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Africa. Similarly, those allies who had willingly held dollars rather than consistently converting them into gold, Japan, West Germany and Canada (in marked contrast to the French from 1965), would allegedly suffer most. Although such arguments may well have carried some weight with the US government in the 1960s, it must be asked whether the US could have in any case ultimately prevented the gold price from rising.

The willingness of various US administrations after 1970 to allow and even encourage large dollar devaluations also suggests that in the final event, accounting losses by foreign central banks were of limited importance. This objection, moreover, did not meet the basic question at issue, which was whether an increase in the gold price would have been sufficient to remove the systemic disequilibrium, which would have benefited all countries, not least the US itself. The US was after all the world's largest holder of gold reserves, while the dollar's link with gold provided US authorities with a criterion of balance of payments discipline and exchange rate management.[59]

By far the most compelling argument for academic economists was that raising the gold price would have provided no 'permanent' solution to the problem of international monetary order. As we saw in Chapter 3, in a world of creeping inflation, the maintenance of a gold exchange standard would require a revaluation of gold from time to time.[60] John Williamson has put the academic case succinctly: '[w]hat most economists doubted was not the feasibility of such a strategy, but its desirability, as opposed to the alternative of developing a fiduciary reserve asset.'[61] The idea of a fundamental instability in the gold exchange standard meant that for many economists salvaging the system was irrational. It goes without saying that the gold exchange standard was not an ideal system by any means, but as shall be argued shortly, it is questionable whether economists of this bent had asked themselves whether a more ideal system was a *political* possibility.

One of the more likely reasons for official US opposition, at least from the mid-1960s, was that the main proponents of a gold price increase on the international level were the French, whose proclamations on the subject no doubt hardened American determination to resist anything that could be associated with the maintenance of the role of gold in the international monetary system. The French policy had long been aimed at reducing the role of reserve currencies and the 'exorbitant privilege' (or seignorage) which that role accorded to the major Anglo-Saxon countries.

This policy became more aggressive under de Gaulle, initially in the Composite Reserve Unit (CRU) proposal in 1963–4, intended to achieve a 'camouflaged' increase in the gold price by creating CRUs in uniform proportion to gold reserves and requiring settlement of deficits in a fixed proportion of gold and CRUs.[62] American inaction prompted de Gaulle (in his famous press conference of February 1965)[63] to give vocal support for an enhanced role for gold, which reinforced the impression that the French wanted to foster a return to a pure gold standard in which there would be no exorbitant privileges.

Though other French officials such as Giscard d'Estaing and even Michel Debré were at pains to stress that France was not asking for a return to the gold standard, they held that a higher gold price was still necessary to bolster the gold exchange standard. From the American point of view, the gold price proposal was consistently presented as implying a 'radical change' in the system and even a return to the gold standard.[64] This in turn prompted the French to take the offensive by seeking to impose gold discipline on the US by regularly presenting dollars for conversion at the American Treasury.

This confrontational policy had two effects. First, it became a question of American national pride to resist the French demands and strengthened the Johnson administration's determination to find a replacement for gold in the international monetary system. This was nothing but the logical extension of the refusal to raise the official gold price. The step from here to the Two Tier Agreement of March 1968 and ultimately to Nixon's *de jure* suspension of the gold convertibility of the dollar in August 1971 was not very far.

Second, French policy made it difficult for other European nations to present dollars for conversion without appearing to be conspiring with the French against American leadership. After 1968, with the official convertibility of the dollar into gold increasingly untenable due to a European fear that major conversions of dollars would prompt the closing of the US gold window, the world was on a *de facto* dollar standard.

To complicate matters, the inflationary impact of Johnson's economic policy during the Vietnam war years led to a rapid deterioration in the US balance of payments deficit and large accumulations of dollar reserves in the rest of the world (see figure 6.2). The massive deterioration of the US official settlements deficit from 1969 owed something to the erosion of the current account surplus, but even before this the gold exchange standard had effectively collapsed due to the growing inconvertibility of the dollar into gold at the official price. Only the US had the power to remove the gold shortage by a revaluation of gold, but it chose not to do so.

Whether this was a mistake remains a highly controversial question. Ultimately, the issue boils down to whether the gold exchange standard was worth restoring, if only in order to buy time for a more

thoroughgoing reform of the international monetary system. As will be argued subsequently, the main difficulty with the argument for an increase in the gold price is whether a system based upon exchange rates pegged to gold was compatible with an international monetary system in which the role of private capital flows was increasingly important.

The world central bank option

The fundamental reason why most economists opposed a restoration of gold exchange standard was because they believed that there was a much more rational and permanent alternative to a system based upon the vagaries of gold production and reserve country deficits. The ultimate aim of their proposals for an enhanced IMF with the power to create and manage global liquidity in the way that Keynes had envisaged during the war was to create a world central bank.[65] As argued in Chapter 3, the crucial difficulty was how to effect a transition from an international monetary system in which central banks had sovereign control over reserves (and at least in principle over monetary policy) to a system in which such monetary sovereignty would be abolished or at least severely constrained.

The role of the IMF in the international monetary system had remained a relatively marginal one. Its ability to affect the adjustment issue between the major countries was extremely limited, while there was little indication that the SDR would be allowed to grow into a major global reserve asset.[66] Above all, as the importance of the dollar in the international monetary and financial system steadily grew in the late 1960s and into the 1970s, the incentive for the US in particular to accept a collectively managed system correspondingly declined.

The American decision to promote the creation of an international fiduciary asset (which became the SDR) in mid-1965 was an attempt to head off French and other European proposals aimed at maintaining or enhancing the monetary role of gold. With the Two Tier agreement and the effective isolation of the French, the US had substantially achieved its aims. As Solomon noted, 'contrary to the French approach, the special drawing right (SDR) was being regarded as a substitute for gold.'[67] Whether SDRs could also replace reserve currencies and in particular the dollar was not at all clear, and seemed to depend upon the lingering hope of many that US dollar deficits would somehow disappear and thereby give SDRs a chance to come into their own.

The evolving structure of the international financial system and America's global commitments made the permanent disappearance of the US deficit an extremely unlikely event. With the *de jure* abolition of gold-dollar convertibility in August 1971 and the effective acceptance of the other countries of a dollar standard with the Smithsonian Agreement of December 1971, the Nixon administration removed the remnants of the main external constraint upon domestic policy under which it had increasingly chafed.[68] In such circumstances, would it have been surprising if the US proved reluctant to accept an even tighter external constraint upon its domestic and foreign policies than had existed in the days of the gold exchange standard?

