of government. No doubt part of it also came from irritation at being coerced to provide assistance to the American balance of payments in other areas, such as the offset agreements mentioned in the introduction.

The SDR negotiations, then, took on the character of a struggle between debtors and creditors. The deficit country Americans, even as they articulated their plan as a reform, still wanted the Europeans, in effect, to finance part of it. The Europeans resisted. The issues that particularly became contentious were the nature of the new synthetic monetary reserve itself, its use, or how it would be transferred from one country to another, the extent to which a country had to accept them, and the voting procedures employed to activate the plan to them. Another consideration, expanding the negotiations to include non G-10 members, was eventually resolved by allowing the IMF to act as their proxy.

Other issues also made the negotiations difficult. One was the set of troubles that Great Britain had with sterling. The sterling situation had severely destabilizing effects upon the international monetary system as a whole.³ The details of sterling's difficulties are discussed more thoroughly in the following chapter. Nevertheless, they

³ U.S. Treasury Administrative History, Chapter XII, 33.
worsened just as the United States was finally clinching the international monetary plan that was being negotiated.

The most pernicious development that affected the American balance of payments and the international monetary relations, though, was the Vietnam War. At no time did the United States seek to use the SDR negotiations as a vehicle to finance the Vietnam War, even if they were aware that these effects were disrupting their efforts. In fact, the financial effects of this war were not at all evident during those seminal months in 1965, when the administration was formulating strategy for international monetary diplomacy.⁴ Over time, these effects manifested themselves with a vengeance, especially in 1967. If the balance of payments deficit measured in terms of the net liquidity balance was $2.5 billion for 1965, and down to $2.2 billion in 1966, by 1967 it had jumped to $4.7 billion.⁵ The particular effect that the war had on the balance of payments cannot be

⁴ U.S. Treasury Administrative History, Chapter XII, 19.

⁵ Economic Report of the President, 1974, 350-1. The net liquidity balance consists of the balance of current account (which includes net military transactions) and long term capital flows net of non-liquid short term private capital flows. The official reserve transactions balance, which includes the net liquidity balance plus liquid private capital flows, was, during this period, a deficit of $1.3 billion for 1965, a small surplus of $219 million for 1966, and a deficit of $3.4 billion for 1967. The surplus figure for 1966 can be largely attributed to the fact that a tighter monetary policy pursued that year induced a large inflow of funds into the United States. See 1967 Economic Report of the President, 179.
exactly quantified. Nevertheless, the damage to the payments position occurred not only in the foreign exchange costs of the war. It also stemmed from the deterioration in the trade balance that resulted largely from the inflation that the war induced. Not surprisingly, the problem became compounded, especially as the Americans were negotiating their plan for creating synthetic monetary reserves.

As pressures such as the Vietnam War and the situation with sterling converged, the American negotiators seemed to be in a race against time to fashion an arrangement that would be conducive to American interests. Ultimately, Fowler, his deputy Frederick L. Deming, and Federal Reserve Governor J. Dewey Daane managed to fashion an agreement that fulfilled many of the objectives that Johnson had originally stipulated in the summer of 1965. Still, there was no guarantee that the Bretton Woods could be saved, despite the reform that the Americans had midwifed.

As the previous chapter has mentioned, Fowler’s Hot Springs address received a favorable reception at home. The fact that he was proposing an international monetary conference on the same level of importance as the Bretton Woods conference or the ERP revealed his confidence that the United States could provide effective leadership. Nevertheless, the international monetary conference as such never came about. Fowler soon had to alter his tactics.
The Continental Europeans were deeply skeptical about the idea of an international monetary conference. They remained unconvinced that the United States was doing anything serious about its balance of payments deficits, despite the progress in 1965. The sudden American volte face did nothing to assuage their reservations. Generally, the Europeans considered the speech as a possible American call for help for the summer's prospective sterling crisis. French President Charles de Gaulle wanted no part of any American effort to assist sterling. If a sterling run worsened the American balance of payments, that was the Americans' problem. Consequently, he withheld Banque de France participation in a multinational loan to the British. Fowler and Federal Reserve Chairman William McChesney Martin were arranging this loan to thwart speculators.6

To induce the Europeans to join in an American-led reform initiative, the Johnson administration jettisoned the idea of an international monetary conference. Instead, Fowler worked to obtain European assent for a contingency plan that could create synthetic reserves if needed. It took the rest of the summer and part of the autumn for him to persuade the European G-10 nations to join in making a contingency plan. He began politicking for such a plan in

late August, when he flew to Europe to meet with his fellow finance ministers at their capitals. His first stop, in Paris, proved to be fruitful. Once he had reassured the French finance minister, Valery Giscard d’Estaing, of America’s intentions for planning only, the other European finance ministers became more receptive to an American initiative. He did not fully win the Europeans over until the IMF annual meeting in September in Washington, however. After Fowler made a pledge that the United States was doing everything in its power to reduce the payments deficits, the European G-10 ministers finally agreed on contingency planning only. The G-10 ministers then instructed their deputies to have a plan ready for the 1966 annual meeting.

The deputies soon set to work. Their task was twofold. First, they had to narrow down eight schemes that the Ossola Report (see previous chapter) had proposed as alternative plans. Second, they had to resolve the political and institutional issues that made resolving the more technical issues more difficult.

Since Robert Roosa had resigned from Johnson’s Cabinet earlier that year, the chairmanship of the G-10 deputies had

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7 U.S. Treasury Administrative History, Chapter XII, 24-5.
9 U.S. Treasury Administrative History, Chapter XII, 26.
fallen to the respected Dr. Otmar Emminger, a member of the Bundesbank's Governing Board. Being a German, Emminger had a difficult role to play throughout the negotiations. He had to strike a delicate balance between the two major protagonists, the French and the Americans. The fact that German negotiators had to navigate between Scylla and Charybdis, figuratively speaking, reflected the fact that they needed the support of both partners in different arenas of their foreign policy. The French were their chief partners in the EEC, while the Americans were the guarantor of their security.10

The German position in the proposed liquidity exercise, therefore, attempted to split the difference between the French and the Americans. What happened during the negotiations, by the spring, was that the French and the Americans effectively shifted their positions on international monetary reform. As the Americans were emerging as the leaders of reform, the French would withdraw from active participation altogether. The Germans disagreed with the French refusal to support reform of any kind. They also disliked the American payments deficits, however. Consistently, the Germans drew a clear distinction between contingency planning, on one hand, and the actual creation of reserves, on the other. This German emphasis upon

10 U.S. Treasury Administrative History, Chapter XII, 25; Strange, International Monetary Relations, 229; McGhee, At the Creation of a New Germany, 132-3.
discipline naturally reflected their own bitter history of monetary chaos in the twentieth century. If they were going to follow the American lead to some extent, they expected a *quid pro quo.*

In Washington, the procedure developed to formulate the American position was thus: extensive consultations between the Deming Group and the Dillon Committee, with frequent, informal briefings to Johnson. During the late autumn and early winter of 1965 and 1966, the American proposal slowly began to take shape. The Dillon Committee members reached quick accord among themselves on a number of issues, which were in accord with Johnson's instructions to Fowler the previous June. Everyone agreed on the major American goal: a monetary reserve to prevent deflationary measures at home and to protect gold stocks from foreign demands to convert large dollar balances. Therefore, the synthetic reserve had to avoid a rigid link to gold. Everyone also conceded that the IMF had a valuable role to play in the reserve creation process. Also, an acceptable solution had to downplay multilateral surveillance, the preference of some Continental Europeans, to as great as extent as possible. 

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11 Strange, *International Monetary Relations,* 230; U.S. Treasury *Administrative History,* Chapter XII, 27-B.

12 U.S. Treasury *Administrative History,* Chapter XII, 27-27-B; Draft Minutes, Advisory Committee on International Monetary Arrangements, 10 January 1966, International Liquidity: IMA Committee, Box 10, Francis M. Bator Papers (BP), LBJ Library.
Agreement on other issues was more difficult to achieve. Whether the synthetic monetary units were to be assets or credits was one. Most of the American officials favored non-repayable assets. The President of the New York Federal Reserve, Alfred Hayes, and his deputy, Charles Coombs, argued for credits and for a firm link to gold. Since the New York branch collaborated with other central banks in currency stabilization operations, Hayes and Coombs were sensitive to European concerns and speculator attitudes. Although they could not win over the other American officials completely, they did elicit some agreement for the need to offer a gold guarantee for any American proposal. 13

More disagreement occurred on the matter of opening the G-10 conversations to non-G-10 officials. The problem was that the non-G-10 developing countries thought that the G-10 was trying to foist onto them a plan that disregarded their interests, particularly the need for capital. In 1964, the Expert Group on International Monetary Issues of the United Nations Conference on Trade and Development (UNCTAD) came into being. The following year it published a report criticizing what they saw as being the exclusivity of the G-10. Fowler had acknowledged their concerns at the September

IMF meeting in Washington in a speech calling for a global Great Society. Not all the Americans were of the same mind, though. Former Treasury Secretary C. Douglas Dillon and Roosa, the two men who dominated the Dillon Committee, argued against including the non G-10 nations, for fear of alienating the Europeans unnecessarily or disturbing the currency markets.  

Other Johnson officials strongly disagreed because they did not want to antagonize the developing countries. Assistant Secretary of State for Economic Affairs Anthony M. Solomon, whose responsibilities included foreign aid, was one of these. He worried about how Dillon’s approach might resonate with the developing world, especially since Johnson was making deep cuts in foreign aid. Federal Reserve adviser Robert Solomon pointed out the possibility of courting allies among debtor IMF members.  

For the time being, the Dillon-Roosa line prevailed, however. Whatever Fowler had said in September, he was now concerned about having a plan as quickly as possible. Developing country concerns thus took second place.

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14 International Monetary Issues and the Developing Countries, (New York, 1965); de Vries, The International Monetary Fund, 73, 83-4; Draft Minutes, Advisory Committee on International Monetary Arrangements, 25 February 1966, Advisory Committee on International Arrangements, 24 March 1966, FP 179, LBJ Library.

Fowler’s major concern was the balance of payments. He was thinking that the progress in 1965 would continue through 1966. Improvement in the balance of payments had come largely through the 1965 voluntary programs. The Johnson administration had renewed these programs in 1966. Delay on a plan only put pressure on American gold stocks, Fowler reasoned, since ending the deficits would shut off this source of world reserves.\(^\text{16}\)

Nevertheless, the inability to resolve the differences only enabled the Deming Group to produce a cumbersome proposal labeled the dual approach. While attempting to bridge the differences between the surplus and deficit countries, it eventually satisfied nobody. The approach derived its name, dual, from the fact that it featured two distinct types of reserves: a reserve asset independent of gold for the G-10, and repayable enlargements of IMF drawing rights for non-G-10 nations.\(^\text{17}\)

Nor had the Deming Group members precisely defined the character of the asset. At this point, though, they did

\(^{16}\) Draft Minutes, Advisory Committee on International Monetary Arrangements, 10 January 1966, International Liquidity: IMA Committee, Box 10, Francis M. Bator Papers (BP), LBJ Library; Anthony M. Solomon to the Acting Secretary, 14 January 1966, January 66, 2 of 2, Box 12, Anthony Solomon Chron File, LBJ Library; Draft Minutes, Advisory Committee on International Monetary Arrangements, 21 January 1966, International Liquidity: Dillon Committee, BP 10, LBJ Library.

\(^{17}\) Anthony M. Solomon, ibid.; U.S. Treasury Administrative History, Chapter XII, 29; Solomon, The International Monetary System, 128-9.
envision that it would not have a link to gold. Deming Group members agreed that central banking authorities should have to accept some sort of minimum amount of units in order to make the proposal workable. The minimums, or acceptance limits, that they agreed upon were the lesser of three times a given allocation of new assets or two-thirds of the total assets outstanding. Also, the plan permitted repurchases of gold with the assets. This provision was an obvious benefit to the United States, as it would help protect domestic gold stocks. Although this proposal was cumbersome, it still represented a significant departure from the status quo stance of the Kennedy years.18

Deming and Daane first presented the dual proposal at the deputies January 1966 meeting. Other countries had also developed proposals, however. The British continued to push for a variation of their mutual currency account. The other deputies gave it polite attention, but, once again, no serious consideration. The deputies also examined a Canadian proposal to create reserves for the GAB nations, with any one nation allowed to opt out of any reserve allocation.19

18 Anthony M. Solomon to the Acting Secretary, 14 January 1966, January 66, 2 of 2, Box 12, Anthony Solomon Chron File, LBJ Library; U.S. Treasury Administrative History, Chapter XII, 29.

19 U.S. Treasury Administrative History, Chapter XII, 29-30.
An EEC submission dubbed the Emminger proposal, so named because the G-10 deputies chairman introduced it into the conversations, had greater support. Although it tried to find middle ground with the Americans while preserving surplus country prerogatives, it completely excluded the non-G-10 nations from consideration. The Emminger proposal consisted of four parts. First, it restricted the creation of any new synthetic, nonrepayable reserve unit to those countries that had, at a minimum, strong convertible currencies. In return, these countries would extend credit lines to the IMF for other members. Second, it stipulated, as a technical matter, that the IMF hold the asset in a separate account. Third, it required a unanimous vote to put the plan into effect. After that, however, the IMF could resolve many issues by majority vote, with voting weighted according to IMF member quota contributions. Fourth, the reserve unit only could be used with an equivalent amount of gold.20

Both the dual approach and the Emminger proposal received thorough discussion during the negotiations of the winter and spring. Little progress emanated from these discussions, however. Aside from quibbling over the technical points of the plans, the biggest disputes centered around the relationship the reserve had with gold and the

voting procedures to activate the contingency plan. These issues remained unresolved until well into 1967. The Americans did not like the firm link that the Emminger plan maintained with gold, while the surplus Europeans insisted that it was necessary. The Europeans insisted upon the gold link. They did not like the fact that the Americans could avoid taking necessary domestic corrective measures. Also, the Americans disagreed with the unanimity voting rule of the European plan. Their observation was that this rule could allow one country, to disrupt a decision to create reserves.\(^{21}\)

The country that the Americans were concerned about here was France. Throughout these first discussions, the French had been showing their increasing opposition to any overhaul to the international monetary system, unless it involved restoring gold to primacy. Even the Emminger proposal did not preserve a firm enough link to gold in their minds. As the spring approached, they retreated from cooperation altogether.

At this point the turnaround in French and American differences was complete. Where once the French had taken the lead with the CRU proposal, they now stopped participating completely. De Gaulle, disconcerted that the

deputies were willing to move away from a prominent role for gold, completely abandoned his support for reform. It seemed that de Gaulle's move here mirrored other developments surfacing in his diplomacy. The previous year he had boycotted the Common Market. Now this trend seemed to develop more radically, and not only with this lack of cooperation in international monetary negotiations. It also included de Gaulle's withdrawal from the NATO military alliance in February 1966. Nevertheless, the French president's truculent behavior was risky, as Ackley confided to Johnson in March. The negotiating sessions of the spring and summer of 1966 proved Ackley right.22

If the issues of voting and the link to gold were not enough to divide the negotiators, another controversial issue soon emerged: the demand of non-G-10 nations to be admitted into the negotiations. Developing countries especially were continuing to protest the manner in which the G-10 were discussing international monetary issues. The UNCTAD report acted as a lightning rod for their complaints. The IMF managing director, Pierre-Paul Schweitzer, also criticized the G-10 nations' way of approaching international money. He was particularly critical of the

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American dual approach, which he caustically dubbed a "separate but equal" solution.\textsuperscript{23} No doubt this was a calculated, irritating remark designed to challenge American officials, such as Fowler, who wanted to broaden the negotiations in the first place.

Schweitzer thus began a campaign to widen the discussions. In an important speech he gave in Kronberg im Taunus, Germany, he played on a few historical fears of the experiences of the 1930s to make his point. After laying out this dark scenario, he closed by disclosing the substance of two plans that the IMF staff was drafting. Each plan contained different variations of proposals that monetary experts had been considering for years, including the American and EEC proposals discussed in the G-10. What the two IMF plans had in common, of course, was that they made provisions for the non-G-10 community's concerns.\textsuperscript{24}

Apparently, Schweitzer's speech made a difference in the deputies' negotiations. It gave Fowler, Deming, and Daane the support they needed to begin to push for an inclusive approach. Instead of letting all of the non-G-10 nations in on the conversations, though, they would invite the IMF to serve as proxy. There were two advantages to

\textsuperscript{23} De Vries, The International Monetary Fund, 84-5, 88.

making the IMF the proxy for the non-G-10 nations. As mentioned above, the IMF would provide more debtor allies in case of a showdown with the creditor Continental Europeans. Moreover, as Assistant Secretary of State Anthony Solomon observed, confining Third World complaints to the IMF forum would keep them from antagonizing the Europeans. After all, the Europeans' cooperation for a contingency planning was indispensable. Restricting discussions to the IMF would also pacify the markets.25

A shift in the attitudes within the G-10 was discernable as early as May. Later, as the deputies compiled the report that the ministers had requested the previous September, broadening the discussions appeared to be one of the few issues upon which most of them could agree. The deputies finished their report in time for the July G-10 ministers meeting at The Hague. Despite the disagreements contained in the report, the ministers endorsed it nonetheless. One minister dissented, however, and withheld his country's approval of the document: French

Finance Minister Michel Debre. Debre was far more orthodox about gold than his predecessor, Giscard d'Estaing, whom he had replaced earlier in 1966. Fowler, along with those American officials who had been favorably disposed to allowing other nations participate, had won a critical victory.26

All that remained was to ratify at the next IMF annual meeting what had taken place. In September 1966, it convened once again in Washington. During the meeting, Fowler busied himself at the separate caucuses of the G-10 and the non-G-10 IMF members to establish the format of the future meetings. He and Schweitzer persuaded everyone to accept the IMF governors and executive directors to negotiate on behalf of the non-G-10 community. With this issue now resolved, a second round of meetings could commence. Before adjournment, Schweitzer called for a reserve contingency plan to be drafted in time for the 1967 meeting.27

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27 U.S. Treasury Administrative History, Chapter XII, 34; de Vries, The International Monetary Fund, 102-3, 105.
The deputies and ministers had to resolve the outstanding issues from the previous spring before a plan could be written. The issues left unresolved from the July meeting at The Hague needed thorough consideration. To establish an agenda, the deputies and the IMF executive directors scheduled a meeting for late November to be held at IMF headquarters in Washington.

The Dillon Committee met about a week before the first scheduled joint session between the G-10 deputies and the IMF governors. With the IMF now participating in the discussions, Dillon suggested that the dual approach be quietly dropped sometime before January. What really concerned everyone present, though, was what the French might do. The concern was not spoken, but was on everyone's mind. To head off any sustained French opposition, everyone concurred that pressure on the Germans was desirable. The committee members also thought that some pressure on the Italians was appropriate because they appeared to be sympathetic to the Americans.28

Why Fowler, Deming, Daane, and Dillon were so worried about the French was because of some adverse developments becoming apparent. Chief among these was the American balance of payments situation, which was worsening and which

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28 Draft Minutes, 18 November 1966, Advisory Committee on International Monetary Arrangements, International Liquidity, IMA Committee, 16 September 1965 to date, BP 10, LBJ Library.
became a major liability for the American negotiators in 1967. The slight drop in the deficit during 1966 was primarily the result of the voluntary balance of payments program. This program offset the deterioration that was resulting from the Vietnam War. Fowler, in a press conference in May 1966, had conceded without saying as much that had there been no military action in Southeast Asia, the United States would have balanced its payments in 1966.²⁹

Nevertheless, the military buildup occurred throughout 1966 and 1967. Consequently, any progress on the balance of payments would be unlikely any time soon. Dillon was among those who recognized this, and feared their effects upon the international monetary negotiations. Within the confidential confines of the committee that bore his name, he expressed grave pessimism about being able to eliminate the deficit before the contingency plan was finished.³⁰

For the most part, the initial November meeting occurred without much incident. Everyone acknowledged all of the unresolved problems that they needed to address. One of these was the exact nature of the reserve, i.e., asset or a credit. The language used to describe precisely the


³⁰ Draft Minutes, 18 November 1966, Advisory Committee on International Monetary Arrangements, International Liquidity, IMA Committee, 16 September 1965 to date, BP 10, LBJ Library.
nature of the reserve was somewhat ambiguous, mainly because the United States wanted assets while the French and some of their more conservative EEC partners wanted credits. Other issues included the extent it would be linked to gold when transferred or used, the backing of the unit, or how it would be financed; and the voting procedures to create the reserves. 31

Although feeing chastened at being isolated at the July ministers meeting at The Hague, the French nevertheless tried to spoil the proceedings. Not having any alternative plans of their own to push, they proposed that gold should be placed on the agenda. Schweitzer rebuffed the French gambit bluntly. The price of gold would not be considered for any discussion. That still did not stop the French from raising the issue time and again as the negotiations progressed. 32

After the November preparatory meeting, the deputies met with the IMF executive directors for another session in January. They held two meetings by themselves in March and April. Little progress occurred on resolving any of the issues. The voting issue was particularly contentious for the time being. As to be expected, the surplus and deficit countries took opposite sides on voting. Everyone agreed that some form of weighted voting based upon IMF quotas was

31 De Vries, The International Monetary Fund, 119-21.
necessary. The differences existed over how to represent IMF deficit and surplus members for voting purposes. Generally, the Europeans, being surplus countries, favored either bloc voting or other methods to give surplus positions greater weight. The issue of opting out also surfaced. Some surplus countries supported this procedure because it would allow them to avoid participating and incurring the responsibilities of reserve creation. Other surplus representatives dismissed it, though, because they thought that this procedure lacked adequate protection against inflation. These representatives feared that the United States would export inflation via its balance of payments deficits.