The abortive monetary reform negotiations which followed the Smithsonian realignment over 1972–4 in many ways were a re-run of the long debate over adjustment responsibilities. The Europeans and Japanese were intent upon removing the asymmetry in the system about which they had always felt indignant, while the Americans complained of the need for constraints upon surplus states. The Europeans correspondingly insisted upon the adoption of an SDR-standard based upon the principle of compulsory 'primary reserve asset settlement', which would have removed the role of reserve currencies in the settlement of imbalances and placed considerable pressure upon any deficit country to adjust.[69]

For its part, the US presented an alternative proposal in September 1972 for a 'reserve indicator system' that defined certain 'objective' points beyond which if a country's reserves increased or fell, would oblige it to adopt adjustment measures, including exchange rate changes.[70] The Americans would only agree to the restoration of dollar-convertibility into primary reserve assets (which would be SDRs) as long as the upper 'primary asset holding limit' defined a point beyond which further accumulations of dollar balances would be inconvertible. In other words, the US appeared unwilling to agree to any 'tight' settlement system for reserve currency balances.

What the other countries overestimated was the US desire to compromise its demands in order to achieve an agreement. The dollar remained by far the most important reserve currency in the system, and with the complete breakdown of the fixed exchange rate system in March 1973, the situation had seemingly changed in the favour of the US. There, floating exchange rates were seen as a means of attaining complete autonomy for domestic economic policy as well as providing a means by which market pressure might be brought to bear upon persistent surplus states to accept either currency appreciation or domestic reflation.[71] By this time, even very trade-dependent countries like West Germany had come to see floating *vis-à-vis* the dollar as a preferable alternative to an inflationary dollar standard,

but the continued commitment to exchange rate stability in continental Europe was demonstrated in the development of the 'snake' and later the European Monetary System.[72]

The oil crisis in autumn 1973 sounded a convenient death-knell to the reform negotiations during which neither side had been able to agree on the basics. Williamson argues that the final outcome was little short of total failure: 'There was no agreement on a set of rules for assigning adjustment responsibilities, no design of a viable adjustment mechanism, no introduction of an SDR-standard, no substitution and no curb on the asymmetries.'[73] Williamson's argument that the failure was ultimately due to a lack of political will and the general incompetence of the negotiators seems implausible. It exaggerates the extent to which the failure of the reform negotiations should be seen as a defeat for the Nixon administration's desire to prevent any circumscription of the autonomy of US domestic and foreign policy. The emerging *status quo* was probably seen by the American authorities as much more satisfactory than any formal agreement they might have got with the other countries and also more acceptable than a gold exchange standard restored through an increase in the gold price.[74]

Although Williamson argues that the Europeans made a mistake by failing to bow to the strength of the US negotiating position and accept the US reserve indicator system as a basis for negotiation, the extent to which the Europeans' hearts were set on a full SDR-standard must also be questioned.[75] After all, was it likely that surplus states would be entirely happy about accumulating international fiat money in the form of SDRs, when only months earlier they had been calling for a revaluation of gold? With gold denied any formal systemic role by the US, the European governments pushed without great conviction a system which, though intellectually appealing to economists, did not solve the basic *political* problem that these countries wanted a system based upon 'tight' settlement in assets that were not another country's or organisation's liability. To describe the continued attraction on the part of national central banks to gold as an 'irrational prejudice'[76] is a typical example of many economists' failure to comprehend the political foundation of the demand for gold as an asset which can be held.

It is therefore not entirely surprising that the major countries have since that time demonstrated a complete unwillingness to enhance the role of the SDR beyond its very limited present one.[77] The creation of the SDR has not represented an important exception to the general trend towards a much greater role for reserve currencies in the international monetary system, to the trend towards a system based

more and more upon private exchange and capital markets rather than upon the principle of collective management. Similarly, the common idea that what emerged from the breakdown of the Bretton Woods system and the failure of the international monetary reform efforts was an international monetary 'non-system' exaggerates the extent to which there was ever any agreement on the fundamental issue of adjustment responsibility.[78]

The notion of a non-system (or absence of rules) has also encouraged the view that this outcome can be explained by an 'absence of hegemonic power' in the post-Bretton Woods era. This is misleading because it underestimates the role that American policies in particular have directly or indirectly played in fostering a system founded upon market principles. The idea of a non-system keeps open the hope that the long-term trend of the evolution of the international monetary system will be towards one founded upon collective monetary management. Whatever one's views regarding the likelihood of an 'ultimate solution' in international monetary affairs, it is difficult not to conclude that internationalist economists have underestimated the political difficulty of the world central bank proposal in a world of separate states.

Exchange rate flexibility

From the late 1960s, a number of economists and officials began pushing for the introduction of greater exchange rate flexibility in order to facilitate adjustment to payments disequilibria. There was undoubtedly a need to make it easier for governments to adjust exchange rates in the face of persistent disequilibria, such as in the case of Britain over 1964–7, as well as to encourage chronic surplus states to undertake adequate revaluations. There were moves within the IMF to promote the 'crawling peg' idea, which gained some support from the US, Germany and Italy, though the traditional supporters of a fixed rate system (France and Belgium) remained opposed.[79]

One of the most difficult issues in the debate was in deciding whether the disequilibrium would have been ameliorated by a devaluation of the US dollar. Over 1955–61, the US economy had been experiencing relatively slow growth of 2 per cent per annum, compared to between 5 per cent and 9 per cent for most of its major allies.[80] The Kennedy administration's determination to boost this sluggish growth by a series of tax cuts heralded a new era of Keynesian expansionism in American policy-thinking, though in practice fiscal expansionism was more a facet of the Johnson years and afterwards.[81] From 1962 onwards, the US economy experienced a much higher pressure of demand than for

any time since the Korean war, with real GDP growth jumping to an average of 4.9 per cent per annum over 1962–8. In 1965, unemployment fell below 4 per cent, capacity utilisation hit record levels and consumer price inflation rose from 1.7 per cent in 1965 to 4.2 per cent in 1968.

The problem in retrospect appears to have been that just as the fiscal expansionism of the Vietnam war and Great Society years reached its peak, US productivity growth showed a marked tendency towards a long-term decline, reducing the scope for non-inflationary increases in real income.[82] Besides the marked decline in the US trade and current account surpluses in 1968–9 (to an average of $600 million and $500 million respectively) and the emergence of large surpluses in countries like West Germany, Japan and Canada, there is additional evidence that the US dollar by this stage had become overvalued relative to some (though not all) other foreign currencies. American export unit values rose by 6.5 per cent over 1965–8, while in France and West Germany they hardly rose at all and even slightly declined in the case of Italy.[83]

From 1968, then, but probably not earlier, there was a good case for selective revaluations of a few important currencies like the Deutschmark (DM), Swiss franc and Japanese Yen against the dollar. American pressure on the major surplus countries to revalue did increase around this time, though this was hampered by the American refusal to revalue gold.[84] It is difficult to see what contribution revaluations on the part of the other major countries could have made to the systemic disequilibrium between gold and the dollar, especially since it would have further eroded the real price of gold in the revaluing countries.

The US trade balance in 1971 was in deficit for the first time in the postwar period. With the Nixon administration increasingly concerned about the impact of a overvalued dollar on domestic employment, US policy became more aggressive in demanding revaluations against the dollar on the part of other industrial countries. Some have argued that US policy under Nixon was aimed from the beginning at forcing America's allies to revalue their currencies through a policy of 'benign neglect' of the US external position (that is, allowing the continued accumulation of inconvertible dollar balances by foreign countries). Charles Coombs of the New York Federal Reserve felt this view to be exaggerated, but argued that 'benign neglect . . . provided an intellectual rationale for all the accumulated frustrations of the Nixon administration in the trade policy area.'[85]

Over 1970–1, the stance of monetary policy moved in the direction of expansion in the US, while in Europe (especially in Germany) it moved in the opposite direction as the Bundesbank sought to head off

rising inflation. Interbank and other deposit rates in Germany hit their highest levels for years, prompting US banks to repay borrowings from the Euromarket made in the monetary squeeze of 1968–9. American official settlements deficits reached catastrophic proportions of $10.7 billion in 1970 and $30.5 billion in 1971. Foreign central banks bought $35 billion in 1970–1, with the Bundesbank alone buying over $11 billion in foreign exchange from January 1970 to May 1971, at which time it decided to float the DM. The Dutch Guilder was also floated at the same time and Austria and Switzerland revalued their currencies by 5 per cent and 7.1 per cent respectively.[86] If the US administration had indeed wished to force the surplus countries to choose between domestic monetary instability and revaluation it was not altogether unsuccessful. The increasing linkage of monetary conditions in the US and Europe due to the growing size of the Euromarkets was rendering a fixed exchange rate system unworkable.

Solomon relates that even in mid-1971, the US 'did not yet have a coherent plan for bringing about a broad and sufficiently large realignment of currencies.'[87] The reigning assumption in the US administration seemed to be that a negotiated realignment of currencies was impossible. Without trying to negotiate a settlement, the Nixon administration decided to apply shock tactics in the final run on the dollar by declaring on 15 August 1971 a suspension of gold convertibility and placing a 10 per cent surcharge on imports as a means of forcing Western Europe and Japan to revalue.

Connally, Nixon's Treasury Secretary, maintained the traditional line that as the US could not change the gold value of the dollar, other countries had to revalue against the dollar. The Americans also argued that they required an average current account surplus of about $9 billion per annum (calculated on a 'full employment basis') out of a total estimated OECD surplus of $11 billion, so as to finance America's international obligations. The adjustment, in other words, had to come from the surplus countries, and at the same time they were called upon to make greater contributions to Western defence and to liberalise their domestic markets.[88]

In denying any responsibility for adjustment, the US was effectively refusing to rehabilitate the gold exchange standard and demanding that other countries peg their currencies to an inconvertible dollar. Not surprisingly, the other countries were opposed to the idea that they ought to accept all the adjustment responsibility as well as a *de jure* dollar standard, with no assurance from the American side that it would accept any external constraints upon its policies. Nor could they agree that the US be granted a kind of natural right to over 80 per cent of the OECD current surplus.

In the end, the strength of the US bargaining position at Smithsonian led to an agreement on the part of the other countries to revalue their currencies in return for a minimal American concession to revalue gold to $38 per ounce.[89] In real terms, the gold price was hardly changed and the dollar remained inconvertible. As Solomon has written:

> In the end, it was the ability of France to hold out while other countries felt a more urgent need to end the crisis that led most of us, rightly or wrongly and with varying degrees of distaste, to capitulate on the gold price question. We comforted ourselves with the knowledge that the continued inconvertibility of the dollar would give the United States considerable leverage in future negotiations over reform of the system.[90]

For the other countries, above all the French, even the minimal US concession on the gold price was a basic precondition for the agreement reached at Smithsonian because it implied that the US accepted some responsibility for the international payments disequilibrium. Keohane seems to miss the point in arguing that the decline of American power was a necessary condition of the breakdown of the 'Bretton Woods system' in 1971: 'Had the US been so dominant in 1971 [as in the 1940s], it could have forced other countries to revalue their currencies . . . but by 1971 the US was no longer strong enough to do this, even after destroying the old Bretton Woods rules.'[91] There was simply no Golden Age in which the US could ever 'force' other countries to revalue; indeed, the reason why it *could* do so in 1971 without giving any real ground on the gold question was because of the weakness of the other countries' bargaining position. The international relations school has somehow overlooked the fact that in essence the rest of the world had tied itself to a dollar standard with no guarantees or constraints on US policy, and that the US refused to make the only concession that possibly could have restored the 'Bretton Woods system'.

If measurement of US balance of payments 'equilibrium' and hence 'discipline' was difficult before, it was to prove virtually impossible now. Without gold convertibility of the dollar, the US had few usable reserves and hence means of managing the exchange rate, and private currency markets lost an anchor for expectations. The breakdown of the fixed exchange rate system which occurred over 1972–3 in the face of continuing large official settlements deficits and a corresponding explosion in global liquidity was implicit in the Smithsonian agreement.