Not surprisingly, the non-G-10 executive directors present strongly rejected bloc voting. Deming and Daane did not oppose bloc voting nearly as strongly. They did want to prevent minority factions, such as the French, from obstructing decisions to create reserves. As a compromise, Deming offered what the Americans termed a band proposal, which stipulated the minimum and maximum votes necessary to create reserves. By early April, after the deputies had met by themselves, the voting procedure remained undecided. The deputies scheduled another joint meeting with the IMF executive directors to take place later that month.³³

³³ Summary, Joint Meeting of the Executive Directors of the IMF and the G-10 Deputies, 25-26 January 1967, Lancaster House, London; Summaries, G-10 Deputies Meetings,
Meanwhile, two events occurred that significantly affected the pace and direction of the negotiations. The first was a speech that Fowler gave in March before the American Bankers Association's annual convention in Pebble Beach, California. He designed his speech, which was stern in tone, to speed the negotiations along, with threats if necessary. Fowler resurrected many of the ghosts from the 1930s to underscore what he had to say: continued declines in world reserves, rises in world interest rates set off by competition for scarce reserves, global stagnation, increased protectionism, and the rise of currency blocs. Several observers drew the impression that the United States might take unilateral action should progress on the monetary talks not be forthcoming. This unilateral action might not be limited in the financial sphere but could include other diplomatic arenas, such as NATO. As far as Fowler and Dillon were concerned, though, they did not want to see the international monetary talks backfire. There were too many problems, such as Vietnam, afflicting the administration already.\(^3\)

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3 March 1967 and 30 March-1 April 1967, all IMA Committee, 18-19 July 1967, FP 180, LBJ Library.

One month later, however, the Europeans sprung a surprise on the Americans. At their April meeting, the EEC finance ministers, under French and German guidance, suddenly put up a united front against the Americans. They came out in favor of credits, instead of assets, and expressed a desire to see general IMF voting procedures changed to reflect creditor, or surplus country positions. This was a voting matter separate from the voting needed to activate the contingency plan for reserves. Specifically, they desired to see any changes in IMF procedures requiring the approval of those countries with 85 percent of the quota contributions, with IMF creditors comprising half this figure. The German move more than likely reflected their desire to bring the French back into the liquidity exercise.\textsuperscript{35}

Deming and Daane expressed disappointment to Emminger over the turn of events. No American official commented publically on them, however. People in the administration feared that the French would seize an American protest as an opportunity to sink the negotiations altogether.\textsuperscript{36}

\textsuperscript{35} Solomon, \textit{The International Monetary System}, 137-9.

The American negotiating strategy had always considered the pivotal German position and its strengths and vulnerabilities. With the pressures that Johnson was facing in other areas, though, his principal advisers were not in the mood to indulge the Germans. They met with German officials at all levels to put for their case. Also, they enlisted private citizens such as John J. McCloy, the former High Commissioner for Occupied Germany, into the effort. Some Germans, such as Emminger and Hermann Abs, Germany's leading financier, remained sympathetic to aspects of the American position. Others were either resentful, such as former Chancellor Ludwig Erhard, or, as with the finance minister, Karl Schiller, were completely resistant. Undaunted, Johnson officials remained persistent with their German counterparts.37

What may well have influenced this German resiliency to American overtures was the outcome of the Trilateral negotiations, which began the previous autumn and concluded

in late April 1967. Great Britain was also involved in the negotiations. These talks, dealing with the military aspects of intra-alliance burden sharing, ultimately resulted in having the Germans bear the greatest share of the cost. The problem that the negotiations tried to resolve was Prime Minister Harold Wilson's threatened pullout of the British Army on the Rhine (BAOR) for balance of payments and domestic political reasons. The United States faced a difficult situation, in terms of its own balance of payments deficits. On one hand, if it were to let Wilson quit Germany, it would have to supply more troops and increase its payments deficits in the process. On the other, if it insisted that the British keep the troops in Germany without relief, the pressures on sterling would become intense. Moreover, several congressmen were agitating for an American pullout in light of the high balance of payments costs incurred from stationing American troops in Germany.³⁸

Consequently, Johnson sent McCloy to Bad Godesburg to see if he could induce the Germans to ante up the difference. What the Americans were doing was continuing

their policy of forcing the Germans to make offset payments in the form of military purchases, an approach first begun under President Dwight D. Eisenhower. The increased American pressures, however, helped to bring down the Erhard government, which had been quite acquiescent to the United States, in 1966. The Erhard government’s successor, the Grand Coalition of Kurt Georg Kiesinger, was far less pliant and more Francophilic. Still, Kiesinger realized that he could not resist McCloy’s pressures. In the end, the Germans pledged to increase their offset payments and agreed to a troop and air wing rotation scheme to ease the American and British payments deficits. There was, however, some relief accorded to them. The Americans agreed that the Germans could partially satisfy their obligation by purchasing American securities. At the same time, though, the Bundesbank had to agree not to redeem its dollar balances into gold.39

The Germans were well aware of what had transpired. Years later, the Bundesbank governor, Dr. Karl Blessing, recounted how McCloy implied American troop withdrawals if

the deal did not go through. Henceforth, they would be act much less pliant, especially when it came to international money. For their part, the Americans were aware of what they were doing. Francis M. Bator, the White House liaison among the various elements of the American bureaucracy involved in the Trilateral negotiations, described the Bundesbank pledge as being tantamount to putting the rest of the world on the dollar standard. Although the Johnson administration probably had no such intention at the time, Bator's words would prove to be prophetic.40

Meanwhile, little progress ensued on the international monetary negotiations. The sharp differences between the Americans and the French, as reflected in the controversy over credits versus assets, could not be resolved. The Americans remained firmly committed to assets, preserving their issue on voting, and a weak link to gold. In May 1967, they drafted an outline of a plan for what they titled a Drawing Unit Reserve Asset, or dura. With some modifications, this became the plan that Fowler and Deming

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pushed. They quietly dropped the old dual approach proposal altogether, as Dillon had recommended the previous November. Many details of the dura plan were quite complex. The basis of it, however, called for the creation of a monetary asset with a weak link to gold. The Europeans remained unswayed. Two IMF plans also became available for consideration, but did not help break the logjam for the time being. At the June 1967 meeting between the G-10 deputies and the IMF executive directors, a rough draft of a plan emerged, but little resolution on the character of the reserve units, their link to gold, or the voting procedure.\footnote{De Vries, The International Monetary Fund, 143-6; "Outline of a Drawing Unit Reserve Asset (Dura) Plan," 15 May 1967, IMA Committee, 27 June 1967; Summary, Deputies Meeting, 21 June 1967; Draft Minutes, Advisory Committee on International Monetary Arrangements, all IMA Committee, 18-19 July 1967, FP 180, LBJ Library.}

At this point, it was obvious that the ministers and IMF governors had to intervene. The deadline for a plan, the 1967 annual meeting in Rio de Janeiro, was fast approaching. Moreover, a contingency plan was far from being complete.\footnote{Solomon, The International Monetary System, 140.}

A ministers-IMF governors meeting was scheduled for mid-July in London. During the coming weeks, Fowler and the other Americans made intensive preparations to get themselves ready. The stakes were critical. The usual debilitating disadvantages to the United States continued to
persist: the American balance of payments situation and the Vietnam War. American officials were very concerned that their G-10 partners would interpret their efforts as attempts to use international monetary reform to finance the Vietnam War or evade domestic austerity. This they did not want to do, and Fowler stressed this to leading Congressmen and to Schiller, who arrived in June on an official visit.

On the other hand, the Americans were beginning to feel that they had to be flexible on certain key points, such as the voting procedure. The one non-negotiable issue for the Americans was that the reserve had to be an asset and not a credit. Also, they wanted to ensure that the reserve’s link to gold, i.e., the reconstitution issue, was as weak as possible. 43

In early July, the officials comprising the American delegation to London met to formulate strategy. They agreed on the negotiating approach to take, but differed over how aggressively they should move. Martin advised caution, fearing a possible sterling crisis, the effects of the Vietnam War, and possible French resistance.

Fowler and Deming favored a more aggressive stance, and prevailed. If they were going to compromise on certain issues such as the 85 percent voting figure for activation, they wanted to make the Europeans fight for it. Should the negotiations fail, they wished to make the EEC publicly responsible. Then, as Deming urged, the Americans could take a plan to the floor at the Rio de Janeiro IMF annual meeting.\textsuperscript{44}

Unfortunately, resolution of the voting and reconstitution eluded the ministers at their July meeting in London. Before the meeting, Fowler had tete-a-tetes with each delegation. His meeting with the Germans had not been promising. Schiller could promise nothing more than a "flexible attitude." The EEC delegates remained firm on the 85 percent voting rule for activation. Schweitzer and Chancellor of the Exchequer James Callaghan concurred. They argued that the EEC had a de facto veto anyway since any plan required their participation.

During the meeting, Fowler encountered resistance on reconstitution when an Italian proposal for what they labeled harmonization had attracted considerable support. Harmonization was a creditor-protecting provision. It required abusers of the new reserve over a given period of time to restore, or harmonize, the composition of reserves.

\textsuperscript{44} Summary, Meeting of U.S. Delegation to the G-10 Ministers' Meeting, 10 July 1967, IMA Committee 11 April 1967, FP 181, LBJ Library.
to what it had been at the beginning of the distribution period. With no more progress evident, Callaghan, who had been presiding, proposed that to have the deputies resolve the unsurmountable issues the following week.45

The deputies finally managed to complete an outline for a contingency plan. Still, full agreement on the voting and reconstitution issues evaded them. Meanwhile, Deming and Daane conceded to the French the name of the synthetic reserve assets: Special Drawing Rights, or SDRs. Neither the Americans nor the Europeans gave ground on voting. Most deputies, though, including the Americans, were able to agree in principle upon a reconstitution rule put forward by Schiller: the 75 percent average net use rule. This rule meant that reserve holders could expend that amount, on average, over a specified time while being required to keep some sort of asset backing for the remaining 25 percent. Unfortunately, this compromise of Schiller’s fell through. The French deputy, Maurice Perousse, lacked the authority to

negotiate on this and other issues. Another ministers’
meeting in August would have to bridge the differences.46

As Fowler, Deming, Daane, and the Dillon Committee
assembled to review strategy, they worried about what might
happen to the gold and currency markets. Their concerns
centered upon what a sterling crisis might do to put
pressure on them, if agreement failed before the IMF annual
meeting in September. Dillon agreed with Fowler that in
case of deadlock, the best thing would be to take a plan to
the IMF executive board at the annual meeting. This
stratagem would allow the French to back down without
completely acquiescing to the Americans. The Dillon
Committee concurred with Fowler that Schiller’s compromise
would result in fewer repayment obligations up front.
Having fewer repayment obligations would lessen the threat
to American gold reserves. All the Americans thought it
best to either sidestep the IMF voting reform issues that
the EEC raised in April or table them to the following
spring. They did not want to disturb the markets, already

46 "Summary of the Deputies Meeting of July 27 and
179; Francis M. Bator, "Draft U.S. Position on
Reconstitution at Deputies’ Meeting, 27-28 July 1967," 26
July 1967, 1-31 July 1967, Bator Chron File; Minutes, IMA
Committee, 17 August 1967, FP 179; Henry H. Fowler to James
Callaghan, 23 August 1967, FP 31, all LBJ Library.
uneasy about sterling's prospects, any more than necessary.47

In early August, events would begin to take shape to enable the logjam to be broken in favor of the Americans. Kiesinger's state visit to Washington in early August gave them the opportunity to exert leverage over the Germans. It was becoming obvious that the Germans were tiring of French obstinacy on monetary reform. The Americans sensed this uneasiness and moved to exploit it. They also wanted to impress upon Kiesinger the critical role that the Germans played in the negotiations. Fowler, Deming, and Daane thought that they had compromised enough on the issues of voting and reconstitution. French concessions, particularly on reconstitution, had to come if the negotiations were to continue. With Johnson's blessing, Fowler was prepared to tell the Germans that they might have to break with the French completely to save the negotiations.48

The pressure on Kiesinger seemed to work. Agreement on an outline for a contingency plan finally came at the Ministers' meeting in London on 26 August. The pressure to

47 "Major Points on Reform of the IMF and the Draft Resolution;" "Main Points on Reconstitution;" both Minutes, IMA Committee, 17 August 1967, FP 179, LBJ Library.

get agreement was intense, as the IMF annual meeting was fast approaching. To help clinch a deal, Fowler made a very significant concession on voting to create reserves. He also agreed to some vague wording on how the contingency plan would define the reserve unit. In other words, he gave the nod to harmonization. Most of the negotiators now seemed ready to accept Schiller’s proposal on reconstitution. The French finance minister, Debre could not, however. Nor could the Italian finance minister, Emilio Colombo, until an evening’s caucusing finally persuaded him.

Debre then relented. He made one demand, however. He insisted that the minutes show that he considered the new SDRs to be a form of credit. Afterward, the ministers issued a communique reading that they now had a contingency plan outline to create SDR’s for the Rio de Janeiro annual meeting.\footnote{U.S. Treasury Administrative History, Chapter XII, 36-8; Solomon, The International Monetary System, 141-2; de Vries, The International Monetary Fund, 158.}

For the most part, this outline was an American triumph, despite the ambiguity of its language on reconstitution that was necessary to obtain agreement. Fowler’s concession on the voting majority issue for activation was an empty one. He knew that the plan could not go into effect without the cooperation of the Europeans. The SDR that emerged was essentially an asset, although the
70 percent net average use rule would require repayment at some point. Still, repayment was not likely in the short term. Deferred repayment, of course, allowed the Americans to hope that they would have time to rectify the payments deficits. The SDR, for all practical purposes, was like gold or any other currency. It was directly transferable. Also, IMF members had to accept it in settlements between central banks.

The implications of this development were that the United States could use the SDRs to reacquire dollar balances, subject to some limits, from the surplus countries. It also had something to create the additional reserves needed once it corrected its payments deficits. Thus, much of what Johnson had desired in his June 1965 memorandum to Fowler had been achieved. The French had little but a semantic victory. Johnson, who had limited involvement in the negotiating process, held a modest ceremony at the White House a few days later to commend the American negotiators for their work.

The Rio de Janeiro meeting, which approved the contingency plan outline occurred amid turmoil in several
industrialized economies. After approving the outline, the IMF governors instructed the executive directors to provide the required amendments to the IMF Articles of Agreement to bring it into force. The ambiguity of the plan's language made its passage much easier, as economist Fritz Machlup noted. It scrupulously avoided words such as "credit" and "asset," or terms that suggested those meanings. Instead, the plan's language stressed that the SDRs were a "facility." Representatives from both surplus and deficit countries could register acceptance of the plan while advancing their own positions. Debre, for instance, could express his satisfaction that the plan was a facility, but that it was not to create a new monetary asset to replace gold. Fowler diplomatically hedged the American position at the meeting, saying that the United States "subscribes strongly to the view that the new facility is designed to assure a satisfactory rate of growth of world reserves."\(^5\)

From the American perspective, approval could not have come too soon. Acrimony marked the ministers meeting at Rio de Janeiro. Economic conditions in the United States, the United Kingdom, Germany, and Canada were contributing to a slump in world trade. Nearly everyone, including Schweitzer, criticized the American payments deficits and the Vietnam War for driving up interest rates and increasing

inflation. If higher American interest rates helped the balance of payments, they would force European rates to increase, thus shutting off growth there. American domestic fiscal and monetary policies drew special criticism because they seemed inflationary. To remedy this inflationary tendency, many of the Europeans present expressed support for a tax increase. At the time, the Johnson administration was battling fiscal conservatives in Congress over passage of a 10 percent tax surcharge to pay for the Vietnam War and to wring some of the inflation that was in the American economy. Also, the French and the Germans were now eager to link final approval of the contingency plan outline to the IMF voting reforms they favored.

To smooth out the differences and clarify the language of the SDR plan, more consultations involving the deputies and ministers were necessary. Further agreement, though, required running the gauntlet of catastrophes that struck the financial markets beginning in the autumn of 1967. As

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52 In 1967, the Federal Reserve reversed a very tight monetary policy that it pursued in 1966. The tight money policy in 1966 was undertaken largely to restrain an overheating domestic economy. In the process, though, it had deleterious effects on those sectors of the economy that were very sensitive to interest rate increases, such as housing and construction.

will be shown in the next two chapters, everything that Fowler, Dillon, Martin, and the rest of the Americans had feared now took place. The sterling situation became particularly bad, leading to a 14 percent devaluation in November. A run on the dollar followed, because the Treasury and the Federal Reserve led the effort to try to save sterling. The markets expected the American balance of payments to worsen. As mentioned in Chapter Four, the fourth quarter 1967, did, in fact, post particularly bad results.

Other factors besides the sterling crisis upset the financial markets, such as the war in Vietnam. Because the administration could not easily pass its 10 percent surcharge, confidence abroad that the United States could maintain the official gold price was undercut. Finally, speculation against the dollar became so intense that Johnson asked the British to close the London gold market. In its place a two-tiered gold market was negotiated. This new arrangement preserved the $35 gold-dollar parity for official transactions while allowing the market to set the price in private transactions. That the United States now wanted approval for the outline as soon as possible was evident. They were willing to risk conceding some control of international monetary affairs to the Europeans and to the IMF to obtain it.
Against this backdrop of turbulence, the deputies tried to resolve the ambiguities of the September SDR agreement. The French, however, refused to cooperate, even as the other EEC members were moving toward accepting the American positions on the remaining issues except IMF voting reform. De Gaulle had become more displeased than ever with the United States with its handling of international monetary matters since the previous autumn. He had not liked the fact that most of the deputies were conceding that the SDR's were, in principle, assets and not credits. What made him especially angry was that the United States successfully negotiated the two-tiered gold market. To him, this two-tiered market he saw as American effort to downgrade the role of the auric metal in international finance. He gave indications that he would continue to try to shake confidence in dollar and sterling.54

Not surprisingly, the Americans became upset with the French. Fowler tried to be conciliatory to Debre. He informed the French Finance Minister, however, that de Gaulle's policies had inflicted "real damage" on American

attitudes toward the French. De Gaulle had even aroused pique over delinquent French World War I debts.\footnote{Fowler to Debre, 7 March and 19 March 1968, International Countries, France, 1968, PP 38, LBJ Library. Much of the criticism in Congress was levied by Representative Lester L. Wolff of New York, with some assistance from Senators Vance Hartke (D-Indiana), Russell Long (D-Louisiana), and Robert Byrd (D-West Virginia). On 1 February 1968, over one hundred House members—including the entire Ways and Means Committee—sponsored House Concurrent Resolution 622 to collect French war debts. Fulbright, for once, was on the side of the Administration and attempted to mollify these criticisms. See \textit{Congressional Record}, 18 January 1968, 193; 31 January 1968, 1580; 1 February 1968, 1778, 1897-1900; 5 February 1968, 2044-5; 6 February 1968, 2368; 7 February 1968, 2588; 8 February 1968, 2712; 21 February 1968, 3676; 1 March 1968, 4887; 20 March 1968, 7056.}

Meanwhile, the deputies and the IMF executive directors tried unsuccessfully to resolve the ambiguities with the outline’s language and the EEC’s proposals for IMF reform. Another meeting of the ministers and IMF governors was necessary. It occurred in Stockholm at the end of March 1968. The ministers clarified the outline’s abstruseness. Nevertheless, the French declined to support it. Debre argued against the final plan because international monetary officials and the public interpreted the SDR as an asset. Once the French had withdrawn their support, the other Europeans pressed for the EEC proposals that had been

\footnote{For a sample of coverage of anti-French sentiment in the United States at this time see \textit{The Wall Street Journal}, 25 January 1968, 1; Seymour Friedlin, "Why De Gaulle Hates Us," \textit{This Week}, 4 February 1968, as read into the \textit{Congressional Record}, 14 February 1968, 2977; and Joseph A. Scerra, "Calling de Gaulle to Account," \textit{The American Legion Magazine}, as read into the \textit{Congressional Record}, 25 January 1968, 1097.}
on the table since the previous April. With some reluctance, Fowler and Schweitzer acquiesced to obtain approval for the outline. The IMF governors formally approved the results of the negotiations in April 1968. By July 1969 enough IMF members had ratified them. Even the French had come around to support the final agreement by then. A calamitous students and workers strike in the early summer of 1968 undercut French financial strength completely. The long term effects of the strike would continue until de Gaulle resigned in April 1969. His more temperate successor, Georges Pompidou, brought Valéry Giscard d'Estaing back as Finance Minister. Giscard d'Estaing helped steer a moderate course in French international policy.

The Americans, then, won the race against time. Despite the compromises, Fowler, Deming, and Daane had succeeded in negotiating a plan to create SDRs. These reserves were monetary assets that were not linked to gold. With this new asset, the Americans thought that they could preserve Bretton Woods but reduce the role of the dollar and gold. Also, they hoped that they could preserve the New Economics. Moreover, they anticipated that the SDR would ensure the global prosperity that had existed since the end

56 U.S. Treasury Administrative History, Chapter XII, 39-42; Solomon, The International Monetary System, 143-8; de Vries, The International Monetary Fund, 170-5.
of the Second World War, once they had stopped America's balance of payments deficits.

Nevertheless, there had been many challenges to attaining these goals. The French had been persistent opponents of American objectives. Their economic preferences converged with de Gaulle's vision for their country to produce a level of sustained and passionate opposition. The Germans, who had been between the United States and the French, shifted toward the latter. Although the Americans won them back over, they did it with intense arm-twisting.

The biggest challenges, though, did not come from the French or the Germans. Instead, they came from the persistent American balance of payments difficulties that worsened significantly in 1967. The deterioration in the payments occurred because of the effects of the Vietnam War and the failure of the Johnson administration to adequately finance it. Administration advisers eventually realized that the balance of payments deficits would end before the G-10 and the IMF completed an SDR plan. Moreover, the failure to finance the war adequately would expose the administration to sharp, adverse criticism from foreign officials, private observers, and the markets. Still, they persevered with the negotiations, hoping that the payments deficits would not become unmanageable.
Other problems indirectly related to American policy made the challenges even more daunting. These difficulties were the sterling crisis and the attack on the dollar that followed the November 1967 devaluation. Conceivably, one might say that the SDR negotiations indicated American strength in the face of world difficulties. Perhaps this was true. On the other hand, the sterling crisis and the attack on the dollar, like the Vietnam War itself, provided the severest tests to American financial leadership since the formation of Bretton Woods almost a quarter century before. After these crises, and their result, American leadership faced new realities. It is now to these subjects, in the next two chapters, that this dissertation turns.
The United States had won a race against time and
trouble to obtain agreement to a synthetic reserve plan that
was to its liking. Nevertheless, the United States did have
to make some concessions. Several challenges confronted its
abilities to carry out other items on its policy agenda.
Until it could satisfactorily resolve issues such as the
Vietnam War, its power to have its way on other policy
questions became debatable.

Another perennial difficulty that the United States
faced in international monetary management was the soundness
of the British currency, the pound. The fundamental problem
with the sterling-dollar parity, which was set at $2.80, was
that Britain lacked the financial strength to support it.
What undermined the pound above all else was Britain’s
inability to correct its payments deficits, which made the
American deficits pale in comparison. The British situation
was the American dilemma in extremis. It had long exceeded
the limits of its capabilities. During the 1960s the
British were continuing to live beyond their means by trying
to expand their welfare net. Simultaneously, however, they still maintained overseas defense commitments. The strain of trying to honor these commitments while failing to increase competitiveness was too much of a burden for the British to bear. Sterling experienced disaster as a result, and in the end, the British had to devalue.

This inauspicious devaluation, combined with failure of the British to solve their economic problems, was a policy defeat for the Americans as well. The United States depended upon the British to maintain the soundness of their currency. The Americans thought that the British had to share the responsibilities of the international monetary system and the anticommunist alliance of Western Europe. Unfortunately, not only did American policies work at cross-purposes with those of the British. These policies worked at cross purposes with each other. Often, the United States had to attend to Britain's financial trials when it had other obligations. These obligations included international monetary reform, its own balance of payments, and difficulties in Southeast Asia.

The fates of the two currencies, then, affected each other in a parasitic way. If what commentators have called the "Special Relationship" imply postwar American dominance of the Anglo-American association, that dominance exacted its price. By the 1960s, this price came not out of British spite, but out of British weakness. Moreover, the
devaluation was but the first of a series of tremors that shook the very foundations of the international monetary system. These financial shockwaves created a new set of problems for the United States to resolve. Thus, the financial ability of the United States to pursue a broad array of domestic and international goals remained in question.

The twentieth century has witnessed two trends with respect to Great Britain's role in the world, especially after the First World War. The first has been the decline in its status as a first class world power, especially in terms of its share of world production, competitiveness, and investment. The second has been the rise of the welfare state. Britain opted for the welfare state at a time when it had difficulties supporting such a system. Simultaneously, the British not only sought to hold on to the remnants of the empire, but also preserve the role of sterling as a world currency.

What made these commitments so burdensome were problems in the British balance of payments position. The perennial British deficits resulted from softening trade balances. External and internal factors contributed to this situation: war-induced losses of capital and markets, increasing money wages, and outdated investment and management habits. Because this state of affairs had hardly changed by the
1960s, the British lost out even more because of the more competitive Europeans across the channel.¹

As a result, sterling's viability weakened. The first attempt to restore sterling's convertibility after the Second World War was cut short within a few weeks during the summer of 1947. No sooner had the British made the pound convertible when they saw their foreign exchange reserves, not to mention the proceeds of a $3.75 billion American loan, evaporate. In 1949, the Chancellor of the Exchequer, Sir Stafford Cripps, devalued the pound from $4.03 to $2.80, to try to bolster the sagging balance of payments.

Several remedies the British tried to improve their payments position did not work. The commitment of both parties, Labour and Conservative, to full employment sabotaged every effort taken. Full employment policies required consistent stimulation that overheated the economy and worsened the trade and payments positions. In response, more stringent fiscal and monetary policies were employed, cutting short domestic recovery. During the 1950s, this problem vexed the Conservatives. Their critics among Labourites, trade unionists, and industrialists derisively

termed these measures "stop-go." As the Conservative tenure lengthened, these criticisms became more shrill.²

Britain's relationship with the United States made this predicament even more complicated. Its eviscerated financial position made it a hostage to American wishes, much to its chagrin. As mentioned before, the Americans prevailed with respect to Bretton Woods prevailed, trade arrangements, and conditions for ERP assistance. The United States could also exert direct financial pressures, as it did by manipulating a run against sterling during the Suez crisis. In other diplomatic situations, American wishes also predominated. American officials prodded the British to dismantle the empire while excluding them from the Australia-New Zealand-United States (ANZUS) pact. In addition American officials discouraged Great Britain from developing an independent nuclear arsenal. On the other hand, the United States wanted British assistance in the Cold War struggle. Americans valued the historic British associations in the Persian Gulf, East of Suez, and in East Asia as a useful proxies for themselves. More importantly,

the Americans firmly held the British to their obligations in Western Europe.³

Nevertheless, if the United States wanted to see Britain play a world role, it had to ensure that Britain would have the financial resources to do so. Succinctly put, the United States had to underwrite sterling. Unfortunately, the United States had to do this at a time when it began to reach the limits of its own financial resources in the late 1950s. The fact that both sterling and the dollar were the reserve currencies of the Bretton Woods system made extended American support even more imperative. A run on the pound might spread to the dollar as speculators sought gold. The run would then impair dollar-gold convertibility at $35 per ounce, especially as American gold reserves fell. Thus, as Treasury Undersecretary Robert Roosa and other American officials put it several times, sterling was the first line of defense for the dollar.⁴


By the mid-1960s, Anglo-American financial relations contained a certain degree of instability. The entire nexus of domestic and international economic policies, along with the diplomatic and military policies, created effects that threatened to undercut each other. The "Special Relationship" frequently alluded to in contemporary rhetoric and in historians' accounts thus became mutually parasitic, at least in part. Moreover, this weakness threatened the health of the international monetary system as a whole.

Officials in Washington and elsewhere were uneasy about what this threat to the international monetary system could do. Often, memories of the 1931 financial crisis, the Great Depression, and the 1947 and 1949 crises resurfaced vividly. Still, the same memories were compelling officials on both sides of the ocean to pursue domestic full employment policies.

It is important to keep in mind this state of affairs that existed by the mid-1960s. After that, an entirely new set of pressures beset both countries. One of these was the return of Labour to power in October 1964 under Harold Wilson's leadership. The other was the full-scale commitment of the United States to the Vietnam War. Combined, these two pressures magnified existing stresses and disrupted all the other policy objectives of the two countries.
Wilson had brought his party to victory because a large segment of the British electorate had despaired of the ability of the Conservatives to move beyond "stop-go" economics. The victors had campaigned on a promise to boost economic growth. Socialist-style planning and consultations with labor and management were to modernize British industry. Wilson and his party also pledged to expand social welfare benefits. Nevertheless, Wilson hardly enjoyed a mandate. In the House of Commons, Labour had a mere majority of three.5

The new government, however, could not escape distrust from abroad. The fact that Labour was willing to cut defense spending, including defense commitments overseas, to pay for new government programs invited criticism from the Johnson administration. What really irritated the Johnson administration, though, was Labour's attitude toward the Vietnam War. Johnson firmly believed that the British owed the Americans some assistance out of loyalty to the shared struggle against world Communism. Opposition to the war from radical Labourites, student groups, and British media figures galled Johnson. Wilson's own ambiguous attitude to

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5 Brittan, Steering the Economy, 294-5; Dimbleby and Reynolds, An Ocean Apart, 280; Callaghan, Time and Chance, 152-3; Wilson, The Labour Government, 1-16. For presentation from this point on of British events only, the author also acknowledges upfront the fine chronological tables presented on 46 in Samuel Brittan and Kathleen Burk, "Symposium: 1967 Devaluation," in Contemporary Record, Winter 1988.
the war, however, especially infuriated him. On one hand, Wilson refused to send troops, although he did not issue a blanket condemnation of the war per se. On the other hand, Wilson tried to act the peacemaker between Johnson and the Kremlin. Had Wilson sent as much as a "platoon of bagpipers" to Saigon, Johnson might have been more forbearing toward Wilson's peacemaking attempts. Since Wilson would not provide even a token force, though, Johnson thought that he should have remained quiet.6

Personal factors prevented also rapport between the two men. Johnson simply disliked Wilson, because he was not like his patrician predecessor, Harold Macmillan, at all. Instead, Wilson, with his omnipresent pipe and ill-fitting rumpled suits, seemed too much like another venal politician, despite his political adroitness.7

Naturally, Wilson and his Cabinet wanted to put their Socialist blueprint, the National Plan, into practice immediately. The balance of payments and the condition of sterling had to take immediate priority, however. Two days after their victory, Wilson and the two ministers responsible for economic policy, James Callaghan, the

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Chancellor of the Exchequer, and George Brown, the Minister for Economic Affairs, discovered a piece of very bad news. Actual British Treasury estimates of the payments deficit were £750 to £850 million ($2.1 to $2.2 billion). These figures were alarmingly high compared to the 1963 deficit of £35 million ($98 million). After conferring with a few permanent undersecretaries, however, they decided not to devalue.⁸

Each minister had his own reasons against devaluation. Callaghan did not want to anger American officials. Brown realized that a devaluation would force austerity measures harmful to Britain's working classes.⁹

The critical decision, though, was the Prime Minister's. Wilson based his reasoning on personal and political considerations and ideology. A Socialist planner like himself abhorred the idea of letting the financial markets to set the value of sterling. History, or at least Wilson's experience with it, gave this economic conviction added emotional weight. In Attlee's government, Wilson had been the President of the Board of Trade who recommended the 1949 devaluation. Wilson later attributed Labour's 1951 defeat largely to the devaluation. Therefore, Wilson remained the British official most committed to maintaining


⁹  Ibid.; Callaghan, Time And Chance, 159-60, 168-9; Cairncross and Eichengreen, Sterling in Decline, 164; Solomon, The International Monetary System, 87.
the parity. He may have had occasional private doubts, but he did not tolerate dissenting views on "The Unmentionable" from his ministers.\(^{10}\)

Wilson and his two chief ministers, therefore, were prepared to live with their decision when the first speculative crisis against sterling just three weeks after their election. Speculators had been uneasy about the pound since the summer, when the Conservatives publicized unfavorable trade figures. After Wilson released the revised, unfavorable trade figures projected for 1964, the speculators went on the attack. They also disliked Wilson's remedy, a 15 percent import surcharge, and Callaghan's new expansive budget.\(^{11}\)

By mid-November, though, it became obvious that Wilson had to take stronger measures to defend the currency. The Bank of England had used much of its prearranged credit (\$855 million of a total of \$1 billion) with the New York Federal Reserve and other central banks. Afterward, it announced a hike in Bank Rate (the Bank of England discount rate) from 5 percent to 7 percent. Wilson, disturbed, feared Johnson's response to the rate increase. The Prime

\(^{10}\) Brittan and Burk, "Symposium," 46; Cairncross and Eichengreen, Sterling in Decline, 167-8; Susan Howson, British Monetary Policy, 1945-51 (Oxford, 1993), 241-2; Solomon, The International Monetary System, 88; Wilson, The Labour Government, 463.

\(^{11}\) Brittan, Steering the Economy, 296-9; Callaghan, Time and Chance, 169-71.
Minister's concern was justified. Across the ocean, CEA Chairman Gardner Ackley warned Johnson to make a public statement to explain that a complementary raise in the Federal Reserve's discount rate occurred "for international reasons." Ackley feared that several banks would raise their prime rate, which would slow economic expansion. Moreover, Ackley worried that if sterling collapsed, speculators would turn against the dollar. This attack on the dollar would wreck the fixed exchange rate and open trading relationships of the international monetary system.¹²

The speculative fever cooled by early December. Short-term financial assistance, offered by several central banks but orchestrated by the Federal Reserve, helped shore up the pound. This financial assistance came from four sources: the New York Federal Reserve, the Export-Import (Ex-Im) Bank, the central banks on the Continent and of Japan, and the BIS. In early December, the Bank of England drew from its IMF standby credit agreements to repay most of what had borrowed, which was about L2.8 billion, or $1 billion.¹³


¹³ Cairncross and Eichengreen, Sterling in Decline, 169-70; Coombs, The Arena of International Finance, 114, 117.
What finally brought the speculation to an end, though, were better trade figures in December. Nevertheless, the 1964 operation was the last time that all of the major central banks cooperated so smoothly. French President Charles de Gaulle forbade the Banque de France from participating in similar rescue operations for sterling, arguably for political reasons.¹⁴

The Americans themselves became reluctant to render assistance to the pound. What Wilson and Callaghan wanted was a large, long-term loan to prop up sterling. Nobody in Washington had much enthusiasm for such a request, however, for several reasons, as this chapter will elaborate. One reason was that the Americans feared that the loan might worsen their own balance of payments deficits. Thus, Washington insisted that if it granted any long-term assistance, leading creditor nations, such as the Continental Europeans, would have to help. American officials knew, though, that the Continental Europeans would not grant such assistance.

Another reason, understandable from the Johnson administration's point of view, was Wilson's stand on the Vietnam War. Still another was Wilson's desire to scale back British overseas commitments. Many in the administration, including Johnson himself, did not want to extend a long-term loan if Wilson were going to pull out

¹⁴ Solomon, The International Monetary System, 89.
East of Suez or even in Europe. A reduction of commitments would improve the balance of payments in any event. The Americans simply could not walk away from the British, however. Unfortunately for the American balance of payments, the fortunes of the dollar and sterling came together. The American Treasury or the Federal Reserve always had to bail out the British somehow. Still, American officials kept that assistance to the short-term and sought help from abroad as often as possible.

The respite from speculators lasted until February 1965, barely three months later. Speculation against the pound began to resume for many reasons. January's trade figures were bad, mainly because wages and prices had been exceeding voluntary guidelines to which government, industry, and labor had agreed. This development forced the Bank of England to announce that it renewed the $3 billion credit package with the central banks. In addition, de Gaulle's dollar redemption policy described in the first chapter, and Johnson's balance of payments program in response to it, also excited sterling speculators.¹⁵

Nevertheless, the speculation did not reach an alarming rate until June 1965. The 1965 trade figures continued to worsen. Voluntary wage and price controls were also not working. Consequently, the run against sterling began.

Wilson and Callaghan's patience with the speculators now

¹⁵ Brittan, Steering the Economy, 304.
reached its limit. They were willing to take a measure, which if it were not drastic, was still extreme. More than anything else, they wanted to launch the National Plan. Nevertheless, they needed a stable currency to do it. To stabilize the pound prompted Wilson and Callaghan to seek a long-term loan. They had no success. The French, not surprisingly, would have no part of such an enterprise, as the French Finance Minister, Valery Giscard d'Estaing, flatly informed them. Callaghan then offered to fly to meet the new American Treasury Secretary, Henry H. Fowler, and sound him out about a long-term loan. Wilson consented. A Washington trip would verify their sense that the Johnson administration wanted them to adopt a more restrictive fiscal policy to maintain the $2.80 parity.16

Their sense of the situation was largely correct. Callaghan did not have much luck. Initially, in the memorandum to Fowler dated 16 June 1965 discussed in the first chapter, Johnson had implied a desire to grant long-term assistance. Then, Johnson had cited it as a "major foreign policy concern."

After discussing the matter thoroughly, however, none of the President's advisers recommended granting the loan. Nobody in Washington wanted the British to devalue, although they were pessimistic about the future prospects for the

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British balance of payments. Still, nobody wanted to make a significant long-term commitment to the British currency.

Johnson's key advisers, though, differed in their reasons behind their recommendations. For Fowler, economic and financial considerations were paramount. His staff had estimated that any potential loan would have to be several billion dollars. Treasury experts based this figure on their assumption that the total British reserves of $5 billion were insufficient for holding off a major onslaught. Fowler also opposed any large devaluation of 20 percent or more. If that happened, he feared, other currencies might follow sterling downwards, making the British devaluation futile. A devaluation might also trigger a rush of gold sales that would threaten America's gold reserves, trading position, and domestic economy.

Were the United States to grant the British a loan, Fowler insisted, the Continental Europeans would have to participate. Still, Fowler was aware that the other major financial powers did not want to make even a short-term loan. The Germans were sympathetic but indignant because they were already making offset payments to both Britain and the United States. The French had already declared their unwillingness to join in. Any additional assistance from the IMF was also unlikely, Fowler reasoned.17

17 Henry H. Fowler to President Johnson, "Britain's Financial Situation," 18 June 1965, with cover "Memorandum for the President," 17 June 1965, CO305, United Kingdom
Johnson's other advisers had strategic considerations in mind. The advisers having these opinions included Secretary of State Dean Rusk, Undersecretary of State for European Affairs George W. Ball, Defense Secretary Robert S. McNamara, and National Security Adviser McGeorge Bundy. The war in Vietnam was beginning to demand more American troops. Still, while Johnson was anxious to have Wilson send some forces, these men were not so concerned about a direct link between troops and money. Instead, they were anxious about planned British cutbacks in overseas commitments, especially from the BAOR and from East of Suez. As the Americans committed more troops to Southeast Asia, they wanted to ensure that the British were holding up their share of responsibilities.\(^{16}\)

Apparently, then, Johnson took their advice. Callaghan received nothing. Neither Fowler nor McNamara, whom Callaghan visited, expressed encouragement. Fowler did not want to stir up European suspicions of two debtor countries evading certain responsibilities to employ austerity.


\(^{16}\) Draft Memorandum for the President, 1 June 1965, Trendex, CF/UK, Box 275, National Security File, with cover memo from D.K. to McGeorge Bundy dated 1 June 1965 attached; Francis M. Bator to McGeorge Bundy, 25 June 1965, 1 April-30 June 1965, Bator Chron File, both LBJ Library.
McNamara, as abrasive as ever, fumed at Callaghan that his government was not making sufficient economies in Royal Navy expenses nor ensuring that it could do its share in East Asia. Johnson himself simply poured on a more charming version of his "treatment," which impressed Callaghan completely. Moreover, at an evening dinner that the Chairman of the Federal Reserve, William McChesney Martin, hosted, all those assembled except for the Chairman asserted that sterling devaluation was inevitable.19

Later that summer, however, Martin would have to help the British buy some time. The sterling crisis only worsened. The Wilson government was forced to respond with a tighter wage and price policy. Washington also became increasingly worried. By mid-July, Fowler was confiding to Callaghan his concerns that the pound would soon sink the dollar. The two officials agreed that they could preserve the existing parity of $2.80, but only if Britain could keep wages and prices in line. Six weeks later, the Bank of England not only had borrowed close to $900 million from the United States. It had also assumed heavy commitments in the forward market.20

19 Callaghan, Time and Chance, 186-9; Richard E. Neustadt to Bator, "Memorandum: Conversation with Jim Callaghan," 11 August 1965, 1 July-31 August 1965, Bator Chron File, LBJ Library; Cairncross and Eichengreen, Sterling in Decline, 177.