This shift to flexible exchange rates was welcomed by a number of economists, especially American ones, who believed that flexible exchange rates would remove the asymmetry favouring surplus states

and that pegged exchange rates were inappropriate for a relatively closed economy like the US.[92] Smithsonian represented the Waterloo of the French policy to maintain a role for gold in a system with pegged exchange rates. West Germany, in contrast, by this stage longed to be free of the inflationary trap of a fixed exchange rate with the dollar.[93]

In George Shultz from May 1972 the US had a Treasury Secretary who was known to favour a system of floating exchange rates, and over 1975–6 the US would win a final battle against the French to legalise the floating which had continued since Spring 1973. The agreement reached at the November 1975 Rambouillet Summit was then enshrined at the January 1976 Jamaica Special Meeting of the IMF. The agreement sanctioned the adoption of exchange rates 'of a member's choice', gave the US a veto over any future proposal to return to a pegged rate system, and abolished the official price of gold.[94]

Though Treasury Secretary William Simon termed the Jamaica agreement 'the most significant development in the international monetary system since the Bretton Woods agreement',[95] it would soon become clear that the move to flexible exchange rates had in fact failed to remove the asymmetries which had always existed in the international monetary system. It will be argued in the next chapter that the extent to which the shift to flexible exchange rates in the early 1970s represented a fundamental caesura in international monetary organisation has been exaggerated.

The dollar standard: The US as world central bank?

In the absence of a desire to retain the gold exchange standard, of the political unlikelihood of an SDR standard and the inability of exchange rate flexibility to provide a full solution, was the only alternative the dollar standard? Proponents of the dollar standard had strongly criticised the series of attempts in the Kennedy and Johnson years to reduce the 'deficit' through restrictions on capital outflows: the 1963 interest equalisation tax, voluntary restrictions on bank lending to foreigners in 1965 and further mandatory restrictions on capital exports in 1968.[96] On the other hand, the encouragement of US multinationals to meet their financial requirements in the Eurodollar market, where US banks were permitted to operate without the regulations which applied to onshore banks, had in conjunction with US deficits further encouraged the growth of the offshore capital markets (see table 6.5). The Eurodollar market took over from US onshore markets as the major source of long term debt for governments and multinational

Table 6.5 Growth of Eurocurrency market, 1964–79.

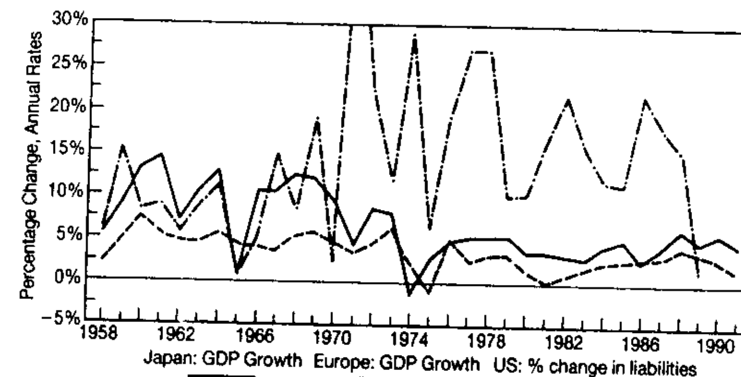
Year	Size[a] ($US billion)	Annual growth (%)
1964	11.6	
1965	14.5	25.0
1966	17.4	20.0
1967	20.8	19.5
1968	29.7	42.8
1969	44.0	48.1
1970	57.0	29.5
1971	71.0	24.6
1972	92.0	29.6
1973	132.0	43.5
1974	177.0	34.1
1975	205.0	15.8
1976	247.0	20.5
1977	300.0	21.4
1978[b]	377.0	25.0
1979	475.0	26.0

Notes: [a] Eurocurrency assets or liabilities of banks in European centres at end of period, net of double counting. [b] First quarter.

Source: Meier, 1982, p. 176.

corporations. London regained its position as the centre for international financial business, but this business was centred on the dollar and the major players were American banks and their clients.

The logic behind the dollar standard idea consisted in the proposition that with the erosion of the gold exchange standard, little sense could be made of the concept of US balance of payments equilibrium. The payments 'deficit' was by definition an equilibrium position and benign neglect was the appropriate response. The fallacy upon which this idea rested was that the erosion of a criterion of US external discipline did not matter. Its proponents usually argued that the basic criterion for stability under such a system was 'stabilising' monetary policies on the part of the US, but this often begged more questions than it answered. McKinnon is more specific in arguing that 'America's principal international monetary obligation was not the *pro forma* link to gold but rather to maintain stable dollar prices of internationally tradable goods as well as an open capital market.'[97] Even this rule contained no criterion of US payments discipline or indeed of what constituted an equilibrium exchange rate for the dollar.



Note: Germany includes the former GDR from 1990.
Sources: IMF, *International Financial Statistics*; European Commission, *European Economy*.

Figure 6.3 Real GDP growth, Japan and Europe, vs. change in US external liabilities, 1958–91.

If the economists who supported the idea of a dollar standard had few answers to these questions, even less was it realistic to hope that private currency markets could provide their own anchor for the dollar exchange rate, or to expect that foreign central banks ought to remain willing to fix their currencies to the dollar in the event of a crisis of confidence in the private markets. Even less realistic was the expectation that the American authorities would adopt an attitude of benign neglect towards the balance of payments; the policy of the Nixon administration over 1971–3 was to restore the US external position and competitiveness by forcing appreciation on the part of the major surplus countries.

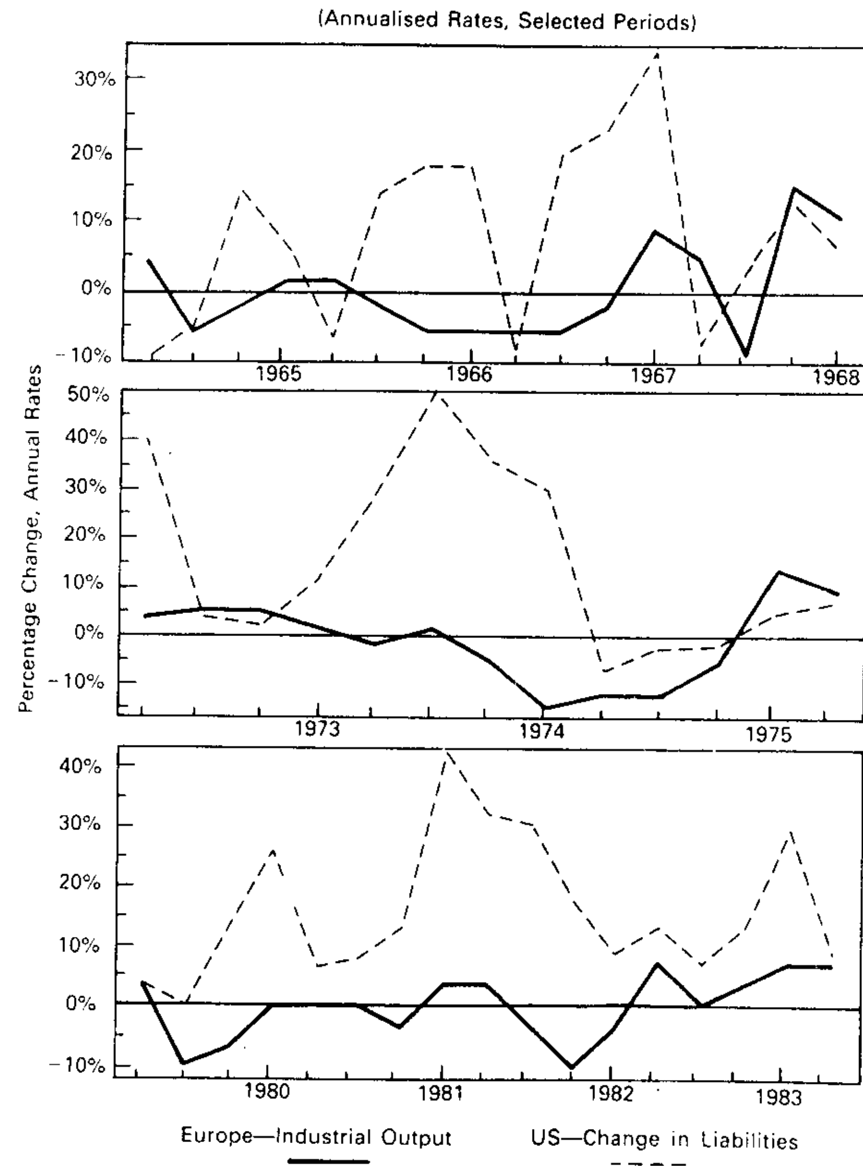
If it is accepted that the US provided the service of financial intermediation for the rest of the world (and especially Europe) that the dollar standard school claims, did it also act as a stabilising central bank? Figure 6.3 gives a rough indication of the fluctuation in US liquid liabilities to foreigners relative to growth in real output in Europe and Japan. It is difficult to find a clear trend towards an expansion (reduction) of US liquid liabilities to private and official foreigners during cyclical downturns (upturns) in the European and Japanese economies from 1958. In the 1958–64 period, US short-term liabilities grew at a fairly steady pace at a time when there was high growth in the other major industrial economies. From around 1968, it appears that there is a change in the situation, with much volatility and high growth in US liabilities. It was in these final years of the

Bretton Woods system, of course, that the US was often accused of flooding the world with dollars and during which global inflation accelerated markedly. It is interesting, however, that the 1970–4 period, one noted for international monetary instability, appears to have enjoyed some degree of anti-cyclicality for changes in US external liabilities.

The evidence it is possible to bring to bear on this question is considerably better than for the pre-1914 period. Figure 6.4 looks more closely at the relationship between changes in US liquid liabilities and in European industrial production on a quarterly basis over three major cycles. Again, it is difficult to perceive a major trend towards anti-cyclical fluctuations in US liabilities. Over 1965–8, there appears to be as much pro-cyclicality as anti-cyclicality, while US liabilities seem to have fallen in the midst of the 1974–5 downturn in Europe (and abroad). The 1980–3 experience is if anything worse, with fluctuations in US liabilities tending to be positively correlated with deviations in European industrial production from its trend rate of growth.

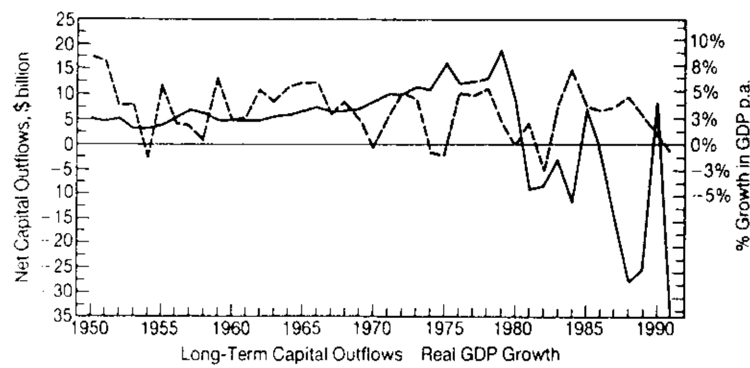
Some of the lender of last resort facilities established in the 1960s (most notably the Gold Pool and the sterling support facilities) were an attempt to live with disequilibria rather than adjust to them. In addition, though the US played an important role in organising the Basle swap network and increased IMF borrowing provisions over 1961–2, these were cooperative agreements based upon a mutual interest in preventing the growth of international capital mobility from undermining the pegged exchange rate system.[98] The $1 billion loan to Italy arranged by the US, Britain and Germany in March 1964 when there was much speculation on a lira devaluation was probably the most successful of these *ad hoc* measures. Although the US took the lead in arranging the credit, it is interesting that like other similar operations of the period, other important countries were involved, as before World War II.[99]

In terms of the relationship between US long-term capital outflows on the one hand and US domestic growth on the other, figure 6.5 shows that there is evidence of an inverse relationship in some years. As with Britain in the pre-1914 period, however, net US long-term capital outflows seem to be dominated by medium-term swings. In particular, net capital outflows grew considerably from 1962, at the same time that the domestic economy began to experience much higher growth than it had in the 1950s. Since the end of the 1970s, large net *inflows* of direct investment from abroad have made the US a major importer of long term capital. Kindleberger himself is therefore rather sceptical of the claim of counter-cyclicality for US lending abroad in the Bretton Woods



Sources: IMF, *International Financial Statistics*; OECD, Main Economic Indicators.

Figure 6.4 Change in US external liabilities vs. economic activity in Europe (industrial production, seasonally adjusted, deviation from trend), by quarter (selected periods).