20 Barron's Dictionary of Finance and Investment Terms, 2d ed., 1987, 146, defines forward contracts to be "purchase(s) or sale(s) of a specific quantity of
Wilson's Cabinet debated what to do during the last week in July 1965. Left-wing Labourites insisted upon devaluation. Later, Brown joined them, anxious as he was to implement the National Plan. Wilson and Callaghan overruled them. They announced tightening measures but not a wage and price policy, which of course did not impress the markets. 21

Meanwhile, some American officials softened their attitudes against devaluation, but the harder opinions prevailed. Although Fowler was concerned about what might happen to the American balance of payments if the crisis continued, he remained opposed to devaluation. McNamara, Rusk, and McGeorge Bundy remained opposed to a long-term loan as long as Wilson was scaling back defense expenses and opposed sending British troops to Vietnam. These officials even suspected that Permanent Cabinet Secretary Burke Trend would try to appeal to Johnson for a loan. Trend was arriving late in July to discuss defense matters.

On the other hand, Ackley, Francis M. Bator, Johnson's influential liaison with the Cabinet secretaries, and Ball were beginning to question this stubbornness. Both Ackley and Bator thought that Fowler's strong opposition toward devaluation without austerity might be unwise. This policy

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might give the Wilson government carte blanche for American assistance, especially if it were in serious danger. Ball began to fear that if there were no multilateral rescue operation before long, any chance of obtaining Wilson's cooperation on all fronts would be lost. These fronts include the Rhine, East of Suez, Vietnam, and the Kennedy Round. Nevertheless, these officials remained in the minority for the time being, as Johnson himself also withheld assent for long-term assistance.22

What assistance the American eventually gave, though, came with a quid pro quo. The Wilson government had to carry out more austerity. While speculators pounded sterling during the summer, Bank of England Governor Lord Cromer and Martin collaborated on a more stringent wage and price policy that just stopped short of being mandatory. In return, New York Federal Reserve Vice President Charles Coombs would coordinate other central banks in a massive operation to purchase sterling on the open market. The Bank of England would guarantee that the sterling purchased would be convertible on demand and would have full dollar

guarantees. Fowler and Callaghan soon gave their joint approval. Meanwhile, Wilson and Callaghan met with the Trades Union Congress (TUC) to secure from the unions an agreement to notify the government in advance of any wage and price increases.21

Coombs' buying operation commenced Friday 10 September 1965, at 9:00 A.M., New York time. By the end of the day, the spot price had stabilized. It cost the Federal Reserve only $13 million, which was the guaranteed sterling purchased during the operation. Moreover, the value of the pound rose the following Monday as speculators attempted to cover exposed short positions.24

The calm that followed in the next months enabled the British government to announce the National Plan on 16 September 1965. What helped the pound over the autumn and winter months was an improvement in the trade position. Still, many goals of the National Plan were debatable, as outside observers noted. One critic, American Assistant Secretary of State for Economic Affairs Anthony M. Solomon, questioned the Plan's dubious assertions to attain full employment and payments equilibrium in the short-term. Despite the doubts, though, reserves began to flow back to the Bank of England, enabling it to repay in full the credits obtained from the United States and many of its

forward exchange commitments. Meanwhile, the lull afforded the British and the Americans the opportunity to squabble over defense matters that affected the balance of payments of both countries. At the September 1965 IMF annual meeting, Callaghan argued the half-truth that the defense commitments alone caused the British payments deficits. Johnson and his advisers remained unconvinced. That December, Wilson paid a call on the White House on yet another one of his missions to try to mediate the Vietnam War. When he arrived, the Americans reminded him of the need to continue the British presence East of Suez and in East Asia.  

Unfortunately, another crisis would soon be brewing, repeating all of the elements of the plot of the previous year. Again, Britain's trade deficits worsened, and wage and price increases exceeded the guidelines. Speculators placed their bets at the earliest possible opportunity. To deflect the speculators, the Wilson government again tried to set up domestic austerity. It also attempted to persuade the United States to allow it to reduce its overseas commitments. The United States again said no to

disengagement and to long term financial assistance. Still, the Johnson administration found itself providing short-term assistance to sterling to protect the dollar.

During 1966, however, this scenario took on elements that would complicate the task of joint financial management. The financial effects of the Vietnam War, already building momentum in 1965, became more problematic in 1966. The domestic German political situation became uncertain. Not the least of the causes of this uncertainty were the offset payments that Germany made to the United States and Britain. Moreover, the United States labored to accomplish two significant economic objectives, the Kennedy Round and the international monetary measures discussed in Chapter Two. A sterling crash could jeopardize these other policy challenges for the United States. Wilson, for his part, not only had to stand for reelection. He also had to obtain Britain’s admission into the Common Market.

The crisis built up slowly. The wage and price policy agreed upon at Brighton, upon which Wilson and Callaghan had pinned their hopes, soon broke down. Before the speculation reached the crisis point, though, Wilson called an election for 31 March. Labour increased its margin considerably in the House of Commons. Despite inflation, Wilson had kept unemployment in check. The electorate could have cared less about international money matters. As Ackley commented,
"Only the British financial community will bleed and die to preserve the international position of sterling."26

The victory permitted Callaghan to introduce a more stringent budget on 3 April 1966. He also predicted equilibrium in the balance of payments later in the year. Despite the broad claims Callaghan made for future progress, observers elsewhere, especially in Washington, again thought that they were dubious.27

These observers were right, of course. The summer brought the deluge of speculation that many feared. A seaman's strike beginning in the late spring touched off the mad sell of sterling. The strike, which lasted into early July, completely shut down British docks and dealt a severe blow to the balance of payments. The events that followed stymied the Labour government even more. De Gaulle insisted that Wilson and Callaghan had to devalue sterling before Britain could join the EEC. This was not easy news for Wilson to receive. He had staked much of his political fortune on Common Market membership. In early July, the Minister of Technology, Frank Cousins, resigned. Cousins


had strong ties to the TUC and was hostile to the existing wage and price policy. The markets interpreted Cousins' move as a fatal blow to the wage and price policy and reacted accordingly.  

After a Bank Rate increase failed to calm the market, Callaghan sought sterner fiscal measures to save the pound. He directed his Treasury advisers to prepare a new austerity program. While most ministers insisted upon devaluation, he, Wilson, and Defense Minister Denis Healey held firm. They prevailed, and Wilson announced the program to the House of Commons the next day, 20 July 1966. This program was more severe than the 1965 program because it contained mandatory provisions. It also stipulated cuts in overseas military expenditures of at least £100 million ($280 million), however. Wilson insisted on reducing the BAOR until its foreign exchange costs equaled the German offset payments. The plan also claimed to reduce demand by more than £500 million, but did not justify its reasonableness or timeliness.

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28 Wilson, The Labour Government, 233, 234, 245, 249, 250, 253. Prior to his being named as Minister of Technology, Cousins was the General-Secretary of the Transport and General Workers Union, the largest union in the TUC. On 132, Wilson states, "His life's work had been based on the doctrine that a trade union leader's job was to get more wages for his men; even a voluntary incomes policy seemed incompatible with that life-long objective."

29 Brittan, Steering the Economy, 335-6; Wilson, The Labour Government, 258-60.
Reactions to the set of measures were sharp. The Conservatives put forth a motion of censure against Wilson’s government. Cousins, who had now resumed his former position as General Secretary of the Transportation and General Workers Union (TGWU), announced that he would not cooperate with the wage freeze. Later, after Wilson scrapped the National Plan in early August 1966, Brown moved to the Foreign Office.  

The Johnson administration, while obviously displeased with Wilson’s program, could not find agreement on how to respond. Administration officials had divergent recommendations as they prepared for a state visit by Wilson in July. Fowler, who was preparing for the critical July 1966 G-10 ministers meeting at The Hague, worried that sterling’s troubles would badly hurt the international monetary system. He now feared, as had Ackley, that the administration could not afford to be intransigent. If the administration insisted that Wilson had to maintain the parity, fulfill overseas commitments, and carry out domestic austerity, it risked bringing down Wilson’s government. Moreover, the Germans would not be enthused about picking up the slack from a British withdrawal, especially as they were entering a slight recession. Fowler reasoned that if the decision were up to him, he would drop the East of Suez commitment than devalue. His great fear was that any set of

policies that would be beyond the financial and political capacity of the British to fulfill would backfire on the United States.31

Ackley again informed Johnson that any demand to remain East of Suez "gives them more leverage against us in financial bargaining". The CEA Chairman continued, "If we tell them they must not devalue, we have to hand them a blank checkbook. And we can't afford that." Moreover, Ackley feared that with the upcoming elections, the Republicans might try to exploit any maladroit handling of the sterling situation.32

Fowler had some support from Ball and Dean Acheson. As usual, though, McNamara and Rusk took the hard line. McNamara continued to insist that the British fulfill all their commitments in full before receiving any assistance for their currency. Rusk also insisted upon staying in Europe and East of Suez, but conceded that the British might be unable able to muster the strength to do so.33


32 Gardner Ackley (signed by Arthur Okun), "Memorandum for the President, Subject: Economics of Sterling," 19 July 1966, Chapter 4, CEA Administrative History.

A background paper prepared for Johnson for his discussions with Wilson expressed little hope that anything being considered in London might work over the long run.\textsuperscript{34} Nevertheless, everyone in Washington remained resolved that Wilson had to continue, as best he could to settle for austerity. The parity would have to remain at $2.80.

Still, the fact that Wilson was firmly against a British presence in Vietnam guaranteed that the Americans would not give him much help until the markets forced them to do so. Wilson knew that he was going to receive "the frozen mitt" from Johnson on his arrival. When Johnson pressed Wilson on defense commitments and troops to Vietnam, Wilson replied "courteously but firmly" that he would send no British troops to Southeast Asia. Defense scale-backs would also commence as planned. Wilson denies in his memoirs that Johnson suggested a link between long-term help for the pound and troops in Vietnam. Nevertheless, given the icy relationship between the two men, it would be surprising if Johnson had not implied this link.\textsuperscript{35}

Francis M. Bator to President Johnson, "Memorandum for the President: Your 22 July meeting on the U.K. Problem (Secretaries Rusk, Fowler, McNamara, and Ball; Messrs. Rostow, Ackley, and Bator)," 21 July 1966, both 16 June-31 July 1966, Bator Chron File, LBJ Library.


\textsuperscript{35} Wilson, The Labour Government, 263-5. At this point, British personnel committed East of Suez totalled about 100,000, including those stationed at Aden and
From this point, Wilson could do little more than wait. His extremely unpopular austerity measures exacted their pain by increasing unemployment, although it was very low at less than 2 percent. While Ackley observed that the central banking community thought that Wilson's draconian measures might work, the speculators did not. The CEA Chairman worried that things would become worse in September, and recommended a window-dressing overnight loan to make the published figures look better. The impending IMF annual meeting also concerned Ackley. He recalled that Cripps carried out the previous decision while the 1949 meeting was in session.36

As summer turned into autumn, the situation for the British began to reflect improvement, partially because Wilson's measures were beginning to show some effect. By the spring of 1967, the British managed to repay the central bank debt completely and liquidate a good portion of their IMF debt. Nevertheless, the markets essentially put the pound and Wilson on probation. American officials

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Singapore. Wilson had recently conducted a Defense Review that called for significant reductions, including closing the Aden base. The forces at Singapore and Malaysia would be maintained until the insurgency on the Malay Peninsula could be pacified. After that, reductions there would more than likely be accelerated. See "Background Paper: U.K. Defense Commitments East of Suez," 27 July 1966, July 1966 Briefing Books for Wilson Visit, C.F./U.K., National Security File, LBJ Library.

predicted, uncannily, as it turned out, that another crisis would begin in spring 1967, and that Wilson remained as vulnerable as ever.37

The lull did not last, of course. Another sterling crisis began in the spring of 1967. This one, however, ultimately forced the devaluation that everyone in London and Washington had sought to avoid. The same causes were at work: a combination of systemic factors within the British economy, and domestic and foreign events outside the British government's control. Again, American help was slow in coming. When it did arrive, it came with requirements involving mutual defense obligations. The Americans held the British to the $2.80 parity to the last minute. This time, though, the only variations in the story were that the external factors were more abundant and intense.

Before the storm broke out, though, Wilson and Callaghan moved on a few policy measures. The EEC application scheduled in May, was one. Another was an attempt in January by Callaghan, Fowler, and their Continental European counterparts to coordinate interest

37 "Background Paper: British Economy," 7 October 1966; "Background Paper: U.K. Domestic Political Situation," 13 October 1966, both Briefing Papers Brown Visit October 1966, C.F./U.K., National Security File, LBJ Library. According to Brittan, *Steering the Economy*, 340-1, the surplus of L141 million ($395 million) generated during the final quarter of 1966 resulted largely from the fact that the improvement in the trade surplus resulted largely from the fact that much importing was deferred until after the surcharge had been lifted--it would be made up in the first quarter of 1967.
rates. Here, the goal was to stabilize the fiscal and monetary situations in both Britain and the United States.\textsuperscript{38}

Still another was the 1967 Defense Review. Wilson planned to announce it July. At a time when the Vietnam War was going badly for the United States, the Johnson Administration wanted the British presence in other crucial areas more than ever. Still, the 1967 Defense Review envisioned a complete phase-out of all British troop commitments East of Suez and in East Asia by the mid-1970s. Wilson needed the Defense Review badly to shore up his declining popularity at home. By this time, with the Vietnam War raging, most of the Labour party and a growing segment of British public opinion saw little use for the commitments. To them, "Lyndon Johnson seemed to be the only beneficiary."\textsuperscript{39}

Unfortunately, by May, when the 1967 crisis itself erupted, the British economy was overheating again. Everyone disregarded the mandatory 1966 wage and price guidelines. Again, the high sterling parity hurt the trade

\textsuperscript{38} U.S. Treasury \textit{Administrative History}, Chapter X, 49-51.

balance by encouraging imports and making exports prohibitively expensive.\textsuperscript{40}

Besides the failure of the 1966 wage and price measures to work properly, two other factors came into play to hurt the British balance of payments: April's bad trade figures and the Six Day War in June. Closure of the Suez Canal and an oil embargo against Britain and the United States for supporting Israel followed. In response to the speculation that followed, de Gaulle inflicted another blow by vetoing British entry into the EEC. Officials on the other side of the Atlantic became alarmed. Bator wrote to Johnson that it would be "a solid bet that Britain (would) really and finally stop playing a serious world role" if Wilson lost control over events. Any rescue operation that they contemplated, though, could not risk a serious strain on the American balance of payments. The foreign exchange costs of the Vietnam War mounted. In addition, Fowler's negotiations over international monetary reform were hitting a snag.\textsuperscript{41}

\textsuperscript{40} Cairncross and Eichengreen, \textit{Sterling in Decline}, 191-3, show that from the last quarter of 1964 to second quarter of 1966, hourly wages rose about 10\% annually. Six months after the July 1966 freeze, wages were increasing over 6 percent (annualized) until devaluation. Cairncross and Eichengreen further state, "This occurred despite the fact that unemployment was actually rising from 1.2 percent in July 1966 to 2.3 percent in November 1967."

Administration officials, however, tried to use Wilson's sorry predicament to induce him to maintain Britain's troop commitments. They came up with the idea of a long-term, multilateral loan or even a grant if Wilson would only reconsider pulling out from his defense commitments. While Callaghan, who went to discuss the loan with Fowler, anxiously wanted it, the *quid pro quo* to stay East of Suez was "unacceptable." Still, Callaghan sought to prolong the discussions of a long term loan, but in vain. Callaghan also approached the EEC with the matter, but de Gaulle's opposition ensured a rejection.\footnote{Callaghan, *Time and Chance*, 211-3.}

Sterling's position remained weak throughout the summer. The clamor for devaluation grew among certain British businessmen, economists, labor leaders, the left-wing of the Labour Party, and the press. Wilson's decision to relax the July 1966 austerity measures also hurt, though he was facing a rebellion in his own party. By July 1967, Callaghan's enthusiasm for maintaining the parity was beginning to wear thin. Wilson held him firm to the $2.80 parity, though, as did Sir Alec Cairncross, Director of the Government Economic Service.\footnote{Gardner Ackley, "Memorandum for the President, Subject: Weekly Balance of Payments Report," 26 August 1967, Supporting Document, *CEA Administrative History*, Chapter 4; Brittan in Brittan and Burk, "Symposium," 52; *Ibid.*, 215; Wilson, *The Labour Government*, 429; Walter W. Heller, "Memorandum for the Files: Sir Alec Cairncross on Sterling," 18 August 1967; "Memorandum on the Fate of the}
Unfortunately, the events from September on dashed hopes for sterling's improved health. On 18 September 1967, a two-month long wildcat dock strike broke out. This strike severely affected Great Britain's October trade figures. During the week of 16 October, Ackley reported to Johnson that the Bank of England had to support the pound's spot and forward markets by $300 million. The news that the Bank of England had negotiated a $104 million loan from private Swiss lenders upset the markets even more, as did a modest rise in Bank Rate from 5.5 percent to 6 percent. Couve de Murville added to the pandemonium. He announced that the British had to attain balance of payments equilibrium and renounce reserve currency status before the French would offer assistance.

By late October, the Bank of England was forecasting a L500 million ($1.4 billion) balance of payments deficit for year-end 1967, and additional deficits for the next two years. In addition, the EEC released a study done as part of Britain's application process. This EEC study raised serious reservations about the viability of the pound as a reserve currency in the international monetary system. 44

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By November, it was almost certain that the sterling parity was no longer sustainable, especially in the face of worsening conditions. Not even another rise in the Bank of England’s discount rate to 6.5 percent could hold off the speculators for long. On 2 November, Cairncross abandoned his support for the $2.80 parity, which persuaded Callaghan to devalue. Both Callaghan and Wilson now agreed that it was necessary to warn the Americans that a devaluation was probably in the offing. Callaghan’s letter to Fowler dated 10 November 1967 hedged the issue, though. It said that

_Economy, 353-5; Callaghan, *Time and Chance*, 215._

While according to Cairncross and Eichengreen in *Sterling in Decline* the total volume of the forward contracts outstanding has never been published, on 184-5, they give some indication of its magnitude. They reason that since the loss figure that was published on all of the contracts since 1964 totalled £356 million ($997 billion), this would suggest a total outstanding figure at the time of devaluation of well over £2 billion ($5.6 billion). Cairncross and Eichengreen note that "the Account engaged in forward transactions from time to time was known in the 1950s, but the scale on which it was prepared to support the forward market from 1964 onwards was a closely kept secret." The breakdown of figures they supply is as follows:

- IMF drawings (net) £656 million ($1.8 billion)
- Other monetary authorities 948 million ($2.8 billion)
- Official reserves drawings (69) " ($193 million)

\[ \text{Total: £1,534 million ($4.3 billion)} \]

- Net forward sales £2,100 million ($5.9 billion)
- Loss on forward sales £356 million ($1 billion)
while Wilson and he wanted to maintain the parity, they could "no longer afford to live hand to mouth."

Last ditch efforts to assemble a credit package failed. The British Treasury official responsible for international monetary affairs, Second Secretary Sir Denis Rickett, and his American counterpart, Treasury Undersecretary for Monetary Affairs Frederick L. Deming, could not assemble one. Callaghan rejected the $3 billion loan offered by the Johnson administration. Apparently, he could accept neither its term (probably too short) nor side covenants (probably requiring the British to maintain their commitments East of Suez). He also turned down a $2 billion IMF loan because it was not sufficient to defend the parity. By this point, devaluation was unavoidable.

All that remained was the amount and timing of the devaluation, which was soon coming. Wilson, Callaghan, Trend, and William Armstrong, the Joint Permanent Secretary to the British Treasury decided upon a devaluation of 14 percent to $2.40. On 16 November 1967, the Cabinet decided to devalue. Nevertheless, the financial bloodletting was not over. During question time in the House of Commons, Callaghan hedged his response to a question about Britain's

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46 Cairncross and Eichengreen, Sterling in Decline, 190; Callaghan, Time and Chance, 220.
seeking a stabilization loan. Afterward, the markets responded more feverishly than they had before.