Sources: IMF, *International Financial Statistics*; OECD, *Balances of Payments*.

Figure 6.5 Net US long-term capital outflows (includes official outflows and direct foreign investment abroad) vs. real GDP growth, 1950–91.

period.[100] Broadly speaking, however, the stability and levels of US official and private long-term capital outflows after the war were an enormous improvement on the situation in the interwar period. It can also be argued that in the sense of providing general *leadership* and guidance in international monetary relations, the US in the 1950s and 1960s did act in some sense like a central bank in a domestic economy (unlike Britain before 1914). It is difficult to push this argument too far, however, because US policy provided no solution to the existing disequilibria and because on virtually all other counts, there is little evidence for the US having played the role of central bank to the world.

The tendency to instability under a key currency system noted in Chapter 3 seems to be borne out by the experience of the dollar standard from the late 1960s. With the formal break from gold in 1971, all the difficulties of managing the dollar in a system without a concept of external equilibrium for the US came to the fore. Shifts in market expectations could result in very large swings of the dollar exchange rate against other currencies and also in the US balance of payments. In such circumstances, even had the US been in favour of retaining a pegged exchange rate system, it is doubtful as to how much longer floating exchange rates could have been avoided. When they did come, this did not lead, at least immediately, to any diminution in the international reserve role of the dollar – on the contrary (see table 6.6).

Nixon had pledged in his 1968 campaign to remove all capital controls, and political pressure to do so built up after the abolition of the gold convertibility of the dollar.[101] That this was incompatible with

Table 6.6 Currency composition of foreign exchange reserves, percentages, all countries, 1964–82.

Year	US $	£ UK	FFR	SFR	DM	YEN	ECU
1964	67.6	21.5	1.5	0.2	0.1	–	–
1965	66.4	22.3	1.5	0.1	0.2	–	–
1966	67.8	21.8	1.7	0.2	0.2	–	–
1967	68.0	19.4	1.7	0.2	0.4	–	–
1968	60.9	21.3	1.3	0.3	0.5	–	–
1969	59.1	20.1	1.1	0.6	0.7	–	–
1970	77.2	10.4	1.1	0.7	1.9	–	–
1971	77.4	8.7	1.0	1.1	3.3	–	–
1972	78.6	7.1	0.9	1.0	4.6	0.1	–
1973	76.1	5.6	1.1	1.4	7.1	0.1	–
1974	77.8	6.5	0.7	1.5	6.1	0.1	–
1975	79.5	3.9	1.2	1.6	6.3	0.5	–
1976	79.7	2.0	0.9	1.4	7.0	0.8	–
1977	79.4	1.6	1.0	2.0	8.2	1.2	–
1978	76.9	1.5	0.9	1.4	9.9	2.5	–
1979	62.4	1.8	0.8	2.0	10.4	2.6	13.9
1980	56.2	2.5	1.0	2.6	11.9	3.0	17.0
1981	58.9	2.0	1.0	2.6	11.0	3.4	15.3
1982	59.9	2.0	1.0	2.4	10.4	3.5	14.4

Note: Changes in country coverage (especially in 1970) may affect the comparability of the data.

Source: IMF, 1983.

the apparent US commitment to maintain a fixed parity for the dollar was shown in the flight from the dollar that followed Secretary Shultz's February 1973 announcement of a further 10 per cent dollar devaluation and of the US intention to phase out all existing capital controls by the end of 1974.[102] Capital controls were in fact abolished at the beginning of 1974, linked with the official encouragement of American banks in the 'recycling' of OPEC oil surpluses and with the revival of New York as an international financial centre. This was entirely consistent with the American aim of fostering an international monetary system organised on the basis of market principles, as was the 1976 decision to eliminate from the presentation of US balance of payments statistics any measure of the overall 'deficit'.[103]

Even in the heyday of what has become known as the Bretton Woods system, there is little evidence to back up the often made claim that the US stabilised the system by playing the role of a discretionary monetary manager. The dominant financial position of the US gives some support to the notion of the key currency standard school that America provided a service of international financial intermediation, although most of this business was conducted in offshore markets by

the end of the 1960s. As with Britain before the First World War, it is possible that acting as an international financial intermediary and acting as a discretionary manager were two tasks which were not necessarily compatible. The role of the dollar in the international financial system became so extensive that it undermined the monetary system based upon a fixed link with gold, but in so doing it removed a criterion for external balance for the US itself. Once this had happened, it was only a matter of time before the fixed exchange rate system fell apart.

6.6 Conclusion

If it is unlikely that the US played the role of discretionary monetary manager for the world after 1945, what was the cause of the stability in the international monetary system in the 1950s and 1960s? It would be wrong to argue that this had nothing to do with the leadership role that the US undoubtedly saw itself as playing in the West. The security structure and the (temporary) resolution of the German problem in Europe removed the fundamental problems that had undermined attempts to create a stable environment for economic growth and prosperity in the interwar period. American promotion of a much more open international trading system was of central importance in fostering a stable world economy, as was the size and stability of official and private long-term capital outflows.

There were many other important factors at work, however. The ability of the Europeans to find a much more satisfactory solution to problems posed by the interdependence of their economic and political security than after the First World War was of central importance, though again the American role was crucial in stimulating a European solution. The ability and willingness of governments to play a much greater role in domestic economic stabilisation in most of the major economies than in the 1920s helped promote an almost uninterrupted period of rapid growth. The compatibility of this with a fixed exchange rate system was assisted for a time by moves towards trade liberalisation and often quite wide-ranging controls on the movement of short-term capital in particular.

The period from late 1958 to the mid-1960s is often seen as the heyday of the Bretton Woods international monetary system. The principles laid down during the war are seen as finally having come into their own, with a period of monetary stability and growing economic interdependence being fostered by US hegemonic leadership.[104] The 'Bretton Woods system', in fact, is a very elusive entity. While the

growth in prosperity and economic interdependence is indisputable, from the late 1950s, the international monetary system was evolving in a direction ultimately incompatible with the premises of pegged exchange rates, capital controls and collective management outlined at Bretton Woods. The shortage of gold was an immediate cause of disequilibrium in the system, and in the absence of a US willingness to increase the gold price, the gold exchange standard was bound to break down. That it limped along for another decade is not so much indicative of a decline of American power as of the ability of the US to implement a number of *ad hoc* policies to bolster the gold-dollar system. Other states, such as Germany, Japan and the UK, by and large supported the US in this (with the notable exception of France) because they too had an interest in the continuation of the system and in accepting the initiatives of their major ally.

Even a very dominant America could not, however, avoid the ultimate collapse of the gold exchange standard in the face of a gold shortage and an ever-expanding role of the dollar in international financial markets. From around the mid-1960s, US policies were aimed at removing the role of gold in the international monetary system. This, and the subsequent promotion of a system founded upon private capital markets and floating currencies was the most important policy factor in the so-called breakdown of the fixed exchange rate system over 1968–73. Of course, it would be wrong to argue that the growing role of private financial markets were entirely a product of American policies; in part it was also due to innovations in the private markets themselves as well as the adept manoeuvres on the part of other countries (above all the UK) to accept unregulated Eurodollar banking activities on their territory. It is still largely true, however, that by the mid-1970s, and contrary to the decline of hegemony thesis, the US had largely succeeded in reshaping the international monetary system in a way that was seen as advantageous for America, though not one which was necessarily stable.

As a result of much greater capital mobility than in the 1950s, strong currency countries like Germany found it virtually impossible to maintain a fixed exchange rate with the dollar and at the same time conduct an independent monetary policy oriented towards domestic price stability. These countries were able to find an alternative more attractive than the dollar standard through exchange rate appreciation, low inflation and high productivity growth. As always, it was the non-key currency, deficit countries with high inflation that had to bear the greatest costs under the new system. On another level, the breakdown of a system of fixed exchange rates reflected the tension between growing international financial integration and the continued primacy

of the national interventionist state. The unwillingness of the major countries to give up national control over monetary policy meant that by the early 1970s, most welcomed the shift to a flexible exchange rate system. Ultimately, however, they would find that flexible exchange rates could provide no effective insulation from the ever-increasing levels of financial integration. The result has been growing calls for the coordination of national economic policies, yet even in the days of greatest American strength, such efforts have been conspicuously insufficient to prevent rising international monetary and financial instability.

For the US, not only was a return to any form of primary asset-based convertibility for the dollar impossible with central banks increasingly able to borrow dollars in the Euromarkets, but the attachment to the principle of pegged exchange rates rapidly faded in the early 1970s. This created an additional problem for private exchange markets, since without a strong commitment to an exchange rate target on the part of the US authorities, expectations and capital flows were increasingly subject to large swings.

Finally, the growing role of private financial markets did not remove a fundamental asymmetry in the structure of the system: the key role which the US financial system and its offshore adjuncts play in the system as a whole. In spite of the declining weight of the US in the world economy, in the early 1970s it still dwarfed other major industrial economies and it remained the most important trading country, though perhaps the least affected by rising economic interdependence. The role of the dollar reached a new height in the 1970s with the rapid growth of private and official international dollar balances (figure 6.3, table 6.6) and with the end of a formal role for gold. The following chapter will argue that financial integration has in many ways strengthened the transmission mechanisms from US policies to other states in the system, at a time when US authorities have had increasing difficulties in managing the domestic economy.

In conclusion, the image of the 'breakdown' of Bretton Woods due to the decline of American power is most misleading because it underestimates the *continuity* in the evolution of the international monetary system since the late 1950s. Since the early 1970s, private capital markets have grown rapidly, further displacing the elements of collective monetary management envisaged at Bretton Woods. The following chapter will argue that this, rather than hegemonic decline, provides the key to the growing instability of the global monetary system.

Notes

1. Keohane, 1984, p.37.
2. Gilpin, 1975, p.85.
3. For example, Kennedy, 1988, p.434.
4. Calleo, 1970, pp.86–7. See also Cohen, 1977, pp.96–7; Gilpin, 1987, pp.133–6; Silk, 1987.
5. Katzenstein, 1978, p.6. Although we will concentrate here upon international money rather than trade, the rise of protectionism and of the more aggressive US trade policy stance of 'reciprocity' since the 1970s is generally seen in similar terms.
6. Kennedy, 1988, p.357.
7. I have recalculated Maddison's US figures, using revised US GDP estimates. See Maddison, 1987, p.682.
8. For two complementary accounts of the negotiations, see Gardner, 1980, and Van Dormael, 1978.
9. Gardner, 1980, p.76.
10. Van Dormael, 1978, pp.97,129–49,247–9.
11. Gardner, 1980, p.112; Van Dormael, 1978, p.85.
12. Keynes' initial scepticism about the practical value of the scarce currency clause is clear from Harrod, 1951, p.550. This would turn out to be justified in the crisis of 1947, although by the 1960s the US would become a major deficit state and would find itself relatively powerless to require adjustment on the part of strong surplus states such as Germany.
13. Van Dormael, 1978, p.163.
14. *ibid.;* Gardner, 1980, p.115.
15. Van Dormael, 1978, pp.251–68.
16. Ruggie, 1982.
17. The administration sold the agreement to Congress by arguing that exchange rate changes would only be used as a 'last resort'. See Gardner, 1980, pp.135–6.
18. Gardner, 1985, p.16.
19. See Van Dormael, 1978, pp.165,200–49.
20. Article IV, section 7. For a discussion, see Gold, 1965, pp.30–43.
21. Bullock, 1983, pp.122–3. See also Gardner, 1980, pp.210–23.
22. Gardner, 1980, pp.236–54; Kindleberger, 1984, pp.429–32.
23. Gardner, 1980, ch.16.
24. Kindleberger, 1984, ch.23.
25. Milward, 1984, p.37.
26. *ibid.*, p.50; Bullock, 1983, ch.10.
27. For the most detailed account of the Marshall Plan and its origins, see Hogan, 1987. See also *Foreign Relations of the United States [FRUS]*, 1947 (3), pp.230–2; Kennan, 1967, ch.13,15; Gaddis, 1982, ch.2,3.
28. Keohane, 1984, p.143; also Block, 1977, pp.89–102.
29. De Vries and Horsefield, 1969, ch.14.
30. Milward, 1984, p.197; Hogan, 1987, p.436. The 'counterpart funds', on which US Treasury hopes for leverage over European economic policies were pinned, were in practice used largely by the ECA to facilitate capital formation, to offset deflationary impacts in some economies and later to help underwrite the trade and payments agreements (Hogan, 1987, pp.152–6).