The following day, 17 November, Wilson and Callaghan set the date for the devaluation would occur on 18 November 1967, a Saturday. After announcing the decision, Callaghan resigned. Wilson then transferred him to the Home Office. The outlook for sterling remained uncertain until the British balance of payments posted a surplus in 1969. Even from then, its position would remain weak. Additional shocks described in the next chapter buffeted the international monetary system in 1968. These shocks made sterling’s position tenuous. Callaghan and the British monetary authorities had announced a set of even tougher measures at the time of the devaluation. Wilson later publicized decisions to reduce defense outlays and to withdraw East of Suez. Concomitantly, the budget reduced welfare expenditures. The budget that the new Chancellor, Roy Jenkins, announced the following spring was very restrictive. It featured several fiscal measures designed to reign in consumer spending and placing yet another cap on wages and incomes. Fears arose about how much the Bank of England was drawing on its credit lines with foreign central banks. To mollify these concerns, it agreed to guarantee in dollars the sterling balances that these creditors held. A move into surplus during 1969, though, strengthened sterling’s position. Moreover, it enabled the Bank of
England to reduce its debt from £3.3 billion ($8 billion) at year-end 1968 to £667 million ($1.6 billion) over the next two years.47

The Johnson administration reacted to the devaluation with concern. Wilson and Callaghan had kept Washington well informed before each decision. The reality of devaluation, however, had a tremendous effect upon all of the domestic and foreign policy decisions that Johnson would have to make. After the announcement to retreat from East of Suez, one American official begged Brown, now Foreign Secretary, "Be British, George, be British--how can you betray us?"48

At a time when the Vietnam War would take a disastrous turn with the Tet Offensive, this decision hardly came at a propitious time for the United States.

This was but one worry that the administration would have to face. As the next chapter will discuss, the international monetary situation had become unstable. Now, the dollar stood on the front line. The last quarter of 1967 posted a tremendous increase in the American balance of payments deficit. This increase was largely the result of the efforts to defend the sterling parity. Moreover, the administration was facing increased pressure from home and abroad to pass a tax surcharge to counteract Vietnam War-induced inflation.

47 Solomon, The International Monetary System, 96-8.
48 Dimbleby and Reynolds, An Ocean Apart, 255.
The inability of both the United States and Britain to manage their currencies, and by extension, their payments difficulties, gave sterling-dollar diplomacy a new twist in the 1960s. The problem was thus. One country continued to live beyond its means. The other approached the point where it had to begin to make choices among its policies. Both countries were pursuing ambitious domestic agendas. One of them, though, was also pursuing an ambitious foreign policy agenda, both in diplomatic and in economic terms. This pursuit only complicated things. In the end, not only sterling but the entire international monetary system would take lesser priority to other concerns. Neither country, especially the United States, wanted to relinquish responsibilities in other areas.

In a broader sense, the sterling devaluation episode, its buildup, and its aftermath, marks a transition point in the Special Relationship. There had always existed an assumption that despite Britain's inferior status to the United States, it still commanded the resources to play some sort of world role. Such a role was important to the United States, although it clearly intended to act in a guiding capacity. The sterling devaluation, however, confirmed Britain's actual loss of status as a world power, even if its economy would continue to be important in the world.

In addition, it proved that the Special Relationship could have certain mutually harmful aspects to both powers.
Still, the British at least had seen this development coming for some time. Britain had attempted to enter the EEC and take up a more European role long before the 1967 sterling crisis occurred. Still, the British wanted to have sterling play a major role in finance while embarking upon a host of domestic programs. This attachment to prestige and to broadening the welfare net made them a hostage to American policy prerogatives.

For the United States alone, however, the sterling devaluation of 1967 also meant that it was time to start setting policy priorities. As Wilson was devaluing sterling, the Vietnam War was becoming totally unmanageable. The effects of the Vietnam War and the requirements of domestic and international monetary stability had not just intersected with each other. They were colliding. This convergence of the war’s requirements and the exigencies of the Johnson Administration’s other priorities showed something. As Chapter Four will show, it revealed for the first time since the end of the Second World War, the limits of American power and capability.
CHAPTER XV

THE YEAR OF RECKONING (1968)

With the sterling devaluation's aftermath, combined with the escalating costs of the Vietnam War, the United States reached the limits of its financial resources. The confluence of these two developments induced severe assaults on the dollar in the expectation that the United States would have to suspend its convertibility into gold. Were the United States to acquiesce to this step, it would endanger the American policy of fostering fixed exchange rates. The year 1968, then, saw many attacks upon the existing international monetary system, and upon American attempts to preserve international monetary order. These onslaughts forced the fixed dollar-gold parity to give way to the two-tier gold standard.

The prospects for the survival of this new standard were at best mixed. Although it relieved immediate pressure upon the markets, the entire network of fixed-rate currency relationships became threatened before long. Domestic economic and social developments in France and Germany caused the markets to render verdicts on their currency parities. American efforts to adjudicate the parity
questions were only partially successful. This existing French parity held until after Charles de Gaulle’s departure from power, while the Germans successfully delayed the revaluation everyone had asked them to undertake.

Unfortunately, these blows to the international monetary system did not occur at a good time for the United States. At this time, it began to lose control of financial costs of the Vietnam War. The weaknesses in the international monetary system and the shortcomings in the American effort to finance the war reinforced each other’s detrimental effects. The Vietnam War had caused the American balance of payments to spiral into large deficits, to the anger of central bankers in Europe and elsewhere.

Upset at the inflationary overheating that the war was causing, these bankers, and others, pressed the administration to pass a tax surcharge. This measure was the same one that Johnson had proposed almost a year before. Thus, the foreign officials joined a chorus of domestic critics who had been arguing for the United States to do something. Eventually, the tax surcharge passed, but only at some cost of Johnson’s Great Society programs. Not since before the First World War were foreign officials were able to influence, if not actually dictate, an American domestic policy decision in such a manner.

In a dramatic way, the surcharge and the recession of Johnson’s domestic agenda underscored the limits of the New
Economics. From 1968 on, its votaries never enjoyed undisputed authority. A return to an earlier tradition grounded in old-style classical liberalism was in the air. Still, while activism began retreating in the United States, it gained ground in Europe. The previous chapter showed how the commitment to domestic activism constrained Britain's freedom of action in international monetary affairs. France and Germany were also adopting policies calling for an increased commitment in domestic economic questions. Their activism made them less willing to cooperate fully with the United States in international monetary matters. For some time before 1968 this development had been underway. Nevertheless, it was the international monetary chaos of that year, coupled with the domestic difficulties that came about independently, that made this development pronounced.

The United States persevered during that difficult year, 1968, out of fear. This fear provided the motivation for Johnson and his advisers to work indefatigably to maintain international monetary order. They worried lest the international monetary system collapse from such pressures as virulent currency speculation and the effects of the Vietnam War. As American officials valiantly moved to preserve the international monetary system and pass the tax surcharge, memories of previous international monetary crises were in their minds. Should another imbroglio recur, they reasoned, the results potentially could be disastrous.
Still, the resources available were less than what their goals required. The foreign and domestic crises that were occurring exceeded their ability to cope with all of them. In the future, the reality was clear. The United States could still provide world leadership, but it would have to be more selective about objectives it pursued. Whether the United States could or would make choices, though, was an open question.

The November 1967 sterling devaluation was, simply put, a serious blow to American international financial policy. From that point on, the dollar would "be on the front line," in Robert Roosa's words. After the devaluation, speculators rapidly accumulated gold in expectation that the United States might either be forced to raise its price, or suspend dollar convertibility. Moreover, the French took advantage of the situation, which encouraged even more speculation against the dollar. De Gaulle and his lieutenants preached about the responsibilities of the reserve currency countries. The French President also vetoed Britain's application for Common Market membership upon which Wilson had rested so many of his political hopes.¹

¹ Le Monde, 24 November 1967, 22d; 28 November 1967, 1d; 29 November 1967, 1, 2, 3, 4a; 30 November 1967, 1a and 2d; 1 December 1967, 21b; 16 December 1967, 5b; 17/18 December 1967, 15c.
The implication of all of the events that the sterling devaluation, along with the financial effects of the Vietnam War, would set in place was that the United States was reaching constraints on its financial resources. No longer could the administration pursue ambitious, unlimited foreign and domestic policy agendas simultaneously. Nor could the administration rely upon fiscal stimulus to induce economic growth, especially with the inflation in the economy. Before long, the administration would have to make some choices among its policy options, however unpopular or painful they might be.

What Johnson had finally acquiesced to in January 1967 was a proposal for a 10 percent tax surcharge to pay for the Vietnam War, absorb the inflation in the economy, and help bring relief to the balance of payments. He had been very reluctant to request the surcharge because he knew that fiscal conservatives would ask for cutbacks in his Great Society programs. Since early October 1967, House Ways and Means Chairman Wilbur Mills (D-Arkansas) and House Minority Leader Gerald R. Ford of Michigan had kept the surcharge bill bottled up in committee until the administration agreed to match the projected surcharge revenues of $6 billion with domestic spending cuts. Johnson had agreed to cuts of $4 billion, but would go no farther.²

The President did not think, or at least he did not say so publicly, that he did not have to curtail either domestic or war spending. He firmly adhered to a belief that the American economy had the capacity to provide for all of his programs. The day before the sterling devaluation, he exclaimed that "we can do it with the gross national product we have" as long as Congress passed the surcharge.\(^3\)

The sterling devaluation, though, began to induce some change of heart within the administration. Linkage among domestic retrenchment, the tax surcharge, and preserving the international monetary system began to occur almost immediately. On 19 and 20 November 1967, Johnson, other Administration officials, and Federal Reserve Chairman William McChesney Martin met with key congressional leaders of both parties. They wanted to discuss the sterling devaluation and its effect upon American domestic and foreign objectives. Treasury Secretary Henry H. Fowler, long the point man for American international monetary objectives, forthrightly explained the situation that the United States faced. He added, bluntly, "What was now happening to the U.K. should serve as a lesson to us." The surcharge was needed to maintain confidence of the

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\(^3\) Califano, *The Triumph and Tragedy of Lyndon Johnson*, 245.
international markets and continue the policy of unconditional dollar convertibility.

Many senators and congressmen present agreed with this grim diagnosis. Senate Minority Leader Everett Dirksen of Illinois expressed his fears of another 1930s style depression if the tax surcharge failed to pass. Still, almost everyone recognized the key role that Mills and Ford had to play here. Everyone recognized that neither Mills or Ford would budge until the administration gave more.4

Fowler was one of the first who recognized the need to cut back on domestic spending. In his mind, some accommodation of Mills was necessary in order to pass the surcharge and show people at home and abroad that the United States was fiscally responsible. As mentioned in the last chapter, he had received an earful of complaints at the September IMF annual meeting from his foreign peers about the need to have a tax increase. Johnson stood firm for the time being. His January 1968 State of the Union address not only preserved existing programs but included proposals for new ones as well. Still, certain advisers, such as White House staffer Joseph Califano, saw Fowler’s attitude as a

serious threat to the Great Society. In his memoirs, Califano described the competing counsels of Fowler and persons such as himself as a "battleground for the President's mind."5

Naturally, this meant that there would be little progress on passing the surcharge for the moment. Meanwhile, the monetary chaos continued. In the first week after the sterling devaluation, CEA Chairman Gardner Ackley reported that the London Gold Pool had disgorged over $641 million to speculators onto the open markets. On 27 November, Treasury Undersecretary for Monetary Affairs Frederick L. Deming negotiated an agreement with the other Gold Pool members to maintain the $35 gold price. Still, as Ackley stressed, what would help most would be successful ratification of the SDR plan approved the September IMF annual meeting in Rio de Janeiro. In Ackley's words, the SDR plan "would remove the tyranny of gold over the world monetary system."

Ackley realized, however, just what the SDR plan was going to entail. In so doing, he too saw that the United States would have to retrench, although in his mind it would be over the custodianship of the international monetary system. He informed Johnson that the plan meant that the United States would have to share control over international

5 Califano, The Triumph and Tragedy of Lyndon Johnson, 253, 255.
monetary affairs with other nations. Moreover, the United States had to bow to some international pressures to put its balance of payments in order. The implication of this, of course, was obvious. The SDR arrangement's original purpose was to provide international liquidity once the United States balanced its payments deficits. Now, the agreement symbolized the limits of American power. No longer could the United States throw a blank check at the world or to its own people.

Successfully ratifying the SDR arrangements was not the only avenue that the Americans were pursuing. American officials were also attempting to negotiate some backup plans to supplement the SDR agreements and relieve pressure on American gold stocks. When the SDR negotiations became contentious during midsummer 1967, Fowler, Martin, and their assistants came up with two alternate schemes to the SDR plan.

The first one included enlarging the G-10's swap lines, combined with requiring gold dealers to obtain special licenses to deal in gold. The Americans soon rejected this approach, however. They realized that licensing would require an accommodation with the South Africans, who were the world's largest non-Communist gold producers. American

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Treasury officials did not want the South Africans to exploit their monopolistic position in the gold markets.⁷

The second approach involved creating another synthetic monetary asset, this time a gold certificate, that central banks could use for official settlements. The Americans settled on this approach, after the favorable response that its author, Federal Reserve official Robert Solomon, received when he discussed it informally with other central banking officials. Nevertheless, the Americans were quite clear that the gold certificate plan was to be but a supplement to their SDR initiative.⁸

As the speculators attacked the dollar, the gold pool central bankers moved into action. On 25 November, Deming, Federal Reserve Governor J. Dewey Daane, New York Federal Reserve President Alfred Hayes, and Charles Coombs, the New York Federal Reserve official responsible for currency operations, flew to Frankfurt to confer with other central bankers. There, everyone debated two options: a proposal of Bank of Italy Governor Guido Carli, and the American gold certificate plan. Carli, and his Belgian and Dutch colleagues, Hubert Ansiaux and Jelle Zijlstra, wanted to end

⁷ Coombs, The Arena of International Finance, 159-60.

⁸ Ibid., 159-60; Solomon, The International Monetary System, 115-6; Gardner Ackley to President Johnson, "Memorandum for the President, Subject: The Gold Situation," 27 November 1967, Supporting Document, CEA Administrative History, Chapter 4.
the pool to stop the hemorrhaging of gold reserves. To replace the pool, Carli proposed a two-tiered system. While the market would decide the price for traders, the central banks would continue to settle with each other at the official price.⁹

Because the Americans had not had the time to study Carli's proposal closely, they eyed it warily. Undoubtedly they did not like, on the first hearing, any notion that there would be any other price than the long standing $35 gold price. Nor had the British and the Swiss liked the idea of closing the gold pool. Instead, they preferred to clamp down on bankers lending to the speculators. In response, Deming, acting on Fowler's instructions, then put forward Robert Solomon's gold certificate plan while supporting the Swiss and the British.

The meeting ended in a compromise. Everyone would continue operations while giving both the two-tiered proposal and the gold certificate plan further study. After the other Americans departed, Coombs remained at the Bundesbank to help coordinate currency market interventions that eventually totaled $2 billion.¹⁰

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The markets remained calm until mid-December. The outcome of that month's BIS meeting in Basle sparked renewed speculation. At the meeting, the European central bankers rejected the gold certificate plan because they found it impractical. It was not this rejection, however, that made the December meeting stormy, but Deming's unannounced presence there. The central bankers preferred to meet in private to discuss various proposals without having to consider their political ramifications. Fowler, undoubtedly worried about the markets, dispatched Deming to Basle. When Deming arrived, he pushed for the gold certificate plan, unaware that the Europeans had already rejected it. Deming also continued to object to the licensing scheme, which the Europeans liked. He thought that it would mean having to grant concessions to South Africa. This displeased the Europeans even more because this uninvited guest was trying to pressure them to go along with an American diplomatic issue that did not concern them. The meeting adjourned without accomplishing anything, and everyone went home disgruntled.\textsuperscript{11}

Once the news of the meeting became public, the market reacted with fervor, to the detriment of the American balance of payments. The thirst for gold was unquenchable. By 18 December 1967, after the market cooled a bit, the

\textsuperscript{11} U.S. Treasury Administrative History, Chapter X, 59-60A; Coombs, The Arena of International Finance, 163.
speculators had purchased over 650 tons of gold worth $750 million. Of course, the speculators did not know what the fourth quarter 1967 figures would be. If they had known exactly the figure that the United States Treasury was estimating, however, they would have reacted with alarm. Fowler's analysts reported to him that the preliminary deficit figure for the fourth quarter of 1967 would be very large: a hefty unannualized $4 billion.¹²

By December, then, several pressures were combining against the United States: market quivers, declining gold stocks, a probable worsening balance of payments, and concerns from foreign central bankers. No relief appeared in sight from Capitol Hill on the tax surcharge to convince speculators and foreign officials that the United States was serious about ordering its finances. Johnson's advisers therefore had to shift their attention from dealing with the gold situation to confronting the threat to balance of payments directly. If the increased speculation made the

¹² "Mr. Deming Drops a Brick," The Economist, 16 December 1967, 1156-7; also 23 December 1967, 1237. For daily figures on gold losses, see The Wall Street Journal, 13 December 1967, 2; 14 December 1967, 2; 15 December 1967, 3; 18 December 1967, 5; 19 December 1967, 24; and 21 December 1967, 16. For balance of payments information see Administrative History, 1 January 1968 Balance of Payments Program, 3. The Economist, 20 December, 1967, 1299, predicted that the third and fourth quarters of 1967 would be the worst for the United States since the Eisenhower years and that "the French would smell blood." The actual figure turned out to be $3.6 billion for the year when it was reported in February 1968. See Strange, International Monetary Relations, 289.
deficit unmanageable, then hopes of salvaging the gold exchange standard would have been lost anyway.

The reaction of the administration marked another significant turning point toward the American approach to the international monetary system. Contrary to the spirit of Bretton Woods, Johnson required direct mandatory capital controls to restore stability to America's balance of payments beginning 1 January 1968. In the past, these programs, as noted in the first chapter, had been voluntary. Now, the administration was undertaking a significant departure from what American policy had been laboring for since the end of the Second World War. For the next two weeks, everyone in the administration who dealt with economic, fiscal, and monetary matters labored round the clock to fashion the new program. Johnson announced the program at his Texas ranch on 1 January, to take advantage of the worldwide closure of financial markets.13

The palliative effects of the new program worked only temporarily. Within a few weeks the market speculation resumed. January's mandatory program, however, gave the administration the opportunity to articulate in public its objectives on international monetary reform again. Fowler released a White Paper to explain the mandatory program, Maintaining the Strength of the United States Dollar in a

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13 Administrative History, 1 January 1968 Balance of Payments Program, 4-7; Califano, The Triumph and Tragedy of Lyndon Johnson, 247.
Strong Free World Economy. It reiterated the need to have a strong dollar, equilibrium in the balance of payments, and the urgency to adopt the SDR plan to provide for world economic prosperity. The document also chided the surplus countries, especially France, for not doing their fair share in international monetary matters.14

Unfortunately, the mandatory program did not restore confidence in American fiscal stewardship. Initially, the financial community seemed to receive it favorably, and the rampant speculation began to recede. In late February, the speculation returned with force, however, after the accumulation of a series of adverse developments. Much of this resulted from the lack of progress on the Vietnam War, particularly from the Tet Offensive in January 1968. Over time, suspicions also grew that the new mandatory program would not help rehabilitate American finances. What seemed to touch off much of it, though, was an impolitic announcement by Senator Jacob Javits (R-New York), calling for the abolition of the London Gold Pool. Many observers considered Senator Javits to be very knowledgeable on monetary matters. His remark no doubt irritated the administration. In January, he had privately made similar

suggestions to Fowler and Fowler's predecessor, C. Douglas Dillon.\textsuperscript{15}

The stage was now set for another demonstration of how America's power was becoming limited. The Johnson Administration compromised the long standing policy of dollar conversions at $35 per ounce. With the total gold pool losses standing at $118 million, many of the central bankers at the March BIS meeting in Basle doubted not only the its prospects, but those of the international monetary system itself. Zijlstra and the Managing Director of the Netherlands Bank, G.A. Kessler, emphatically argued for closing the gold pool. Martin and Bank of England Governor Sir Leslie O'Brien overruled the Dutch bankers, though, and publically announced that the pool would stay open. The Federal Reserve Chairman did not want any decision made in Basle to affect political developments in Washington. Congress was debating a bill that would abolish any requirement to back American currency with gold so that more gold could be made available to defend the dollar. O'Brien wanted to avoid any chance that Jenkins' new stabilization plan might be jeopardized.\textsuperscript{16}

\textsuperscript{15} Congressional Record, 28 February 1968, 4550-1; C. Douglas Dillon to Fowler, 19 January 1968, Gold Crisis and Meeting With Central Bank Governors, 1 of 3, FP 88, LBJ Library; Solomon, The International Monetary System, 117.

Nevertheless, the tempo of speculation began galloping out of control the next day. Probably neither Martin nor O'Brien thought that the system could remain intact. Other American officials also knew that the Gold Pool could no longer hold together. By the end of the week, they had acted to restrict uninhibited dollar convertibility.

Monday, 11 March 1968, the day after the Basle meeting, former Treasury Undersecretary for Monetary Affairs Roosa penned a memorandum to Fowler. His memorandum contained suggestions that resembled Carli's two-tier proposal in November. 17

The question arises: was this memorandum influential in American thinking? Or, did it simply reflect what was already occurring in the thinking of American officials? Whatever the answer, Roosa's proposal became the solution adopted during the following weekend at a Washington meeting of central bankers to discuss the gold situation.

The real issue, however, was not abrogating the London Gold Pool, obtaining finalization of the SDR agreements, or any other policy move. Again, it was the issue of confronting restrictions upon fiscal resources, or in other words, returning to fiscal responsibility. This, of course, was an issue that the administration and Congress, feared to

164-7.

face openly. The slow progress on lifting the gold cover, passing the tax surcharge, and restoring equilibrium to the balance of payments clearly showed this reality. Deming bluntly admitted these developments to Fowler on Wednesday, 13 March. Closing the gold pool, he went on, would prevent gold losses to speculators but not restore confidence. He too saw the need for fiscal restraint. Without this restraint, markets would interpret closing the gold pool as suggesting weakness, not strength.18 By the end of the week, the situation had deteriorated badly. American tourists were embarrassed because Europeans refused to cash their travelers checks.19

Even Fowler capitulated on gold on Thursday, 14 March. That day the Senate had finally voted to lift the 25 percent gold cover. After conferring with his lieutenants, Fowler decided that the London gold market had to be closed, and informed Johnson accordingly. After he accepted this
recommendation, Johnson telephoned Prime Minister Harold Wilson, who arranged for the market's closure.  

Now that the London gold market was closed, gold pool officials had to act quickly. Martin took charge initially by inviting his overseas colleagues to Washington for the weekend to discuss possible courses of action. The following Saturday, 16 March, the following men assembled in the board room of the Federal Reserve building to discuss the situation: O'Brien and three other officials from the Bank of England and the British Treasury; Bundesbank Chairman Dr. Karl Blessing and his aide Johannes Tuengler; Bank of Italy officials Carli and Rinaldo Ossola; Zijlstra and van den Bosch from the Netherlands; Erwin Stopper and Max Ikle from the Bank of Switzerland; Ansiaux from Belgium; and Pierre-Paul Schweitzer, the Managing Director of the IMF. At the last minute, Martin also invited two BIS officials, Gabriel Ferras and Milton Gilbert.

What did Martin hope to accomplish at this meeting, which would last through Sunday, 17 March? He wanted to convince the markets that the United States was serious about maintaining the official gold price. On the other hand, he hoped that he could dissuade the other central bankers from redeeming their dollar balances into gold.

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Nevertheless, the question over whether the United States could honor its pledge would haunt people within the United States Treasury Department, the CEA, and elsewhere. No American official wanted to suspend convertibility. Still, Martin was probably willing to use the threat of suspending convertibility as a bargaining chip. This potential threat, as one of Fowler's assistants pointed out, was the most powerful token that Martin possessed.²²

Still, the possibility that Johnson might have to stop this policy remained. It must be kept in mind that March 1968 was arguably one of the worst months of the Johnson Presidency. The Vietnam War was going very badly, inviting mounting criticism at home and challenges for the Democratic nomination for the presidency that eventually forced Johnson to withdraw. At no other time did any post-World War II President face the boundaries on his courses of action so painfully. The House and Ways and Means Committee was stalling on the surcharge bill. Fowler soon gave a sober warning to Defense Secretary Clark Clifford, who had recently replaced Robert McNamara. This warning was that the United States could no longer continue the fighting for fear of escalating the gold panic.²³ Nobody concerned with


financial matters could have been ignorant of the awful situation that the Johnson administration faced, or the potentially drastic actions that it might take in response.

What happened at the meeting was that a new two-tier gold market was established, in return for some tacit quid pro quos to which all of the parties assembled agreed. Carli then stepped forward to resubmit his two-tier plan, which gained nearly everyone's acceptance by the next day. The Federal Reserve would continue to buy and sell gold with the other central banks at the established parity. The market would decide the price for private gold transactions. Nevertheless, Martin and Deming understood that the Johnson administration would continue to work aggressively to pass the tax surcharge. While this was not mentioned in public to avoid embarrassing the United States, Fowler confirmed this understanding to Washington Post reporter Hobart Rowen after Rowen had reported the event on 15 March 1968. Beyond that, Fowler remained taciturn. He did not mention to Rowen that the Germans would agree to follow looser monetary policies to discourage large capital inflows and that everyone was prepared to cooperate in currency stabilization operations. Nor did Fowler volunteer to Rowen the understandings that Martin and Deming successfully persuaded the others to show care in redeeming their dollar balances,
a fact not openly stated but instead suggested in the meeting's communique.24

What did the new two-tier gold standard and the side agreements mean? In effect, they represented that the United States had to narrow the scope of the conduct of its domestic and foreign policies. Other financial officials and the markets became convinced that the United States would honor its international monetary commitments, and, as a result, the speculation quieted for some time. The United States, on the other hand, had to make certain concessions to fiscal responsibility. As Okun pointed out to Johnson, the two-tiered gold standard was appropriate but only a temporary expedient. Lasting measures that were necessary, he stressed, included the SDR plan, the surcharge, and a balanced payments position.25 Private observers, such as Washington Post columnist Marquis Childs, also thought that restoring soundness to America's finances was essential.26


Some progress on two areas of international and domestic finance occurred within the next few months. As mentioned in Chapter Two, the G-10 ministers approved the SDR arrangements, although not without some amendments. French criticisms, made even more intense by the creation of the two-tier gold standard, did not withstand the determination of everyone else to complete the plan.

Progress on the tax surcharge came about with much greater difficulty. Resistance by Mills and Ford to its passage intensified in the late winter and early spring. They continued to demand significant cuts in Great Society programs. Nor did the fact that Johnson was by this time a lame duck help. As the process stretched out, observers inside and outside the administration became frightened. Califano, still frustrated with persons such as Fowler, tried to urge the President to stop negotiating with Mills and take his case directly to the public. Individuals as diverse as Martin, Schweitzer, and the President and Vice President of the American Bankers Association, J. Howard Laeri and Charles Walker, called for passage of the tax surcharge. In a memorandum he labeled as being "HIGHLY SENSITIVE," Okun worried about another 1930s-style depression if passage failed because the United States would not have convinced the markets that it was fiscally
responsible. Meanwhile, Fowler reinforced this concern in public.27

Johnson showed Okun's memorandum to a number of congressmen, trying to stress what the country faced if the tax surcharge did not pass in Congress. He exclaimed, "That's the risk Wilbur Mills is taking with our country because his momma doesn't like the welfare program." In December, Mills had angered the President by disclosing his mother's complaints about black welfare mothers in Arkansas.28

Nevertheless, Johnson had to acquiesce to obtain passage of the surcharge in June. The $6 billion in revenues it promised to raise were met dollar-for-dollar in cuts in expenses, as Mills and Ford insisted. Johnson had the surcharge, largely at the prodding of the international financial community, conservatives in Congress, and, increasingly, from key financial and economic advisers in his own administration. Nevertheless, it was at the expense


28 Califano, The Triumph and Tragedy of Lyndon Johnson, 245-6, 286.
of his anticipated domestic legacy, his hoped-for claim to greatness in American history.

The sum of developments thus far, then, shows that the United States could no longer pursue its aims, foreign or domestic, without regard to the costs. Fiscal policies of the New Economics, which emphasized stimulating or manipulating demand, were not panaceas. On the other hand, there were limits to certain aspects of American power. The United States could not induce, without resistance, other countries into helping pay for its own fiscal and monetary policies, or sharing the costs of the international monetary system.

There is nothing to suggest here that the United States was on the road to decline, however. Many of the Great Society programs did survive, as Califano points out.\footnote{Califano, \textit{The Triumph and Tragedy of Lyndon Johnson}, 288.} Moreover, the Americans had managed to obtain approval for the SDR plan, much of which was on their turns. The two-tier gold standard still preserved a semblance of the former unconditional convertibility pledge. Also, the convertibility pledge remained a powerful bargaining chip for the Americans. If exercised, it could potentially give the impression of a declaration of insolvency. It also, suggests, however, as Bator had observed about the 1967 \textit{Bundesbank} pledge, that the United States had put the world
on the dollar standard. As explained in the final chapter, this eventually was the case in August 1971. That month, Richard Nixon unveiled his New Economic Plan and suspended dollar convertibility to combat inflation and dwindling gold reserves.

For the present, however, the United States had to maintain international monetary order under the abridged terms of the Bretton Woods agreements. This challenge was formidable, because the international monetary climate remained unstable. Any sign of irregularity or weakness would be bound to cause speculators to move. Thus, United States still had to ensure that all of the other parts of the international monetary system, such as fixed exchange rates, continued to work. Moreover, the United States had to carry this task out with limited resources.

Three challenges came before the United States once the two-tier market came into being. The South Africans and the Americans squabbled over the former’s right to sell gold to the IMF at the market price. The French experienced serious domestic disturbances that sparked a speculative rush against their currency. Then, the Germans, because of their recovering economy, benefitted from the run on the franc because the markets deemed their currency overvalued. Afterward, most other G-10 nations, including the United States, tried to persuade the Germans to revalue.
A discussion of the South African case before the others is appropriate. Of the three situations, it was the least irritating to the United States. Essentially, the South Africans sought to sell about $35 million in gold to the IMF to bring relief to their balance of payments situation. Schweitzer and the Continental European Directors agreed, but the United States objected. American officials wanted the South Africans to sell in the open market to relieve pressure on the market price, which was higher than $35 per ounce. What the United States feared was that South Africa was trying to take advantage of gold market fluctuations. South Africa was requiring the IMF to purchase its gold while unloading additional gold on the open market at the higher market price. The fact that the South Africans had withheld their usual sales of gold at the time of the sterling devaluation had irritated Fowler tremendously. American and South African officials bickered about the matter for the next twelve months. Finally, the Americans agreed that the latter could sell enough gold to the IMF to ease its balance of payments difficulties. They also conceded to the South Africans the right to sell, annually, additional amounts up to $35 million on the open market.  

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30 Fowler, Undated and Unsigned Memorandum; Seymour E. Harris to Fowler, "Gold and International Reserves," Undated, both Gold Crisis Working File, 2 of 2, FP 83, LBJ Library; de Vries, The International Monetary Fund, 409-12; Solomon, The International Monetary System, 124-7; Strange,
The French franc crisis was of greater significance than the scrap with South Africa. This crisis, which began in the spring of 1968, threatened to disrupt the international monetary system just like the perennial sterling crises. Speculators could still threaten a mad dash for gold and undermine the ever-fragile two-tier gold market. There were some observers who now thought that all national currencies had lost credibility.\(^{31}\)

Consequently, the United States Treasury and the Federal Reserve responded quickly to support the franc. Any disruptions in international finance could spread to a run on the dollar. Moreover, the crisis lent even more urgency to getting the tax surcharge passed in Washington.\(^{32}\)

The French balance of payments had made the franc's value vulnerable for some time. After the November 1967 sterling devaluation, The Economist had predicted a major run on the franc as the next serious currency crisis.\(^{33}\)

\(^{31}\) Remarks, Dr. A. Schaefer, Chairman, Union Bank of Switzerland, At the Monetary Conference, Puerto Rico, 19-24 May 1968, Gold Crisis, Meeting with Central Bank Governors of the Gold Pool, 16 March 1968, 2 of 3, FP 88, LBJ Library.


\(^{33}\) U.S. Treasury Administrative History, Chapter X, 44; The Economist, 2 December 1967, 930-1.
What touched off the speculation against the French franc, however, was the series of violent student and workers riots that erupted in Paris in early May. Shortly afterward, the fracas in Paris mushroomed into a nationwide strike that paralyzed critical sectors of the French economy, including most communications.

Currency speculators went on a spree against the franc. French reserve losses in May totaled $300 million, contributing to a balance of payments deficit. Before the month was over, the French were offering to sell gold back to the United States. Eventually, United States recouped over $925 million in gold. By early June, the Banque de France would use its entire swap line of $100 million with the Federal Reserve. It would also have exhausted all of its entire gold tranche drawing rights with the IMF.34

Officials in Washington recognized the need to move quickly to save the French franc, and they responded with dispatch. Nevertheless, they did speculate about some long term ramifications of the crisis might be favorable to American policy. In a memorandum to Johnson, Okun predicted that de Gaulle might be forced to end the crisis by increasing domestic spending and initiating expansionary fiscal and monetary policies. These policies, Okun reasoned, would reduce the French balance of payments.

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34 Coombs, The Arena of International Finance, 178-81; Loriaux, France After Hegemony, 189-90.
surplus and remove much of the incentive that he had to pursue his dollar redemption policy. Ultimately, he added, the crisis could drive Le General from power, which would lessen the role in gold in French policy altogether.\footnote{Coombs, \textit{The Arena of International Finance}, 180; Arthur Okun to President Johnson, "Weekly Balance of Payments Report," 26 May 1968, Supporting Document, CEA Administrative History, Chapter 4.}

Okun was partially right, but de Gaulle remained in power for the time being. His determination to preserve the franc parity, combined with his steadfastness during the riots, won him reelection at the end of June with a considerable majority. Nevertheless, the riots forced him to abandon his conservative fiscal and monetary policies and choose expansionary policies and large wage increases. At a time when the franc was being besieged, however, these highly inflationary measures were dangerous. De Gaulle was determined, though, that the franc and French finances would remain sound. Knowing that the French capital markets were not equipped to handle the increased demands of the public sector without significant rises in interest rates, he raised taxes. Unfortunately, the markets were unimpressed. By September 1968 the speculation had forced the \textit{Banc\`e de France} to draw over $490 million from its Federal Reserve swap line, and use the remainder of its other credit sources. As the French franc joined sterling on the American list of endangered currencies, American officials
agreed to put up a significant portion of a credit package to help the French.\textsuperscript{36}

The franc was not the only currency coming under speculator pressure. As the speculators attacked the franc, they simultaneously tried to bid up the value of the Deutschemark, which many observers thought was undervalued. Moreover, the German economy was again generating trade surpluses, now that it had shaken off the recession of 1966-67. By the late summer, then, the parity of the Deutschemark became a contentious issue. The Germans drew criticism from many quarters. The French were especially unhappy, because they had to restrict credit to support the franc. They charged that the Bundesbank was keeping the Deutschemark's value low to stimulate exports. The line now issuing from Paris was that if de Gaulle were forced to devalue the franc, then the Bundesbank had to revalue the Deutschemark simultaneously. Much of de Gaulle's approach to monetary policy, then, began to be directed to achieve that aim.\textsuperscript{37}


\textsuperscript{37} Solomon, \textit{The International Monetary System}, 155-6.
It would fall to the United States to act as referee in this currency dispute. The Americans agreed that the Deutschemark's parity was too high, perhaps by as much as 7 percent. Consequently, they began working to induce the Germans to revalue. The Germans, of course, denied that their currency was overvalued. Chancellor Kurt Georg Kiesinger's Grand Coalition of Christian Democrats and Social Democrats was particularly sensitive to this issue. It counted on the electoral support of exporting interests, such as agriculture and industry.38

The Germans was also beginning to resent the fact that while their country was an economic giant, everyone else, particularly the United States, treated it like a political and diplomatic nonentity. They thought that they had been doing their fair share by agreeing to hold dollar balances and depart from restrictive monetary policies to encourage expansion and discourage capital inflows. As Bundesbank Chairman, Karl Blessing, pointed out, German payments surpluses did not come from Germany's trade surpluses. These German payments surpluses, Blessing insisted, resulted just as much from the deficits that the United States, Britain, and France were running. Moreover, these balance of payments deficits were now exporting inflation to Germany. If the world's balance of payments were to regain

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38 Solomon, *The International Monetary System*, 156.
equilibrium, the deficit nations would have to do their part. The outspoken Schiller echoed similar criticisms.\(^39\)

Thus, the Germans stood fast. As a conciliatory gesture in early November 1968, however, the Kiesinger government levied a 4 percent border tax adjustment on exports. It announced that this border tax adjustment might, over the medium and long term, induce a decline in the German balance of payments. Nevertheless, both Blessing and Finance Minister Franz-Josef Strauss, bluntly explained that nobody would readjust the Deutschemark's parity upward. Strauss stressed that a revaluation would negatively affect critical sectors of the German economy, particularly agriculture and export manufacturers. Nevertheless, Blessing sought to reassure his audiences that the Bundesbank did not want a return to the beggar-thy-neighbor policies of the 1930s to solve the world's payments polices.\(^40\)

This cacophony coming from official financial circles, only encouraged the speculators, prompting the United States

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to take action. There was another reason for the Americans to act as well. The British were starting to see a decline in their balance of payments. Besides threatening the new sterling parity, the payments weaknesses would tempt the Wilson government to withdraw the BAOR completely. British leaders had threatened to do that in 1966 and 1967.41

Because Fowler and Deming happened to be in Europe accompanying Secretary of State Dean Rusk on a visit to NATO headquarters in Brussels, Johnson instructed them to call a meeting of the other G-10 ministers and Schweitzer. Since Johnson had contacted them in Bonn, they met with Schiller, who agreed to chair a meeting. Unfortunately, Fowler and Schiller misunderstood each other beyond that point. Schiller thought that he had made it clear that Germany had no intention of devaluing. Fowler, Deming, and Martin, who later joined them, assumed that Schiller implied that the parity of the Deutschemark was an open question.42

The meeting convened in Bonn. It lasted from the 20th through the 22nd of November. Its discussions were frustrating for everyone. It had all of the characteristics of a typical surplus country-deficit country showdown. There would be no revaluation of the Deutschemark. The ministers did assemble aid for the French. It was unclear,

though, whether de Gaulle would allow any devaluation, or perhaps a partial one. Nevertheless, this time, the officials from the lone surplus country, Germany, successfully stared down their opponents.

The ministers managed to put together the credit package for the French by 21 November. It totaled $3 billion, with the Germans, the United States, and the BIS providing over a third of it. Still, it was conditional upon an agreement over the parity issue between France and Germany. The French Minister, Francois-Xavier Ortoli, informed the group that unless Germany revalued, his government would have to devalue up to as much as 15 percent. Fowler thought that the French could justify no more than a 3 percent devaluation, while the others thought that a devaluation of 10 percent was appropriate. After giving Ortoli time to telephone Paris, nearly everyone settled on an amount of 11 percent. Fowler finally agreed, but only after he received assurances that only the Franc Area would follow the French. Ortoli announced that de Gaulle would study the proposal and announce his decision over the weekend. Everyone at the meeting, though, interpreted these developments as hinting that de Gaulle would devalue, given the volume of speculation against the franc.43

43 Handwritten Transcript of Proceedings of November G-10 Meeting by Secretary Fowler, International Economy, European Trip, November 1968, Folder 3 of 3, FP 31, LBJ
The meeting ended Friday 22 November. From Fowler's perspective, it was a disappointment. Despite pressure from a majority of the ministers present, the Germans refused to revalue. Moreover, the French course was not completely certain. Schiller and Strauss, though, were jubilant as they confronted the press after the session ended.44

The German press played up the role of the two ministers, praising them for standing up to Fowler and Jenkins, whom they accused of employing strong-arm tactics. On 26 November 1968, the following Tuesday, Kiesinger, Schiller, and Strauss reported the results of the meeting to the Bundestag. Much to the delight of the assembled deputies, Schiller quoted lines from Goethe commemorating the steadfastness of ancient Germans in the face of foreign threats.45

This German attitude was not unusual. What happened in Paris was different. On 24 November, de Gaulle overruled

Library; Jenkins, A Life at the Centre, 268; Solomon, The International Monetary System 159.

44 "Informal Translation of an Official Statement by the Minister of Finance as Released by His Ministry," 22 November 1968; Notes on Press Conference by Minister Schiller, Minister of Economics, Bonn, Germany, 1545, 22 November 1968, both documents International Economics, European Trip, November 1968, Folder 3 of 3, FP 31, LBJ Library; Solomon, The International Monetary System, 159.

his advisers and announced that he would not devalue the franc. De Gaulle's decision heartened the Americans. Surprisingly, though, the markets remained calm.

Developments over the next twelve months, however, proved that the existing franc parity could not hold. Beginning in the spring of 1969, the French trade balance worsened. Anxiety over the results of an April referendum on French constitutional reform also disturbed the markets. When the French electorate rejected the referendum, de Gaulle resigned on 28 April 1969. De Gaulle's successor, Georges Pompidou, had to contend with the franc's problems. On 8 August, Pompidou announced a devaluation of the franc of 11 percent, the very amount recommended at the Bonn conference the previous November. Only the Franc Area followed the French currency on the exchanges. Nevertheless, at least for the near future, the French would not regain the capacity to play spoiler in international monetary politics. Going forward, a commitment to an expansionist course at home to placate dissent occupied more of their attention.