31. *FRUS*, 1948 (3), pp.597–613,1069–77.
32. *FRUS*, 1949 (4), pp.377–83,391–4,397–9,793–7. See also Cairncross, 1985, ch.7.
33. For example, Block, 1977, p.98.
34. See Cairncross, 1985, pp.165–85; Harris, 1982, pp.434–7. The sterling devaluation of 30.5 per cent, more than was generally expected, was followed by equivalent devaluations by the Scandinavian countries, and devaluations of 30.2 per cent, 21.8 per cent, 20.6 per cent, 12.3 per cent and 8 per cent by the Netherlands, France, West Germany, Belgium-Luxembourg and Italy respectively.
35. Bullock, 1983, pp.532–41,659–61,705–9.720–3.
36. *FRUS*, 1950 (1), pp.815–21.
37. Kindleberger, 1984, 437–42; Hogan, 1987, pp.321–3.
38. Hogan, 1987, pp.320–1; Milward, 1984, pp.326–32,472–4; Cairncross, 1985, pp.289–94.
39. See Milward, 1984, pp.501–2; Hogan, 1987, pp.438–45.
40. See Acheson's memorandum to Truman of February 16, 1950 (*FRUS*, 1950 (1), pp.834–41), expressing concern that ERP had achieved little in terms of dollar viability for Europe and that this would necessitate further measures to close the dollar gap after the end of Marshall aid in 1952. Acheson's main argument for this was the security angle, as it was for Kennan in a draft memorandum to Acheson only a day later (*ibid.*, pp.160–7).
41. Milward, 1984, p.488 (see also pp.349–59); United Nations, 1954, pp.353–60; Cairncross, 1985, pp.207–11.
42. As does Gilpin, 1987, p.133. For evidence, see United Nations, *Economic Survey of Europe*, 1954:I, pp.33–6 (especially chart 9), and 1959:I, pp.1–6; IMF, *Annual Report*, 1954, p.29; US Bureau of the Census, 1956, p.915.
43. Figures calculated from OECD, *Balances of Payments*, and IMF, *International Financial Statistics*, 1980 Yearbook.
44. Strange, 1976, p.36; Horsefield, 1969, pp.353–5,397–402.
45. See Deutsche Bundesbank, *Auszüge aus Presseartikeln*, January 3, 1959 [1].
46. Bank for International Settlements (BIS), *Annual Report*, 1971–2, p.14.
47. *ibid.*, pp.5–10.
48. Many have argued, including ex-officials of US monetary authorities, that from this time pressure was placed upon America's allies not to convert dollar reserves into gold (e.g. Coombs, 1976, p.8). From 1958 to 1964, the proportion of the official settlements deficit financed by gold sales did fall steadily from 99 per cent in 1958 to 8 per cent in 1964.
49. IMF, 1983, pp.10–22. For figures on the declining production and availability of new gold for monetary purposes, see BIS, *Annual Report*, 1971–2, p.8.
50. Strange, 1976, ch.3,4.
51. Solomon, 1982, p.54.
52. See Council of Economic Advisers, *Economic Report of the President* [hereafter *ERP*], 1959, pp.57–9, 1960, p.68, and 1961, pp.39–41.
53. See Gilbert, 1980, pp.84–8; Solomon, 1982, pp.58–60,86–113; Strange, 1976, pp.129–33,147.

54. In the crisis at the end of 1967, Johnson moved to impose mandatory controls on foreign direct investment by corporations and foreign lending by US banks. Yet the improvement in the balance of payments in 1968 was also due to tighter US monetary policy, leading banks to borrow from their Euromarket subsidiaries, which would sooner or later need to be repaid. Part of the difficulty, in other words, was due to the increasingly important relationship between the domestic and offshore banking systems. See Strange, 1976, ch.6; Solomon, 1982, ch.6.
55. Calleo, 1982, p.89.
56. Katzenstein, 1978, p.6.
57. See Gilbert, 1980, p.xiii.
58. For a detailed history of the US official attitude on this question, see Gilbert, 1980, especially pp.125–49, and Triffin, 1961, pp.79–82; Hinshaw, 1967. For a comprehensive statement from Johnson's Secretary of the Treasury, Henry Fowler, see his speech of September 24, 1968, in Bundesbank, *Auszüge*, October 9, 1968 [69].
59. Gilbert, 1980, p.xiv. Another less than compelling argument was that Congress might be unwilling to grant the authorisation required for an increase in the gold price, though in fact there were movements within Congress from a very early stage to double the gold price. The most adamant opposition always came from the US Treasury itself (see *The Times*, February 23, 1959).
60. There was also some suggestion that this would only lead to increased speculative demand for gold, though this would be unlikely if the rise in the official price were large enough to convince private and official agents that another increase would be long in the distant future (*ibid.*, pp.144–6).
61. Williamson, 1977, p.31. See also Triffin, 1961, pp.81ff; *Frankfurter Allgemeine Zeitung*, January 24, 1968; Hinshaw, 1967, ch.6.
62. Solomon, 1982, pp.76–7. See also Horsefield, 1969, pp.254–6,294–5.
63. See *Le Monde*, February 6, 1965.
64. See *New York Times*, March 29, 1968, and the earlier speech by the Chairman of the Federal Reserve Board, William McChesney Martin, in Bundesbank, *Auszüge*, February 23, 1968 [16].
65. See Triffin, 1961, part II, ch.2,4, and 1968, part II.
66. For an assessment, see Scammell, 1975, ch.5–7.
67. Solomon, 1982, pp.143–4.
68. For semi-official rationalisations of this strategy, see the US Council on International Policy, 1971, and the Commission on International Trade and Investment Policy, 1971. See also Gowa, 1983; Coombs, 1976, ch.12; Gilbert, 1980, pp.150–63.
69. See Williamson, 1977, pp.61–6.
70. The US negotiating document is reprinted in *ERP*, 1973, appendix A.5.
71. See Volcker, 1978–9, p.3.
72. See Emminger, 1979, p.4.
73. Williamson, 1977, p.73.
74. Alfred Hayes, then President of the New York Federal Reserve, remarked in 1974 that 'I was always of the view that, once the key element of the postwar system no longer existed, i.e., the link between the dollar and