Over that same period, neither would the Germans maintain the value of their currency. The output of their economy surged throughout 1969, and the ever-vigilant Bundesbank tightened up monetary policy accordingly. Naturally, this brought the German balance of payments into greater surplus as interest rate sensitive funds streamed
into the country. Although even Strauss suggested that the Germans might revalue, Kiesinger excluded the possibility, pending the September 1969 elections. Those elections, though, swept the Christian Democrats out of power for the first time. A new coalition of Social Democrats and Free Democrats under the leadership of Willy Brandt took power. That new government revalued the Deutschemark by 9 percent and eliminated the border tax adjustment.46

Nevertheless, what would these developments mean for the United States? The Bonn conference occurred during the twilight days of the Johnson Administration. Its lackluster conclusion hardly matched the bold stance taken well over three and a half years earlier. Then, Fowler proposed a comprehensive reform of the international monetary system at Hot Springs. In his memoirs, Johnson expressed his satisfaction that he had left office with the dollar and the international monetary system strong.47 This self-assessment, however, might stretch the bounds of credibility to some extent. To be sure, the Bretton Woods mechanisms remained in place and Fowler had managed to complete the negotiations on the SDR plan.

Still, the reality showed that grave weaknesses in the international monetary system remained. The events of 1968

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46 Solomon, The International Monetary System, 162-5.
47 Johnson, The Vantage Point, 321.
showed that problems stemming originally from America's balance of payments deficits and its continued involvement in Vietnam weakened its ability to play its customarily dominant role in international finance. Foreigners feeling the pressures from their own constituencies could and did challenge American leadership with some success. This situation was true since the United States was committed to defending the status quo. Moreover, they could pressure the United States to retrench at home and abroad, something that they could not do since the First World War.

In addition, there were at work changes on the intellectual landscape, at least as far as economic policy was concerned. The events had accumulated up to the year 1968 had, gradually, begun to show that the New Economics did not have the answer. Fiscal policies that promised growth stimulated by the public sector would not be a painless path to prosperity. The inflation that was beginning to rage out of control during the latter 1960s proved that was so. This was the case even if much of the inflation resulted from Johnson's failure to put the economy on a wartime footing at the beginning. Finally, this inflation finally began to validate the theories of another school of economists, the monetarists. After three decades of being shunted off the stage, the classical liberals would again have a chance to speak.
The ramification of these developments, though, is the material for the last chapter. It was not Lyndon Johnson's lot to confront the outcome. Instead, that lot was his successor's.
The Johnson administration bequeathed to its successor a host of unsolved financial problems. Nevertheless, the administration of Richard M. Nixon had difficulty departing from the policies of previous administrations. This was true in other matters as well. These areas included trade, the Vietnam War, and the conventional defense of Western Europe. Nixon's approach differed from that of its predecessors only in degree and intensity. Initially, he and his advisers did not want to end Bretton Woods. Still, they found it very difficult, for many reasons, to make vigorous efforts to sustain it. Like all of its post-Depression predecessors, the Nixon administration was committed to maintaining full employment. It was hypersensitive to the potential political fallout that would result if it failed to reach this goal. Thus, it used activist policy, to some extent, to maintain full employment. Energies spent on sustaining full employment, then, took away from those available for the international monetary system. On the other hand, ideological factors of a different kind permitted them to downgrade Bretton Woods
on their list of priorities. A revival of classical, free-
market economics gave the Nixon administration a theoretical
framework for its decisions in international monetary
policy. Once Bretton Woods became too expensive to
maintain, the Nixon administration used the old orthodoxy to
enable it to be passive on international monetary questions.

The administration's passivity could not continue,
however. Eventually the Nixon administration reached the
point where it had to make the sacrifices to preserve
Bretton Woods or jettison it completely. Since the
sacrifices were too costly in domestic terms, the Nixon
administration decided to cast Bretton Woods aside.

The purpose of this final chapter, then, is twofold.
It will summarily discuss the Nixon administration's
approach to international monetary policy in order to bring
the reader up to the end of the Bretton Woods regime in
August 1971. After that, this chapter will summarize the
dissertation's findings and offer concluding comments.
These conclusions will attempt to address the basic themes
enumerated in the dissertation's introduction and developed
in its body.

Economic concerns were not what elected Nixon to office
in November 1968, but rather widespread dissatisfaction with
the Vietnam War and the domestic unrest that that war had
helped to generate. When he assumed office, Nixon, like his
predecessor, downgraded the importance of international monetary concerns. Foreign and military matters took greater precedence, and Nixon organized his administration staff accordingly.¹

Domestic economic concerns, though, were important to Nixon, for political reasons. This concern of Nixon's was so marked that it prevented him from opting for austerity to balance of payment's deficit.² To be sure, Nixon was not committed to rejuvenating the Great Society, but during his tenure he had to face a Democratic opposition committed to more government spending. Although he tried to parry Congress by impounding appropriated funds, Congress overrode this strategy by passing legislation against it.³

Nevertheless, Nixon did not want to revert completely back to the laissez-faire Republicanism of Calvin Coolidge. Nixon had firsthand experience of what an economic slowdown could do to a political career. In 1960 he had lost the Presidential election because of Eisenhower's refusal to stimulate the economy out of the third recession that struck during his term. Nixon never forgot that defeat. No recession would occur on his watch, if he could help it.

¹ Volcker and Gyohten, Changing Fortunes, 64-5.
² Gowa's Closing the Gold Window focuses extensively on the domestic pressures that led Nixon to suspend gold-dollar convertibility, and the following analysis is informed by some of her findings.
³ Stein, Presidential Economics, 197-201.
Nor did he want to cut programs his middle class constituency cherished. Nixon did have a distaste for government controls that derived from a brief stint with the Office of Price Administration (OPA) of the Second World War. As will be shown, though, he allowed political expediency to take precedence over economic principle.\(^4\)

Likewise, Nixon’s economic team were cast a "pragmatic" conservative mold: David Kennedy, his first Treasury Secretary; Paul Volcker, a holdover official from the Johnson administration who became Treasury Undersecretary for Monetary Affairs; and George Shultz, who served first as Budget Director and later as Labor Secretary. His leading CEA appointees, Paul McCracken and Herbert Stein, had been, like the New Economists, graduate students during the 1930s. Nevertheless, as Stein has confessed, he and his like-minded fellows had not fully imbibed Keynes’ teachings. Stein, like Nixon, had worked for the OPA and had developed the same distaste of governmental control. As the top research economist with the postwar CED, however, he had accepted that body’s recommendation to balance the federal budget at "high employment." This, of course, was the rule that Eisenhower later followed.\(^5\)

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Nor was Arthur Burns, whom Nixon appointed to head the Federal Reserve after Martin’s retirement in 1970, a doctrinaire free-marketeer. As noted previously, Burns was an associate of the *laissez-faire* Mont Pelerin Society that Friedrich Hayek had founded. Nevertheless, his performance as a public official was attuned to political realities. He had served as CEA Chairman during the first three years of Eisenhower’s Administration, where he was Nixon’s closest ally. During that time, Burns had pleaded with Eisenhower to relax his adherence to the CEA "high employment" budget balancing rule and tight monetary policy. After Burns left that Administration in 1956, he insisted even more that the Administration relax stringency, especially during the 1960 election. Naturally, once Nixon finally triumphed, he wanted Burns on board. When Martin retired from the Federal Reserve in early 1970, Nixon appointed Burns as Chairman.6

Nixon’s approach to international monetary questions, then, was initially passive. Nevertheless, the balance of payments deficits and international monetary problems continued to exist once Nixon assumed office. To be sure, the balance of payments measured in terms of the official reserve transactions balance posted a $1.6 billion surplus in 1968 and a $2.7 billion surplus in 1969. These surplus figures, however, were the result of a tight monetary policy

pursued at the Federal Reserve under the leadership of Chairman William McChesney Martin. As money became more expensive at home, American-based multinational banks borrowed cheaper funds from their foreign branches to lend more profitably at home.\footnote{Calleo, The Imperious Economy, 58-60; 1974 Economic Report of the President, 350-1. That same Economic Report of the President, though, shows the balance of payments in terms of the net liquidity balance, though, at deficit figures of $1.6 billion and $6.1 billion for 1968 and 1969, respectively.}

The origins of Martin's tighter interest rate approach lay in the particular fiscal policies followed under the Johnson administration. Johnson, as has been mentioned, was committed to an expansionary domestic economic program. This program, though, gave little leeway for the application of fiscal remedies against the inflation that began to surface in late 1965. Consequently, Martin's Federal Reserve had to play the restraining role with monetary policy. In December 1965, Martin and the other Federal Reserve governors, much to Johnson's ire, raised the discount rate by half a percent. Unfortunately, a credit crunch followed that struck particularly hard at the building industries and brought the country into near-recession by the middle of the summer 1966. Concerned that the country might drift into recession, the Federal Reserve reversed its policy by the end of the year.
As has already been discussed, by 1966, another major factor had emerged to exacerbate the management of fiscal and monetary policy, that being the Vietnam War. The Vietnam War did much to cause the rate of inflation to increase significantly in 1967 and 1968. Still, the Federal Reserve backed off from raising interest rates and tightening credit until late 1968. Its reluctance to act quickly stemmed from its fear of congressional criticism, the anger of business groups, and international situations, such as the fight to save sterling in 1967.\(^8\)

The war-induced inflation contributed to the balance of payments woes in another way. That inflation caused the trade surplus over time to deteriorate. Essentially, the inflation, under the prevailing fixed exchange regime in place under Bretton Woods, had caused the dollar to become overvalued. What happened from there, of course, was quite logical. American imports, from 1964 onwards, significantly exceeded American exports. The Kennedy administration had pushed for trade liberalization as a way to improve the American trade balance, and, from there, the balance of payments. By the time that the Kennedy Round had successfully concluded, however, the deterioration in the American trade balance was already underway. In the inflationary climate that was occurring, trade

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liberalization gave foreigners an excellent opportunity to increase their market share in the United States. American multinationals, on the other hand, were not nearly as fortunate. More and more legislators called for protectionist measures. The result was, eventually, a deficit position in the trade balance that became permanent.  

Theoretically, the way to halt both the inflation and the balance of payments deficits was through monetary policies that would have required austerity to some degree. For domestic political reasons, though, Nixon was not about to accept this remedy. If the balance of payments improved in 1969, that improvement was still short lived. The Nixon administration saw to it that it lost out to domestic political advantage. By late 1970, the balance of payments was back in deficit, this time permanently. The deficit measured in terms of the net liquidity balance was $3.9 billion. The official reserve transactions deficit reached almost $10 billion, largely because of interest rate differentials with foreign money markets. Upon his appointment to the Federal Reserve, Burns resorted to an easier money policy largely to accommodate Nixon's political needs.

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Nevertheless, the balance of payments was not the only casualty of Burns' approach. Another consequence was that inflation roared out of control again. Unfortunately, beginning in 1970, a recession also set in. The concomitant occurrence of these two trends persisted, creating a new phenomenon that economists termed *stagflation*. Whatever it was, it hurt Nixon in 1970. In that year's elections, Republicans suffered big defeats at all levels of government. The following year, in an attempt to stimulate the economy, Burns sped up monetary growth. The economy eventually came out of its recession, but not without inflation.10

This stagflation defied all theories to explain it. It dealt a crippling blow to standard Keynesian explanations of the relationship between inflation and unemployment that the British economist A.W. Phillips had expressed in 1956. Phillips' analysis postulated that inflation was a necessary cost for unemployment and economic growth. With Keynesianism discredited, classical theory began to make a comeback. This onset of the stagflation only seemed to confirm the criticisms of one particularly vocal economist, Milton Friedman. His credibility increased during the late 1960s as his critiques of Keynesian theories appeared to have merit. By 1967, he had been elected president of the

American Economics Association. Later, he went on to become a Nobel Laureate.\footnote{Matusow, The Unraveling of America, 162.}

Friedman theorized that, above all else, inflation was a monetary phenomenon. In much of his analytical work, he castigated the Federal Reserve, and all central banks, as institutions. For example, in the early 1960s, he and another economist, Anna Schwarz, had written an influential monetary history that had blamed the Federal Reserve for the Great Depression. With respect to money, and the Federal Reserve's management of it, Friedman reasoned as follows. He observed that people continuously try to adjust the money they have in their bank balances to conform to some constant. If they have more than what is optimal, they spend it. If less, they save it. Therefore, if the Federal Reserve decides to increase the money supply to a greater amount than what people wanted, they returned money to circulation. The short run consequences of monetary stimulation, he continued, might increase the economy's output. Once stimulative policy became habit, however, people soon realized this and adjusted their expectations accordingly, i.e., higher rents, prices, and interest rates.\footnote{Milton Friedman and Anna J. Schwarz, A Monetary History of the United States, Princeton: Princeton University Press for the National Bureau of Economic Research, 1963; Matusow, The Unraveling of America, 164-5; Calleo, The Imperious Economy, 38-41.}
Friedman's Keynesianesque critics criticized his work as being much too impressionistic and not based empirical study. From 1966 onwards, though, Friedman had the upper hand, as Martin's Federal Reserve appeared to stumble. By 1968, Friedman was serving as an economic consultant with the Nixon presidential campaign.13

Friedman also had a tremendous influence in international monetary thinking. He had kept up his advocacy for flexible exchange rates throughout the 1960s, frequently sparring with officials such as Robert Roosa.14 Again, Friedman's advocacy originated in his libertarianism that opposed any sort of "arbitrary" determination of the value of anything, including money. Flexible exchange rates would enable the markets to set the value of currency parities instead.

Nevertheless, Friedman's influence upon administration policy was mixed. His influence was probably strongest in the area of international monetary policy. Floating exchange rates reinforced passivity. This influence of Friedman's came via a Harvard economics professor, Gottfried Haberler. Haberler headed an early administration task force to study various options with respect to international monetary issues. He had longstanding ties to Wilhelm

13 Matusow, The Unraveling of America, 163, 165-7.

Roepke, Friedman's Mont Pelerin Society colleague.\textsuperscript{15} He was also a former professor of Volcker's, although Volcker did not share the teacher's enthusiasm for passivity in international monetary matters. In 1969, Volcker and his staff had conducted a study that rejected passivity and floating exchange rates as being too destabilizing.\textsuperscript{16}

On the other hand, Friedman's free-market approach did not become domestic policy. Instead, Nixon reverted to something that he had professed to abhor: direct wage and price controls. The idea had probably originated with Nixon himself, or Burns. Both men recognized that controls were politically expedient. Throughout 1970, Burns intimated in public that he favored certain types of mandatory controls. Unlike any liberal Democrat such as John Kenneth Galbraith, the "conservative" Burns could get away with such a recommendation, just as only Nixon could go to China. Following the 1970 election debacle, Burns stepped up his advocacy even as he increased the rate of growth of the money supply.\textsuperscript{17}

\textsuperscript{15} Bradford A. Lee, "The Miscarriage of Necessity and Invention: Proto-Keynesianism and Democratic States in the 1930s," in The Political Power of Economic Ideas, Peter A. Hall, ed., 155, 157; Gowa, Closing the Gold Window, 67-8; Calleo, The Imperious Economy, 70-3.

\textsuperscript{16} Volcker and Gyohten, Changing Fortunes, 62, 66-7; Eckes, A Search for Solvency, 260-1.

\textsuperscript{17} Stein, Presidential Economics, 155-7.
If Burns had done much to prepare the administration and the American public for accepting price controls, the key player for implementing them was John Connally. Connally, a career Texas politician and close friend to Johnson, succeeded David Kennedy as Treasury Secretary in late 1970. Connally was pivotal in American economic policies for another reason besides the price controls per se. More than any other adviser, Connally joined the supposedly contradictory domestic and foreign monetary policies with the instrument of price controls and the end of the gold-exchange standard.¹⁸

Connally's concern about fusing wage and price controls with leaving the gold exchange standard was well-founded. The Continental Europeans were not pleased about American talk about floating exchange rates. Their biggest concern was, rightly enough, it seemed, that floating rates would give the United States an excuse to avoid domestic fiscal and monetary discipline.¹⁹ Even so, what plans the Continental Europeans initially lay to preserve fixed currency parities soon gave way. Beginning in 1970, they began serious talk about forming what eventually became the European Monetary System (EMS) to preserve fixed parities

¹⁸ Stein, Presidential Economics, 162, 166.

¹⁹ Volcker and Gyohten, Changing Fortunes, 68; van der Wee, Prosperity and Upheaval, 475.
and provide a common front against the Americans. Nonetheless, by the spring of 1971, even the Europeans were beginning to back away from the notion of fixed parities. The surging American inflation, along with the balance of payments problems, invited a run on the dollar. By May 1971, the Germans announced that they could no longer support the dollar as they had done before.

Another factor that occurred in the 1971 that hastened the Nixon administration onto its eventual course was the completion of the Peterson Report. Its author was Peter Peterson, whom Nixon had appointed to head the Council on International Economic Policy, an adjunct to the National Security Council. Peterson's report attempted to diagnose the decline in American competitiveness, which was behind the deterioration in the American trade deficit. Nevertheless, Peterson laid considerable stress on the fact that the international monetary system had thrust "intolerable burdens" onto the United States. The solution to that problem was to seek assistance from abroad. This recommendation, of course, as mentioned before, was very consistent with the advice dispensed during the Kennedy and Johnson Administrations. Peterson, however, stated the point more bluntly. Significantly, though, Peterson avoided

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20 Van der Wee, *Prosperity and Upheaval*, 476.
any lengthy mention of the Vietnam War as causing the problems with the payments deficit.\(^{22}\)

By June, Connally had become convinced that the time to act was approaching. The turmoil in the international monetary markets continued. Other political pressures also increased at home as the inflation raged. Businesses began clamoring for relief from union wage demands, while unions demanded protectionist measures. Republican politicians, fearing another upset in 1972, became anxious.\(^{23}\)

Two events in August accelerated the pace for action. First, the British, of all people, requested permission to convert $3 billion in dollar balances to gold. Second, the House Subcommittee on the Balance of Payments, chaired by Henry Reuss (D-Wisconsin) recommended going off the gold exchange standard and floating the dollar.\(^{24}\)

On 13 August, then, a Friday, Nixon, along with a small circle of top advisers, repaired to Camp David to make the ultimate decisions. The group accompanying Nixon included Connally, McCracken, Peterson, Shultz, Stein, Volcker, and Burns, and White House staff members H.R. Haldeman and John Erlichmann and speechwriter William Safire. The men had to


\(^{23}\) Stein, Presidential Economics, 167; Stevens, Vain Hopes, Grim Realities, 117-8.

\(^{24}\) Volcker and Gyohten, Changing Fortunes, 77.
make an announcement by Sunday evening, before Monday's markets opened.\textsuperscript{25}

What they decided at Camp David, the New Economic Plan, occurred with little debate, or, as Stein later admitted, previous contingency planning. So too with a surcharge on imports to help the American balance of payments. Also, everyone agreed that fiscal stimulus was necessary, primarily for political reasons. Tax reductions would be matched dollar for dollar with expenditure reductions to avoid increasing the budget deficit. Beyond that, Stein notes, nobody had done much to estimate carefully what amount of stimulus was necessary. The speech itself, which Nixon and Safire composed, aired on Sunday evening, 15 August, at 9:00 P.M., Eastern Time.

Bretton Woods was thus dead. The reaction at home differed sharply from that abroad. At home, public opinion was elated. Abroad, people were generally upset. The United States had slammed the gold window shut. It had abrogated the postwar international monetary system and had unilaterally slapped an import surcharge on foreign products.\textsuperscript{26}

Little could be done to restore some sense of international monetary order. In December 1971, at a meeting at the Smithsonian Institution in Washington, D.C.,

\textsuperscript{25} Volcker and Gyohten, \textit{Changing Fortunes}, 78.

\textsuperscript{26} Stein, \textit{Presidential Economics}, 177-8.
the Americans, still concerned about maintaining their preeminent position domestically and internationally, managed to extract some concessions from their Continental and Japanese partners. In return, the United States agreed to devalue the dollar by 10 percent in relation to gold. This Smithsonian Agreement was short lived, however. The world was well on its way to fully floating exchange rates. International monetary chaos and domestic inflation encouraged the United States to attempt a second devaluation in late winter 1973. The following spring, all of the world's major currencies had abandoned fixed parities completely.

Perhaps this was just as well, as Joan Edelman Spero has noted. None of the leading industrial nations were willing to swallow the bitter pill of domestic austerity needed to make a fixed currency parity system work. American inflation continued as the Federal Reserve persisted in following an accommodationist monetary policy. By 1973, the United States had successfully managed to place the world on a dollar standard, and the balance of payments question became moot. More instability followed beginning in 1973 when the Organization of Petroleum Exporting Countries (OPEC) engineered the first of several oil price hikes. OPEC nations took this measure primarily because they wanted to preserve their purchasing power against inflation. Unfortunately, the OPEC shocks added to the
inflationary stresses already present. The increased volumes of dollars that OPEC was accumulating, however, created the germ for the Third World debt crisis of the 1980s. American-based multinational banks, which took OPEC dollar deposits, had to re-lend them somehow. They found ready customers among developing nations that needed to finance increasingly expensive oil imports. When developing countries began having difficulties servicing their debt in the early 1980s, the instability in the international monetary system only became compounded.

In this precarious climate, the leading industrialized nations could hardly hope to reestablish the comparatively ordered world of Bretton Woods. Their meeting at the Chateau de Rambouillet in late 1975 did not attempt to do so. Instead, it simply set the precedent for future annual summits where the G-7 discussed economic questions. By this time, the Benelux and Sweden had dropped out of the G-10. The January 1976 meeting of the IMF also did not decide anything new, but instead, ratified what had already taken place. It recognized the SDR as the major reserve currency of the international monetary system and legitimized floating exchange rates. It did not discuss other problems, however. Genuinely multilateral coordination of the international monetary system through the IMF remained elusive. The markets continued to establish exchange rates, although central banks intervened to uphold currency
parities. The dollar continued as the *de facto* world currency, even if the SDR had become the world's "official" reserve.\textsuperscript{27}

At this point, the inquiry of this dissertation is for the most part closed. What remains to be done is to summarize the findings and draw general conclusions. The end of Bretton Woods did occur on Nixon's watch. Certainly, he and some of his aides, most notably Connally, were not highly disposed to keeping it functioning. To correct the deficits, which had caused the problem, was too costly in domestic political terms. Friedman's theoretical developments gave them the philosophical justifications for moving in a unilateral fashion. Nixon's decision of 15 August 1971, then, was simply a formal recognition that there were limits to the extent that the United States could promote policies that had been considered indispensable.

Nevertheless, the salient observation to make about much of the dissertation's findings is that the limits to American freedom of action in international monetary affairs, and other arenas of policy, had been well-established for over a decade. The roots of those causes that ultimately led to the collapse of Bretton Woods ran deep. The critical weakness of the international monetary

system as it emerged over the postwar years, that being the American balance of payments deficits, had its origins in a number of policies that enjoyed a consensus of support from both political parties, and the American electorate at large.

The problem with pursuing these policies simultaneously was that their ramifications ultimately conflicted with each other, at least under the policy frameworks that were employed. Unfortunately, in the minds of American political leaders and policy officials, neither the policy frameworks nor the policies themselves could be easily abandoned. The military policies, from the beginnings of NATO through the Vietnam War and beyond, were seen, in one form or another, as being indispensable to the security of the United States and its allies. The economic issues that contributed to the balance of payments problems resulted from the deep-set importance that economic questions have assumed in American politics during the twentieth century. Free capital flows, the wartime economic planners assumed, would help promote global prosperity. Global prosperity, in turn, would ensure prosperity for the domestic economies of the United States and those of its allies. Abandonment of the military policies might invite totalitarians to run amok around the globe. Scrapping the economic policies could possibly bring about another global depression.
The officials who drew up the postwar economic arrangements, at home and abroad, had acted in good faith. They sincerely hoped and thought that their plans would prevent the recurrence of another Great Depression. Policymakers of both parties here in the United States, as well as elsewhere, shared this deep concern not to see another cataclysmic economic slowdown. They fashioned their policies appropriately. Economic freedom was part and parcel of human freedom, to be sure, but it could not come at the expense of economic well-being for the majority of citizens. The domestic policies were, characteristically, middle-of-the-road. Different political persuasions leaned either to the left or to the right, but nobody opted for either total laissez-faire or for collective planning. Not even John Maynard Keynes' proposals, which gave the intellectual justification for much of postwar domestic economic policy, were followed dogmatically. The international monetary and trade policies were also designed to promote maximum freedom of activity within very broad parameters. The particular blueprints that the Americans drew up for the international monetary system were thought to be able to reconcile domestic autonomy with international interdependence.

If these policies seemed to work for the first ten years or so of operation, the contradictory sum of their effects became manifest over time. By the late 1950s, then,
trouble had surfaced. The collection of economic and security policies that the United States was pursuing had engendered ramifications unforseen by their creators. These ramifications imposed costs that proved to be difficult to cover, at least for the institutions that had been crafted to deal with them. Overseas military outlays and foreign investment, in effect, cost more than the supply of gold that the United States had on hand to pay for them. On the other hand, no American official wanted to alter significantly or disregard the Bretton Woods system, at least until the 1960s. Thus, American responses in the area of international finance had the appearance of a set of stalling actions, or holding patterns, because American leaders basically thought that their options were very limited.

The Eisenhower administration first became aware of this problem. Since it occurred at a fairly late point in that administration's tenure, neither Eisenhower nor his advisers devoted much thought to resolving it. Aside from implementing some stop-gap measures and trying to force the Germans to ante up more for the common defense, that administration did essentially nothing.

One might have been expected that the generally activist stance of the Kennedy administration would have invited a decisive solution one way or another. Certainly, there were Kennedy officials from the very start who sought
a proactive solution to international monetary questions, if only to preserve freedom of action in other policy areas. During his time in office, though, Kennedy demurred. He feared acquiring a reputation of being heterodox, or just simply irresponsible. The October 1960 gold crisis had done much to keep him cautious. Action on the international monetary front and the balance of payments took a lesser priority. Although the Kennedy team undertook several measures to resolve the balance of payments and international monetary policies, they were still improvised in nature.

Actually, Kennedy began a number of policies in other areas that, over time, made the task of international monetary management more complicated. He embarked upon a more expensive diplomacy and military strategy, both in its conventional and in its novel features. His domestic agenda, at first tentative, later became bolder. It was his advisers who argued that there existed certain social ills that the federal government had to resolve. Moreover, it was his advisers who argued that government-stimulated growth would provide for all the problems that his administration wanted to solve. As mentioned, the Revenue Act of 1964, originally a Kennedy proposal, marked a significant point in postwar American economic policy. The embodiment of its proposals explicitly called for a set of
policy measures that closed the freedom of action of the United States in handling international monetary affairs.

Johnson, however, reaped the whirlwind of the competing policies that his predecessors inaugurated. Of course, he preferred not to deal with any of them. Johnson’s passion was for domestic reform, a deep-seated concern welling up from both venal and magnanimous impulses. Unfortunately, for his domestic goals, Johnson and his advisers, most of them inherited from the Kennedy administration, shared most of the assumptions of the postwar consensus on economic and security policy. Bound by these assumptions, then, Johnson and his circle carried the disparate strains of American policy to their logical conclusions. The conviction of the certitude of these assumptions that his officials shared led to the ultimate undoing of all of them.

On the other hand, it was Johnson’s Treasury Secretary, Henry Fowler, who effected what appeared to be a daring stroke in American monetary policy, that being the SDR negotiations. It was an initiative born out of the necessity to resolve a problem, or rather a perceived problem, that stemmed from the solution of a closely related development. Interestingly enough, that solution, the voluntary capital controls program, could be seen as an implicit recognition of the limits of American financial power. The program compromised the vision of Cordell Hull
and Harry Dexter White of free flows of capital bolstering free trade that generated global prosperity.

At the same time, it was hoped that the SDR negotiations might serve more parochial American interests. The Triffin Paradox that the New Economists accepted, and feared, seemed to provide an opportunity for a bold maneuver. This paradox, or phenomena, as it was viewed, stirred up the old fears of economic hardship that American policy sought to prevent. Reducing dependence upon both dollars and gold would ultimately allow the United States to avoid debilitating domestic austerity. Intellectually, the conception appeared to be a brilliant tour de force, a way to resolve several dilemmas simultaneously and effortlessly. It also harmonized nicely with the Keynesian-inspired approach that the administration had taken as its guiding precepts of economic policy on the domestic front.

Still, as vaunted as the SDRs were, they cannot be said to be a crowning glory for the Johnson administration. Superficially, Fowler's achievement was a diplomatic success. The American vision of "reform" prevailed over French and other European ideas. Nonetheless, this achievement was overshadowed by a series of failures of policy that seemed to descend upon the Johnson administration en masse. For one thing, distrust of American motives grew as the negotiations progressed. For another, American officials had to contend with other
stresses in the international monetary arena that threatened to sabotage the SDR negotiations entirely. The fight to save sterling in 1967 was one of these. The gold crisis and the currency crises the following year were others.

As the findings indicate, American officials were long in realizing that they probably had to make some tradeoffs among the policies they were pursuing, the SDR negotiations notwithstanding. It took a major crisis, though, to force the Johnson administration to begin to see this reality. This crisis, the Vietnam War, provided the biggest trial for Johnson's international monetary efforts. The Vietnam War reduced the priority of international monetary matters for the Johnson administration even lower than what it had already been, even as it made their resolution more difficult. The precise financial and economic effects of that war cannot be quantified with certainty, as studies by Robert Warren Stevens and Anthony M. Campagna suggest. 28

28 In 1976, Stevens, Vain Hopes, Grim Realities on 108-11, reported a synthesis of estimates with respect to the damage that the Vietnam War inflicted upon the American economy. He himself calculated the damage from the Vietnam War to the balance of payments to be $1.7 billion out of a total deficit increase of $2 billion. Other studies he cited attribute war-related damage to the balance of payments at $3.6 billion (Leonard Dudley and Peter Passell, 1968) and even as much as $5.7 billion (Emile Benoit, 1970). The Dudley-Passell study also took into account an estimate of the inflationary aspect of the Vietnam War spending. Both Dudley-Passell and Emile Benoit looked at the deficit on the current account, that portion of the balance of payments that measures the net trade, investment income, travel, and services figures. Dudley-Passell calculated their figures over the period 1964 to 1967. Benoit calculated his figures over 1964 to 1968, noting that most
Nevertheless, there are things about that war that can be said with certainty, even if the measures used are not always consistent. It certainly was not the reason why Johnson's administration pursued the particular goals it did in international monetary policy. No American official could foresee how much the war would cost when it began. Moreover, the steps that put American international monetary diplomacy into motion were begun long before an escalation in Vietnam was ever contemplated. Instead, the Vietnam War served to exacerbate the stress points in all of the aspects of policy it affected. With respect to international monetary matters, the war worsened the American balance of payments, which increased the distrust of the other nations whose cooperation the United States desperately needed for the effective governance of the Bretton Woods system. From there, the war weakened America's ability for dealing with the other problems in international finance, such as the sterling parity and the strength of the dollar.

The Vietnam War, along with the sterling crisis, then, made it clear that from late 1967 onward, any thought that these limits to American policy were inescapable was unfounded. One casualty of the crisis events that began after the sterling devaluation was the series of voluntary capital control programs in place since 1965. The 1968 deterioration occurred in 1968-69. Anthony M. Campagna also cites the Dudley-Passell study in The Economic Consequences of the Vietnam War (New York, 1991), 103.
program was mandatory in nature, the closest that Johnson ever came to making investment and resource allocation decisions during the war. Also, foreign officials as well as concerned domestic observers reinforced those advisers of Johnson's who wanted a tax surcharge to help pay for the war and reduce the inflation in the American economy. In the process of obtaining passage of the surcharge, much of the Great Society was set aside, to Johnson's chagrin.

Adding to the pressures to pass the surcharge was the tumult in the currency and gold markets resulting from what was, in effect, a vote of no confidence in America's ability to order its finances while the Vietnam War was being prosecuted. America's European partners agreed to modifications in the gold redemption policy, but only on the condition that Johnson put America's fiscal house in order. Finally, the gold crisis underscored the fact that the United States could no longer carry on the war itself, simply because the war's inflation and foreign exchange costs had become unmanageable.

Much of the aforesaid might seem an indictment of European behavior as being ungrateful to an erstwhile savior, since it shows that the Europeans also imposed limits upon American policy. To some extent, such an indictment might be justified, especially in light of French behavior. Not a little of Charles de Gaulle's diplomacy and strategy had its origins in vainglory instead of rational
national self-interest. One could muster economic arguments supporting his dollar redemption policy, and the motivations of his principal economics adviser, Jacques Rueff, emanated from a particular vision of international finance. To a considerable extent, one could concede to Rueff the validity of his concerns. Nevertheless, other factors ranging from a certain vision for France's role in Europe, concern over American diplomacy elsewhere, resentment over past mistreatment, and sheer jealousy were very strong in driving his measures. It was this collection of motives, some arguably noble but many of them petty, that probably infuriated the Johnson administration as much as it did.

On the other hand, an indictment is far too strong a judgment to render against the Europeans, particularly those enjoying balances of payments surpluses. German reactions to certain American policies were understandable. In many cases, they resulted from the fact that Germany occupied a delicate position in strategic and military matters. With respect to international monetary policies, though, the Germans felt antagonized simply because they thought that American policies might be inflationary in nature. The Germans, more than any other European power, had had terrible historical experiences with inflation. Hence, they sought to avoid it at all costs.

Had the Europeans continued to be economically prostrate, the United States could have continued to exert
some sort of leverage to follow American wishes. By the late 1950s, though, that was no longer possible, given the European recovery. In this there was some irony, considering the original intent of American policy officials during the immediate postwar years. The architects of American policy had assumed that Europe would generally follow America's cue in all major policy directions, whether they be strategic or economic. To be effective participants in the trans-Atlantic alliance, then, required the Europeans to have requisite economic strength. Once the Europeans had attained that strength, with American help, though, they began to reassert some independence of action, to the great frustration of American officials. In the area of international monetary policy, the SDR negotiations were protracted. Frequently, American officials had difficulty obtaining European help in other aspects of international monetary relations, such as in certain currency crises. Neither Kennedy, nor Johnson, nor Nixon were able to effectively smooth out all of the differences that cropped up during the 1960s. Moreover, an increasing predilection towards more interventionist economic policies in Western Europe reduced their freedom to cooperate with American policy.

At the same time, economic and financial weakness in an ally could also place limits on American freedom of action, as the entire sterling devaluation episode showed. In the
British case, though, this weakness was partially aggravated by certain American policies. To be sure, Great Britain's problems were largely of its own making. The British, like the Americans, were pursuing more financial, social, and military policies that what they could afford. Harold Wilson, the politician who returned Labour to power in 1964, and his top advisers sensed that they had to retrench, even as they attempted to expand the public sector's role at home. Nevertheless, the area in which they wanted to reduce spending, overseas military outlays, was the very one in which the Johnson administration expected continued participation. At the same time, Johnson officials expected the British to continue to support the $2.80 sterling parity without substantial long term assistance. Of course, the Americans would have granted a loan had Wilson agreed to provide token support in Vietnam, but he was not willing to do so. Ultimately, a strong pound was no longer supportable, given these competing stresses on the British. Unfortunately for the Americans, the reward that they reaped for their persistent pressures on the British was a worsened balance of payments deficit and a gold crisis.

Given all of the aforementioned competing pressures on American financial resources, then, it would have been very difficult, if not impossible, for any American president to continue without relaxation the various domestic and international economic, strategic, and social agendas that
had become policy by the late 1960s. Even one of the leading architects of the American Cold War policies, Dean Acheson, acknowledged the difficulties of pursuing a broad array of military and economic initiatives, given the limits on the ability of Bretton Woods to handle all of them.29

What ultimately freed the Nixon administration to end Bretton Woods was the premium it placed upon domestic political expediency. The economic philosophy it accepted in international monetary matters simply reinforced its decision to act as it did. The New Economics were not completely routed during the 1970s. Nor was a complete return to laissez-faire hardly possible, because of domestic economic pressures. Still, Friedman's advocacy of floating exchange rates helped make it feasible to employ new policy approaches in international monetary matters.

In the process, the Nixon administration dared what its predecessor contemplated only in private. It essentially placed the world on the dollar standard. The process of removing the world from gold began well in the Johnson years with the SDR negotiations and continued with efforts such as the Bundesbank pledge, the two-tiered gold standard, and so forth. The ability of the markets beginning in the late 1950s to allow large, destabilizing currency speculations rendered the notion of fixed exchange rates as being totally unrealistic. After the numerous currency crises of the

29 Stevens, Vain Hopes, Grim Realities, 120.
1960s and early 1970s, combined with the willingness to de-emphasize asset-based currencies, only a floating exchange rate system was possible. By formally suspending gold-dollar convertibility, ending Bretton Woods, and consenting to the Smithsonian Agreement and subsequent arrangements, Nixon’s administration only consummated what was already taking place.

If this discussion so far has belabored the point that by 1960 or so the United States could not continue pursuing a boundless array of foreign and domestic policies, a certain perspective, however, must be kept in mind. In order to truly understand the events analyzed in this dissertation, this point cannot be made emphatic enough. The notion of limits has to be understood simply as that—as limits—and nothing else. Contrary to what scholars such as Paul Kennedy have written, the financial and foreign policy developments of the Johnson years do not seem to suggest any sort of "decline." Certainly, the Vietnam War acted as a catalyst for American officials to reassess seriously certain policy assumptions, and for good reason. As Richard Neustadt and Ernest May and Yuen Foong Khong have discussed, the analogies that these policymakers drew from history were not always appropriate.30

30 Richard Neustadt and Ernest May, Thinking in Time: The Uses of History for Decision Makers (New York, 1986); Yuen Foong Khong, Analogies of War: Korea, Munich, Dien
With international monetary policy, one could make the same observation about faulty analogies, however, but with different implications. Despite the fact that the confluence of expensive foreign and domestic policies showed that American financial resources were not unlimited, there nevertheless existed a considerable freedom of action of which American officials were not aware. Many assumptions and predictions of observers during the 1960s about the international monetary system did not come to fruition. By the late 1960s, the idea of a liquidity shortage seemed ridiculous. Nor did the United States, as it turned out, declare bankruptcy or inaugurate another 1930s-style depression.

Also, the fears that the American officials had that their country would have to relinquish either a tremendous amount of control over the international monetary system or considerable policy autonomy at home also seem to have been unfounded. This fear of giving up control, or sharing it, had made Americans initially passive about international monetary reform. Concerns about domestic political reactions to austerity later led the Nixon administration to return to passivity.

What actually happened, though, was that the United States effectively placed the non-Communist world on the

dollar standard, just as Francis Bator had once predicted might happen. The American currency has remained the leading world currency ever since. As Nye has observed, Nixon's decision in August 1971 demonstrated that the United States continued to possess a preponderance of economic prowess. Moreover, that strength enabled it to continue to provide the strategic leadership against the Soviet Union and its allies until 1990. Whatever one might say about the resurgence of Japan or Germany, or, conversely, about the problems that the American economy has had with productivity or competitiveness, the relative strength of that American economy was critical for underwriting the anti-Soviet alliance as a whole. In addition, unlike the Soviet economy, the American economy was able to do so while providing an high standard of living for a large segment of its society, however that economy's wealth might have been distributed.

This is not to say that abandoning an asset-based currency was, in and of itself, a prudent move, however. There exists much accepted wisdom that an asset-backed currency is far more salutary for all who use it over the long run rather than merely paper money. The history of the age of the preeminence of the dollar in international finance is not yet over, and, therefore, a final verdict cannot yet be rendered. Events subsequent to this writing

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Nye, Bound to Lead, 94.
might suggest otherwise. Moreover, the ongoing pressures of domestic politics must always be considered, as Gowa reminds us. If the past few decades are any indication, fears about domestic recession will always take precedence over international monetary cooperation. From the perspective of a quarter-century hence, though, Nixon’s move to end gold-dollar convertibility has not appeared to have crippled the ability of the United States to provide leadership in security and economic matters.

The confluence by 1960 of the different American policies pursued since the beginning of the Cold War indicated that, somehow, some of them had to be altered or abandoned. Assumptions grounded in philosophy and historical experience held that all of these polices were indispensable. This reluctance among American leaders to choose among them at first postponed making the difficult decisions. A war that few Americans really wanted, however, forced the resolution of a number of questions, because it magnified the incompatibilities among the policies. Nevertheless, that war, and, at least its financial repercussions, seemed mostly to force American leaders to rethink assumptions and rearrange priorities. American power and leadership continued after Vietnam, although it had to be more flexible and less demanding than formerly.
### APPENDIX: BALANCE OF PAYMENTS AND RELATED STATISTICS
1960-1972
(In millions of dollars)

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Notes:
1. Net military transactions consists of direct expenditures less sales abroad.
2. Current account balance consists of the net merchandise trade figure; net military transactions; net U.S. government and private investment income (not shown); net travel and transportation expenditures (not shown); remittances, pensions, and unilateral transfers except for military grants (not shown); and net of other services not included in the previous categories (not shown).
3. The net liquidity balance consists of the balance on current account and long-term capital; net of non-liquid short term private capital flows (not shown); allocations of special drawing rights (not shown); and errors and omissions.
4. Official reserve transactions balance consists of the net liquidity balance plus liquid private capital flows (not shown).
5. Gold stocks are the holdings of the U.S. government only.
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